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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

January 21, 2019

ACPM Response to the Federal Consultation Paper: Enhancing Retirement Security for Canadians

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FOREWORD

ACPM (THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT)

ACPM (The Association of Canadian Pension Management) is the leading advocate for plan sponsors and administrators in the pursuit of a balanced, effective and sustainable retirement income system in Canada. We represent plan sponsors, administrators, trustees and service providers and our membership represents over 400 companies and retirement income plans that cover more than 3 million plan members.

ACPM believes in the following principles as the basis for its policy development in support of an effective and sustainable Canadian retirement income system:

Diversification through Voluntary / Mandatory and Public / Private Options
Canada's retirement income system should be comprised of an appropriate mix of voluntary workplace and individual savings arrangements ("Third Pillar") and mandatory public programs ("First and Second Pillar").

Empowering Choice in Coverage
Third Pillar arrangements should be encouraged and play a meaningful, ongoing role in Canada's retirement income system.

Adequacy, Security and Affordability
The components of Canada's retirement income system should ensure a healthy balance between these three objectives to enable Canadians to receive adequate and secure retirement incomes at a reasonable cost for members and employers.

Innovation in Plan Design
Canada's retirement income system should encourage and permit innovation in plan design in all three Pillars.

Adaptability
Canada's retirement income system should be able to adapt to changing circumstances without the need for comprehensive legislative change.

Harmonization
Canada's pension legislation should always strive for better harmonization.

Clarity and Transparency
Legislation, regulations and retirement income arrangements should be clearly defined, and pension plan beneficiaries should be appropriately informed of risks, costs and benefits.

Good Governance
Excellence in governance and administration in the retirement income system.

Response to the Federal Government's Consultation Paper: Enhancing Retirement Security for Canadians

Initial Comments

ACPM supports the federal government's review of approaches to address the security of the pension, wage and benefit entitlements for workers and retirees. That being said, it should be acknowledged that corporate sponsorship of DB Plans has been on a strong decline over the past two decades, with many sponsors deciding to close plans to new members, ceasing benefit accrual, or winding them up entirely.

In addition, while there have been a few high profile corporate failures over the past two decades that have led to pension and benefit reductions, the occurrence of corporate failures with DB Plans is fairly infrequent. The sad reality, however, is that even in the case of a corporate failure that results in a reduction in DB pensions, we suspect that the vast majority of affected members and pensioners would have been worse off had they never had a pension in the first place. For this reason, we suggest caution in creating any new significant disincentives that would push more corporations to abandon their DB plans.

It is ACPM's view that one of the best protections for workers' and retirees' pensions is a strong employer. While a number of pension, corporate, and insolvency options can be explored, to the extent that some options end up accelerating the insolvency of the employer may not be in the ultimate best interest in the employees and retirees. These options are inherently complex and we encourage the government to be cautious in its analysis of such options.

Part 1: Pension Options

The Consultation Paper sets out four pension options to consider:

A. Solvency Reserve Accounts;
B. Pension Funding Relief Criteria;
C. Transfers to Self-Managed Accounts;
D. Clarify Benefit Entitlements.

In this submission, we provide comments on each of the options as well as additional options for consideration.

A – Solvency Reserve Accounts

ACPM is supportive of the concept of a reserve account into which companies could remit special payments to eliminate a solvency deficit similar to the regime that exists in Alberta and British Columbia. Contributions to such an account would be an asset of the Plan for the purpose of determining minimum funding requirements, but unlike the main pension fund, the reserve account would be available to the employer to withdraw when the Plan has a solvency ratio of at least 100%.

This feature would provide greater flexibility for employers in funding a pension plan and would provide greater incentive for companies to keep their plans well-funded by allowing employers relatively easy access to the portion of the funding excess held in the reserve account.

It would also reduce the current pension funding asymmetry by assuring plan sponsors that if a plan is terminated, any excess funding remaining in the reserve account after all benefits have been settled would automatically revert to the sponsor.

Should the federal government agree to introduce Reserve Accounts as a means to provide additional funding flexibility (beyond the usage of existing rules for letters of credit), we would be pleased to provide separate commentary and suggestions on how such accounts could be established, administered, and used by the plan sponsor when the plan is in a funding excess situation.

While the reserve account may indeed improve retirement benefit security by improving funding flexibility, we believe that it may also or instead be worthwhile to consider a modernization of funding rules similar to what has occurred in Quebec and Ontario. In the context of modernized funding rules, ACPM is supportive of a reserve account for contributions required to build a PFAD, similar to what exists under the Quebec regime.

