January 31, 2019

Via email: mark.schaan@canada.ca

Mark Schaan
Director General
Marketplace Framework Policy Branch
Innovation, Science, and Economic Development Canada
235 Queen Street, 10th Floor
Ottawa, Ontario
K1A 0H5

Dear Mr. Schaan:

Re: Enhancing Retirement Security for Canadians: Consultation Document

The Canadian Bar Association Pensions and Benefits Law Section (CBA Section) is pleased to comment on *Enhancing Retirement Security for Canadians: Consultation Document* (Consultation Document) released by the Minister of Seniors on behalf of Innovation, Science, and Economic Development (ISED), Finance Canada, and Employment and Social Development Canada.

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. The CBA Section comprises lawyers from across Canada who practice in pensions and benefits law, including as counsel to benefit administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefits consultants, investment managers and advisors.

The CBA Section is pleased that the federal government is conducting this public consultation on retirement security for Canadians, as it committed to in Budget 2018. In the face of declining workplace pension coverage, a growing number of people are not saving enough to maintain their standard of living in retirement. Rising health care costs and the loss of post-retirement health and medical benefits add pressure on retirement income security for people across Canada.

Private workplace pensions are just one part of the retirement income system, and we urge the federal government to examine and improve on each of the three pillars cited in the Consultation Document. We also commend the federal government for its recent reforms of the Canada Pension Plan.

66 Slater St., Suite 1200, Ottawa, ON, Canada K1P 5H1
tel/tél. 613 237-2925 • **tf/sans frais** 1-800 267-8860 • **fax/téléc**. 613 237-0185 • cba.org • info@cba.org

Our comments are limited to the Pension Options raised in the Consultation Document. We encourage the federal government to continue to support the long-term sustainability and viability of defined benefit (DB) pension plans. We also support a broader review that considers action beyond the implementation of the described Pension Options.

Guiding Principles

In our July 2018 submission to Finance Canada[1], the CBA Section said that as a policy objective, Finance Canada should support a sustainable framework and measures to strengthen pension coverage that consider the interests of various stakeholders. There are differing views on whether this policy objective could be achieved by modifying the current solvency funding requirements applicable to federally registered DB pension plans.

That said, the CBA Section urges Finance Canada to consider three guiding principles in 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 facilitate 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.

Retirement Income Security

As stated in the CBA's 2010 resolution on *Funding and Security of Pension Benefits*[2], promoting retirement income security is an important function of government. We urge governments to support and promote reasonable measures to increase the funding and security of pension benefits, and appropriately consider the impact of those measures on pension plan sponsors, pension plan members and other stakeholders.

Sustainability

The solvency funding framework must be manageable and sustainable in the long term, and 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.

Harmonization

All stakeholders will benefit from an efficient and effective pension regulatory system, and harmonizing pension legislation is key to creating that system. The CBA Section has long advocated for harmonized

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[1] See *Solvency Funding Considerations* (Ottawa: CBA, July 2018)

[2] Canadian Bar Association Resolution 10-02-M, *Funding and Security of Pension Benefits*, available online (https://bit.ly/2KRVK1H)

pension legislation across Canada.[3] We highlight the need for, and the inherent fairness in having rules across Canadian jurisdictions that are as harmonized as possible, particularly on funding.

Pension Options

1. **Pension funding relief criteria**

The Finance Minister has authority to provide federally regulated employers with special pension funding relief to improve the long-term sustainability of their pension plans. The Consultation Document asks for input on appropriate criteria or conditions to impose on plan sponsors in this situation. As background, special funding relief from the regular going concern and solvency funding regime in place under federal pension funding standards has fallen into two broad categories:

1. After 2008, general temporary solvency funding relief was made available for DB pension plan sponsors on a time limited basis under the *Pension Benefits Standards Act 1985* (PBSA) (following notice to/consent of beneficiaries), recognizing the effect of the 2008 global recession, prolonged and declining interest rates and volatile asset returns. Similar temporary relief measures were made available in many other Canadian pension standards jurisdictions in the same timeframe. These measures generally permitted payment of solvency deficits beyond the five-year period in the legislation. The PBSA, and legislation of other jurisdictions, also introduced the use of letters of credit to meet certain solvency funding obligations to relieve some cash flow pressures created by the solvency funding regime generally.