B – Pension Funding Relief Criteria

In reading this paragraph in the consultation document, it was not clear if the relief being described was the "distressed pension workout scheme" or "special sponsor-specific regulations", or both. That being said, we observe that the latter has been used successfully resulting in one-off regulations (for example, in the situation with Air Canada). In that situation, it appears that the company and the Minister of Finance were indeed able to create a set of rules that allowed the corporation to move forward. Part of the reason that was a success is that the parties were able to negotiate directly without having blanket requirements which might have made it unworkable.

In the case of the "distressed pension workout scheme", we are aware of very few requests to use that legislation. We suspect that the reasons why the provision has rarely been used is twofold:

1. The public declaration necessary to initiate the process of the distressed pension plan work-out scheme can itself be an act of insolvency and/or a breach of lending covenants under the employer's credit facilities. It may therefore not be possible for some employers who could benefit from the work-out scheme to access it.
2. The two-step nature of the process adds uncertainty to the outcome. Specifically, only once it has been agreed to by the corporation and representatives of the members and beneficiaries, does it go to the Superintendent's and Minister's offices for approval.

We suspect that such schemes would be more likely to succeed if the declaration were eliminated. We also suggest that the discussions be trilateral. That way, if a Minister needed additional assurances (*e.g.* limitations on increasing dividend payments for a period of time), it could be brought into discussions ahead of time. The corporation could then make representations as to whether any such restrictions would have a significant impact on its ability to borrow or raise the capital it requires in order to stay in business.

Given the complexity of such special situations, care should be taken in assessing the entirety of the specific situation before enforcing the various conditions the Minister may feel are needed before granting funding relief.

C – Transfers to Self-Managed Accounts

We understand the potential motivation of permitting retirees to take their share of assets in lieu of a reduced monthly income from a group annuity purchase, but have some important concerns with respect to the potential impact to individuals electing this option and to the remainder who will receive their lifetime income through a group annuity purchase. Specifically, our concerns are as follows:

- **For individuals**: Retirees electing this option will potentially lose the benefit of asset pooling and scale and effectively may end up paying higher management fees and expense than were applicable to the pension fund. Many retirees will also need assistance in selecting investment strategies and investment managers who can implement those strategies, thus necessitating the need for advice and costs associated with that advice. As an individual, longevity risk would no longer be pooled, which could either force the individual to be extremely prudent in their spending or run out of retirement savings before their death. Retirees suffering from dementia may also be incapable of making prudent decisions and could be at greater risk of being exposed to fraud and elder abuse. Finally, the current tax code (*c.f.* Regulation 8517 under the *Income Tax Act*) may prevent a significant portion of the lump sum transfer from being sheltered from tax, resulting in individuals realizing significant, immediate and ongoing tax burdens, including the loss of the availability to defer taxes on earned investment income. At the very least, if this option is pursued, then Regulation 8517 should be amended so as to not apply in the case of a lump sum settlement of a lifetime pension on the termination of the pension plan for an insolvent plan sponsor.

- **For the remaining group that will have their pensions**: Allowing retirees to select a lump sum in lieu of their monthly pensions would not only violate current *Income Tax Act* provisions that prohibit a retiree from changing their form of pension once commenced, it would provide a significant opportunity for anti-selection, which would likely increase the cost of the group annuity contract, as the insurer could take into account the fact that unhealthy retirees would more likely elect the lump sum option, resulting in a population of retirees with lower expected mortality rates than would otherwise be the case, had the lump sum option not been offered.

For the above reasons, the proposal may not succeed in enhancing retirement security for Canadians.

That being said, we understand and appreciate the motivation to explore opportunities to continue to invest the pension fund as a way to mitigate the immediate cost increase associated with an annuity purchase. Indeed, many pension plans are well funded on a going-concern basis but would not have the assets necessary to purchase a group life annuity contract that would settle all promised benefits. This is why ACPM supports pension funding models built on an enhanced going-concern model. With this thought in mind, we propose an additional approach (a "Pooled Lifetime Retirement Income Fund") at the end of this section which we believe could be of great value to workers and retirees involved in the insolvency of an plan sponsor.

D – Clarify Benefit Entitlements

We observe that many pension plans do not guarantee the indexation of pensions, but may try to do so on an *ad hoc* basis or even through mechanisms such as excess return indexing, whereby a pension fund return beyond a hurdle rate can be translated into the partial indexation of pensions. In such pension designs, it will be inevitable that the indexation of pensions will be affected by the termination of a pension plan.

We agree that it would be helpful to allow pension plans to be amended to provide the flexibility of DB pension plans to offer different benefits in different circumstances in pursuit of plan-specific objectives, such as addressing affordability and sustainability issues that are critical to the employer. Further, we believe that a plan sponsor should be allowed to pursue an agreement through employee representation, on the clarification of the order of priority of assets in the case of the termination of the plan. For example, an agreement could be negotiated where assets upon wind-up would be used first to provide the base pension benefits without indexation, and to extent additional assets exist, some portion of the original intended indexation would be provided using such excess assets. This approach would improve immediate benefit security by reducing the potential impact on retirees in the case of a terminating plan with an insolvent employer.

Finally, in the case where an agreement on the order of priority of assets is not reached before a plan's termination, we believe that retirees should have the option of electing a non-indexed or partially indexed pension in lieu of a more significantly reduced pension.

For example, we suspect that a retiree with a $1,000 fully indexed monthly pension from a terminating pension plan with an 85% solvency ratio, might want to select a $1,000 monthly pension with partial indexing over a $850 fully indexed monthly pension. Indeed, there may be a rationale to make the reduced indexation option be the default option when preparing such options for retirees.

Other Pension Options – Pooled Lifetime Retirement Income Fund

While we have concerns with the option of permitting the transfer of lump sums for retirees to individual self-managed accounts, there is an argument to be made about providing access to a going-concern like approach that does not require the purchase of annuities or a complete de-risking of the program. As noted earlier, many plans which may have a deficiency on a solvency basis are well funded on a going-concern basis. This suggests that a moderate amount of investment risk can provide a reasonably high chance that the promised pensions could be paid, if the fund were allowed to continue.

This may indeed be the thinking behind the model available in Quebec, where a pension fund can continue through a government agency rather than force the purchase of annuities (and why Ontario had looked at this option during its recent revisions to the pension funding model).

We believe that this model could be expanded by allowing pension entities, such as a government agency, a pension corporation, or a board of trustees to operate a pooled investment and longevity structure that would accept transfers of pension assets in exchange for a lifetime retirement income using a target benefit model. For example, the PLRIF should be required to develop, maintain and publish investment policies, funding and benefit adjustment policies, as well as publish annual reports on historical pension fund performance, overall funded status of the program, and historical adjustments to pensions.

There are such existing arrangements in Canada (New Brunswick Shared Risk Pension Model; Nova Scotia Public Sector Superannuation Plan; the aforementioned Quebec government agency; as well as the Alberta and British Columbia target benefit plan models) that could be examined and adapted to a more usable approach for terminating underfunded pensions by insolvent employers.

Once the framework of the PLRIF has been established and implemented, a number of large existing pension organizations may well wish to offer a PLRIF option to terminating pension plans. The amount of the initial monthly pensions would depend upon the funded policy of the PLRIF and its current funded ratio. Retirees of terminating underfunded plans could then elect a direct transfer (without triggering taxation of amounts above the 8517 limit) to a PLRIF with either no reduction in the initial monthly pension, or at the very least a much smaller reduction in the monthly pension that would otherwise occur by purchasing a group annuity contract.

To be clear, the proposed PLRIF vehicle is meant as a new lifetime retirement income vehicle regulated through the *Income Tax Act*, rather than the various pension benefits standards acts. (Using this approach could permit any terminated registered pension plan from offering employees this option regardless of the pension legislation governing that pension plan.) **The PLRIF could significantly enhance the retirement security for Canadians** by allowing retirement assets to be invested prudently on a going-concern basis and, importantly, by pooling mortality risks for all retirees who elect to transfer their assets to that vehicle.

In order to maximize the chance for success of this option, the federal government could establish an agency to administer such an option for terminating plans (like Québec did for their orphan plans), with powers of delegation where needed. Alternatively, the agency's mandate could focus on the establishment, promotion and oversight of such vehicles.

Finally, the PLRIF could enhance the security of retirement income for employees who have no access to a defined benefit pension plan, by allowing any retiree the option of transferring registered assets to the vehicle. For more information on the latter concept, please see the letter from the coalition letter to the Minister of Finance and the Minister of Seniors entitled "Enhancing the efficiency of retirement income options for older Canadians" (https://www.acpm.com/ACPM/media/media/resources/7/media/AGR/Govt_Submission/2018/Coalition-Letter-Collective-Longevity-Risk-Pooling-Arrangements-Sept-26-2018.pdf).

Other Pension Options – Permitting the Discharge of Liabilities on Annuity Buyout Transactions

Bill C-27 included a section that allowed for the discharge of liabilities upon an annuity buyout transaction that meets the requirements of the *Pension Benefits Standards Act*. We believe that such a measure could enhance the retirement security of Canadians by allowing employers the option to strategically parcel off portions of pension liability, while at the same time reducing the size of the remaining pension fund and keeping it manageable (large enough to be efficient, but not so large that it could someday threaten the health of the employer.) If an employer could periodically discharge liabilities for retirees, then all those retirees who are covered by a group annuity transaction would not be affected by the insolvency of the employer, and the remaining pension fund would be smaller and potentially make it easier for the employer to restructure itself and exit insolvency as a stronger employer.