2. Where plan sponsors are unable to make required solvency funding payments (either in or out of formal insolvency proceedings), special funding relief has taken the form of either plan-specific regulations (e.g. Air Canada and Canadian Press special regulations) or negotiated solvency funding schedules pursuant to the Distressed Pension Plan Workout Scheme (DPPWS) requirements of the PBSA and regulations.

Both categories essentially establish plan-specific measures to grant relief from pension funding requirements on a case-by-case basis. However, there have been limitations with both categories.

Category #1 measures have not resulted in sustainable improvements for DB plans. Many DB plans have taken advantage of temporary solvency funding relief more than once and are still underfunded on a solvency basis. While time has allowed pension plans to recover from some challenges like the 2008 recession, other factors such as interest rates and longevity remain and are expected to continue for the foreseeable future. The measures in Category #1 have been ineffective at responding to those issues.

Under Category #2, the DPPWS requirements involve court-appointed representatives for non-union beneficiaries and approval by both the Superintendent and Finance Minister. Workout agreements must comply with a narrow set of regulatory requirements, following the declaration of a plan sponsor unable to make its solvency special payments. Because the declaration could itself be an act of insolvency under the *Bankruptcy and Insolvency Act* (BIA), the DPPWS has been rarely used as making the declaration could itself be a breach of lending agreements vital to the solvency of the business. A business that might benefit from the relief may be unable to even enter discussions with its stakeholders to negotiate it. While restrictive, the criteria and conditions on which the relief is granted are appropriately targeted to ensure benefit security for beneficiaries is not reduced.

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

The other form of Category #2 relief available for plan sponsors unable to make solvency special payments (which also often involves corporate insolvency) – and which is not provided under any PBSA framework in the way the DPPWS regime is – is provided through plan-specific regulations establishing stand-alone funding regimes and exemptions from various provisions of the PBSA. In those limited cases, under the federal jurisdiction (and parallel situations in provincial jurisdictions), the CBA Section believes that the best outcomes are custom-made regulations unique to the plan sponsor and the particular stakeholder groups, rather than a scheme like the DPPWS. It is possible and appropriate under regulations to impose appropriate and agreed-on terms, including those the Finance Minister may deem necessary related to the corporate actions of the plan sponsor.

For plan-specific measures, existing forms of relief for plan sponsors requiring relief because they are unable to make solvency payments (Category #2) strike the balance between protecting benefit security and offering employers who cannot make solvency payments a measure of flexibility for the long-term sustainability of the DB plan and avoid immediate plan termination. Neither the DPPWS nor a plan-specific regulation are easy routes to solvency relief and are relatively rarely used, but these mechanisms should remain available in the limited circumstances where they apply.

However, the CBA Section believes that broader action is required, even if some new plan-specific measures are implemented, for reasons including:

- The temporary solvency funding relief measures noted in Category #1 have inadequately addressed generalized pressures or volatility.

- The vast majority of plan sponsors are not able to access Category #2 relief.

- Solvency funding regimes have not prevented pension losses related to insolvent employers.

Rather, the solvency funding regime places enormous pension funding pressures on employers. In addition, the current regime has created significant volatility that threatens the long-term sustainability of DB plans as plan sponsors seek to close existing plans and are generally unwilling to create new DB plans. As noted in the Consultation Document, some employers are responding to the pressures and volatility of the current solvency funding regime by closing DB plans to new hires. Our members also report that these closures are being extended to future service for all members in some cases, as plan sponsors seek to limit the growth of DB funding pressures beyond what only closing the plan to new hires would provide.