Other Pension Options – Permitting Pension Plans to Replace Floating for Fixed Indexing

Floating indexation (i.e. based on CPI) can be extremely costly for insurance companies to fully hedge and as a result, significantly increases the cost of an annuity in comparison with a similar annuity with a fixed rate of indexation. For example, an annuity with a 2% annual indexation rate will often be significantly less expensive than a fully indexed pension even though the Bank of Canada's long term target for inflation is 2% per annum.

Upon plan wind-up, pension plans should have the option of replacing a floating indexation provision with an equivalent fixed rate level of indexation. (The equivalency could be tested using transfer value assumptions recommended by the Canadian Institute of Actuaries or some other means that would satisfy the regulator that retirees would be expected to receive a similar level of indexation on average.)

Other Pension Options – More Expansive Modernization of the Pension Funding Framework for Federally Regulated Plans

As was noted in the beginning, the best chance for improving retirement security is to ensure plan sponsors remain healthy and that the pension plans they sponsor do not threaten the very viability of the plan sponsor. The solvency reserve account is one small measure which could help in this regard by providing additional funding flexibility and reducing pension funding asymmetry. A more significant overhaul of the pension funding approach such as that taken by Québec and Ontario could further reduce the variability of funding requirements in exchange for requiring provisions for adverse deviation in going concern valuations. In many cases, projections suggest that the change in the funding model may ultimately lead to greater (but more stable) funding than under the current solvency funding approach. For example, contribution holidays may be restricted until after the PfAD is fully funded and the plan has a solvency funded ratio of at least 105%.

Part 2: Corporate Governance Options and Part 3: Insolvency Options

While our expertise as an organization does not lie in corporate governance in the broader sense or insolvency, with respect to Parts 2 and 3, we strongly urge the government to avoid implementing options with consequences that would serve to further discourage employers from offering DB plans. Many amongst our membership are highly concerned that the options being contemplated would do just that.

In addition, we would like to offer the following comments on the two corporate governance options set out in the Consultation Paper:

A – Restrictions on Corporate Behaviour

This proposal introduces potentially significant restrictions on dividend payments, share redemptions and executive compensation during periods when a pension has a large deficit. We note that the term "large" has not been defined and will be very difficult to define with any certainty (which should be a goal of any reform). The size of a deficit will not necessarily correlate with a funding security concern. For example, take two DB plans, each with a deficit of $20 million. One plan is sponsored by an employer with 200 employees, and the other plan sponsored by an employer with 20,000 employees.

Depending on the circumstances, the pension plan of the smaller employer could be more “secure” than the pension plan of the larger employer, and vice versa.

In any event, funding requirements do allow for deficits (large or otherwise) provided that the plan sponsor makes the required special payments, regardless of how “large” the deficit is. We caution the government against considering any significant restrictions to dividend payments or share redemptions whenever there is a “large pension deficit”, if such measures would increase the cost of capital, thus weakening the plan sponsor. The result would be a worsening of, rather than an improvement to, retirement security. Even restrictions to executive compensation could reduce the ability of the corporation to attract and retain key talent needed for the success of the corporation. Without a viable and competitive employer sponsor, retirement income security will not be enhanced.

B – Increased Corporate Reporting and Disclosure Requirements.

We note that legislation placing a fiduciary obligation on plan sponsors and requiring them to adhere to a standard of care when acting as an administrator to a pension plan already exists. Fiduciary duties of directors and officers also already exist under corporate statutes.

While the focus on corporate social responsibility is one that is gradually being promoted worldwide, we caution against imposing measures that would impede the competitiveness of employers against their international peers.

Conclusion

We recognize the great challenge of trying to enhance retirement income security given the complexity of pension funding approaches and the capital market dynamics and resulting pressures on DB Plan sponsors.

That being said, there are some concrete approaches here which could enhance retirement security, including:

- reserve account and potential further modernization of the pension funding framework;
- clarification of benefit entitlements (*e.g.* the priority of assets on plan termination by providing greater emphasis on the base benefit); and
- the Pooled Lifetime Retirement Income Fund option which could not only enhance the retirement security of employees and retirees from a terminating plan with an insolvent employer, but potentially even retirees who had no access to DB plans in the first place.

We hope the government will evaluate these options carefully and find solutions that will truly enhance the retirement security of employees and retirees.

Please feel free to contact us if we can be of further assistance.

ACPM