For these reasons, the CBA Section believes a broader review of the solvency funding regime is needed in the federal jurisdiction (following initiatives of other jurisdictions including Quebec, Ontario, Alberta and British Columbia). The objectives of this review should be to develop balanced solvency funding reforms in the federal jurisdiction, geared to ensuring benefit security for plan beneficiaries, affordability for plan sponsors, and the long-term sustainability of DB plans generally. It should also consider many solutions reviewed by other jurisdictions, including but not limited to elimination of or reduced solvency funding, enhanced going concern funding, and other measures such as solvency reserve accounts. It should involve and incorporate the views of beneficiaries, unions and other associations for employees, employers and administrators, possibly with the assistance of a stakeholder committee.

2. Solvency reserve accounts (SRAs)

The CBA Section supports measures intended to improve the funding of DB pension plans, which in Alberta and British Columbia have included the concept of solvency reserve accounts (SRAs). The

approach in those provinces offers increased flexibility for administrators of DB pension plans subject to solvency funding and assists in avoiding trapped capital by allowing withdrawal of SRA funds under certain conditions. We offer some considerations, noting that there are differing views within the Section about the merit of adopting SRAs, and these measures alone cannot be expected to provide a long-term solution to plan funding.

The CBA Section stresses the need for and inherent fairness of harmonizing rules across Canada as much as possible, in particular for funding. Quebec and Ontario have already moved in a completely different direction by largely eliminating solvency funding in favour of enhanced going concern regimes. By adopting SRAs, the federal government could increase harmony with British Columbia and Alberta, but move even further from the regimes in Ontario and Quebec. If the federal government were to introduce SRAs with rules that deviate from the approach in Alberta and British Columbia, it would further exacerbate the current patchwork of funding rules across Canada. If SRAs are adopted by the federal government, we support harmonization with the Alberta and British Columbia rules.

If SRAs are introduced, specific attention should be paid to how funds are held in SRAs. Funds held in a way that meets the definition of a trust under general trust principles are less likely to be found to form property of the employer in the event of the bankruptcy or insolvency of the employer. In Alberta and British Columbia, SRAs must be in an account within the pension fund and may be held under the pension fund's main trust agreement or pursuant to a separate formal trust agreement. The only funds that may be deposited into an SRA are payments made in respect of a solvency deficiency, and assets may not be transferred into an SRA from any other account in a pension fund.

The CBA Section's members are divided on entitlement to excess funds held in SRAs on the bankruptcy or insolvency of the employer once solvency funding requirements have been met. Some are concerned with enhancing the employer's (and, through the employer, third parties') access to surplus funds to which plan members may otherwise be entitled. Others believe that creditors should be entitled to any excess funds after meeting solvency funding requirements. However, we have long advocated for clarity in legislative guidance around pensions and believe that all stakeholders would benefit from clearer direction, particularly in circumstances of the insolvency or bankruptcy of the employer where parties may already receive less than their entitlements.

3. Transfers to self-managed accounts

Another option identified in the Consultation Document is to amend the PBSA to permit retirees in insolvency or bankruptcy circumstances to transfer their reduced pension amount, as a lump sum, to a self-managed locked-in savings plan. It notes that currently annuities would have to be purchased for retirees when a federally regulated DB plan is terminated, resulting in permanently reduced benefits for retirees where the plan is underfunded and the plan sponsor is insolvent.

While transfer options could give retirees more flexibility to address hardships in insolvency scenarios, the federal government should balance this with additional risks that retirees may face when they transfer pension entitlements to a self-managed account, including:

- **Investment Risk –** by transferring assets to self-managed accounts, retirees would no longer have the security of a pre-determined retirement income. Investment performance would have a significant impact on the amounts available as retirement income and these retirees would have significant exposure to market corrections, with reduced means to recoup any losses.

- **Longevity Risk –** self-managed accounts create uncertainty for retirees on the amount they can withdraw each year (within the prescribed maximum and minimum limits set under the *Income Tax Act* (Canada)), to ensure they do not outlive their retirement savings.

- **Management Fees –** retirees may not have investment expertise to make informed decisions about investing account balances and would typically pay retail fees for the investment of their self-managed account. The accumulated investment or advisory fees can be significant.

- **Tax Inefficiencies –** the *Income Tax Act* (Canada) identifies the maximum amounts that can be transferred on a tax-deferred basis to a locked-in retirement account (LIRA) or a life income fund (LIF). Any amounts over the maximum transfer limits would have to be paid in a lump sum cash payment that is taxable, which may create tax inefficiencies.

In certain circumstances, this transfer option could still benefit retirees. For example, for DB plans with unconditional indexing benefits, annuity purchases may be prohibitively expensive. An alternative would be to make this transfer option available as a case-by-case solution through plan specific regulations to the PBSA. This approach has been used in other Canadian jurisdictions (e.g., Ontario regulations to provide this transfer option in the Nortel insolvency).

The CBA Section also recommends that the federal government consider, as an alternative, adopting reforms analogous to those in Quebec. Under the *Supplemental Pension Plans Act* (Quebec) (SPPA) and its regulations, a pensioner whose benefits are reduced due to insufficient assets in connection with the termination of a DB plan may request that the pension be guaranteed by an insurer (i.e., an annuity be purchased) or choose a pension paid out of the assets administered and invested by Retraite Québec. This has the benefit of allowing the recoupment of pension losses over a specified period (the SPPA requires that annuities be purchased for retirees whose assets are managed by Retraite Québec within 10 years), while avoiding the pitfalls associated with members transferring their assets to self-managed accounts. For this approach, the federal government could consider, as necessary, outsourcing administration or investment responsibilities to one or more federally registered public sector pension plans with the requisite experience to prudently manage these assets and improve retiree outcomes.

Benefit Security

1. Clarify benefit entitlement

The discussion under this heading suggests that the PBSA does not permit benefits that are conditional on plan funding, on the plan's ongoing status, or on some other measure of plan performance (asset returns or net gains, for example). The CBA Section believes that the PBSA does permit these benefits. Further, our experience is that the benefits are common among federally regulated employers and in other Canadian jurisdictions, with the most common type of conditional benefit being conditional indexation. Our experience is that such benefits are often, but not always, the product of collective bargaining, and have a long history in the plan.

We believe that conditional benefits, such as indexation conditional on there being adequate surplus to fund the benefits, is a responsible, sustainable benefit design. Many public sector and quasi-public sector pension plans in other Canadian jurisdictions include conditional indexation among the safety valves that prevent plan liabilities from growing when the plan can least afford it. Our view is that these benefits should be encouraged. Other forms of conditional benefits, such as unreduced early retirement benefits or early retirement subsidies should also not be prohibited by legislation, for the same reasons.

The CBA Section understands that when conditional benefits are not properly communicated to members, it can create confusion among the plan's membership. We support full and adequate disclosure of the conditional nature of these benefits to all plan members. Our experience though is that these benefits are typically well communicated and a description of the conditionality of the benefits is usually included in the PBSA-mandated plan summary provided to members. The PBSA does not require amendment to enhance disclosure regarding conditional benefits. Any deficiencies in administrative practice may instead be easily remedied through additional guidance from OSFI.

The Consultation Document also proposes additional flexibility for DB plans to offer different benefits in different circumstances. We welcome additional flexibility in plan design, so long as it is not unilaterally used to reduce accrued benefits. For example, the CBA Section would welcome an amendment to the PBSA to explicitly enable a CPI-based indexation formula to be converted to a fixed-rate indexation formula of equivalent actuarial value in the event of an annuity purchase or wind-up. While ability to do this arguably already exists under the PBSA,[4] explicit authority for this kind of change would add clarity. The Registered Plans Directorate of the Canada Revenue Agency is currently consulting on a similar item.[5]

The CBA Section appreciates the opportunity to comment on the Consultation Document. We trust that our comments are helpful and would be pleased to offer further clarification.

Yours truly,

(original letter signed by Gaylene Schellenberg for Sonia Mak)

Sonia Mak
Chair, CBA Pensions and Benefits Law Section

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[4] See PBSA s. 10.1 which permits an employer to make an amendment that does not reduce the pension benefit credits or immediate or deferred pensions without Superintendent consent, or to make one that does reduce pension benefit credits and immediate and deferred pensions with Superintendent consent.

[5] See: Registered Pension Plan Annuity Contracts – Draft Newsletter for Industry Consultation