December 21, 2018

Ms. Lynn Hemmings
A / Director General
Financial Sector Division
Financial Sector Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

Mr. Mark Schaan
Director General
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Submitted online: https://www.ic.gc.ca/eic/site/116.nsf/frm-eng/LCOE-B6KKX6

Dear Ms. Hemmings and Mr. Schaan:

Re: Consultation re Enhancing Retirement Security

I am writing on behalf of Canada's life and health insurance companies in response to your Departments' November 22nd announcement of a public consultation regarding how best to protect consumers' incomes from private pension plans where the sponsoring employers of those plans become insolvent. Our industry greatly appreciates the opportunity to provide input on this matter.

As you know, the Canadian Life and Health Insurance Association (CLHIA) is a voluntary industry association representing manufacturers of life, health and wealth insurance products throughout Canada.

CLHIA members manage approximately two-thirds of registered pension plans in Canada, with a particular focus on defined contribution plans for small and middle-size employers and their workers. In addition, Canada's life insurance companies administer over eighty-five percent of capital accumulation plans, which include workplace-sponsored Group Registered Retirement Savings Plans, Deferred Profit Sharing Plans, Tax Free Savings Accounts and other non-pension forms of retirement savings.

Life insurers also provide de-risking services to defined benefit pension plans, both in terms of funding and investment risk, and longevity risk management. It is primarily in this context where we believe our comments may be most relevant, given that the key issue addressed by the consultation paper relates to defined benefit pension plans, rather than defined contribution pension and non-pension arrangements. (Existing regulatory mechanisms to monitor required contributions to defined contribution pensions provide some consumer protection under such plans, although trust-based protections to ensure employer contributions to other forms of capital accumulation plans may be less proactive.)

Corporate insolvencies are not new. But recent insolvencies of a small number of comparatively larger employers, and the impact such insolvencies can have on employment and retirement benefits of workers and retirees from those entities, have brought increased public awareness to this issue.

In CLHIA's view, some of the strategies proposed by various stakeholder groups would negatively impact the viability of efforts to rehabilitate insolvent corporations. In particular, increasing the priority of claims by employees and retired employees – or of employee benefit arrangements on their behalf – against the employer's estate in order to secure employment and retirement benefits would reduce the existing protections provided to entities granting credit to such corporations. This is generally acknowledged as being likely to reduce the availability of such credit, making work-outs, and the consequential protection of employees' jobs and the future funding of benefits for retirees, less likely to succeed. That is, protecting future benefits could further jeopardize current employment. Even if such reductions in credit availability were not to occur, such measures strike CLHIA as reactive and with potentially limited effect, rather than being proactive and comprehensive.

Instead, CLHIA believes that more stringent funding, investment and valuation standards for defined benefit pension plans are a better means of protecting such benefits.

Such standards should reflect both solvency and going concern funding measurements, recognizing that, depending on investment returns, demographic trends and other current economic factors when a particular valuation of a pension plan's funded status is performed, either may be the more cautious model, and thus preferable from a prudential perspective. Abandoning or reducing solvency funding requirements in favour of going concern funding (as some jurisdictions have done), strikes us as inherently unreasonable when the continuing status of the employer (particularly of private sector employers) as a going concern is in doubt.

Canadians have seen too many long-standing employers collapse, despite their being characterized as dominant players or "too big to fail" relative to their competitors; the reality is that continually changing technologies, consumer preferences and economic realities mean that traditional business models may not be sustainable, and that such insolvencies are likely to continue, across a wide range of economic sectors. Attempting to protect pensions and other benefits once such employers are "on the ropes" is simply impractical and ineffective.

A key part of prudent pension funding is smart risk management that aligns investment assets with plan liabilities. Broad, liability-driven, investment policies, or more narrowly defined asset-liability matching analogous to the risk management practices required of life insurance companies, seem much more likely to maintain consumer protections than do funding models that assume an enduring premium built into the yields on equities, and that induce significant risks of volatility and mis-matching of assets relative to the regular outflows required by pension obligations.

CLHIA recognizes that more robust funding and valuation standards at the federal level would not protect all pension plans in Canada, given the large number of provincially regulated pensions. And we recognize that addressing retiree protections via the *Bankruptcy and Insolvency Act* may have some appeal, given the wider potential application. But CLHIA believes this reactive model is the wrong approach, and the wrong tool.

CLHIA also recognizes that more prudent funding and valuation standards for defined benefit pension plans may discourage the creation and/or preservation of such plans. But given broader economic and demographic pressures, as well as evolving corporate accounting and disclosure standards, such plans may no longer be appropriate, particularly in the private sector. Ongoing evolution of defined contribution plans to include stronger default investment options and sustainable incomes through use of life annuities, together with target benefit plans and other models striving for a middle ground of predictable contributions and benefits, may inevitably replace defined benefit plans that are predicated on long-term employment relationships with enduring employers. Trying to shore up defined benefit plans when the underlying economic model has shifted materially may no longer be reasonable, and a focus on transitioning such plans into more balanced designs may be more appropriate.

Pension Options

Employers bear an asymmetric and more onerous obligation vis-à-vis employees with respect to funding of benefit shortfalls under defined benefit pension plans. At the same time, surplus within pension plans has often been claimed by employees, on the bases that it is partially funded by employee contributions, or that the pension plan as a whole represents deferred compensation that would otherwise have been paid to employees. However, especially where a plan is fully employer-funded, it is unclear that funding

that generated a surplus would have otherwise been payable as wages; absent the pension funding requirement, such amounts might have equally been invested in corporate infrastructure to supply new or expanded markets.

In order to incent employers to fund pension plans at more stable and prudent levels, CLHIA believes that recoverability of excess funding and yields is reasonable and balances the asymmetric obligation to fund benefits. Consequently, CLHIA supports the use of **Solvency Reserve Accounts** to provide a buffer to pension plan assets, without locking-in such assets to enhance benefits beyond agreed levels.

A key challenge of such accounts is whether employers would actually fund solvency reserve accounts on an ongoing basis if use of such accounts were optional. Put another way, base funding requirements could, and arguably already have, become a *de facto* maximum funding level. An alternative may be to require enhanced base solvency funding corresponding to plan liabilities within a pension plan plus a margin, and to permit additional solvency funding at a level in excess of that margin, with such excess being recoverable by the sponsoring employer without regard to surplus division terms of the plan and ignoring any claim by employees or vested or retired plan members and their beneficiaries. In effect, this would limit any potentially competing claims regarding division of surplus to the required surplus funding level, and not to surplus or funding reserves above such levels.

Various jurisdictions have adopted, modified and extended **funding relief** regimes for specific employers with respect to funding of defined benefit pension plans. While Ministerial discretion can serve an appropriate purpose in providing such relief, the range of funding relief options may suggest an unreasonable degree of ad-hoc customization, such that predictability, consistency, member accountability and transparency of the pension funding relief regime are significantly diminished. CLHIA believes that, to the extent possible, Ministerial discretion would function better, and balance the economic interests of shareholders, creditors, employees and retirees, if it reflected pre-determined, consistent, options, and included measures to limit discretionary payments by the corporation to shareholders, executives, creditors and related parties until funding of a defined benefit pension plan attained prescribed levels. Such limitations could reasonably extend beyond dividend payments.

Some stakeholders have suggested that **transferring pension assets to individually managed accounts** would allow pension plan members and other beneficiaries to better manage assets in the hope of accumulating sufficient funds to provide reasonable income security throughout their remaining lives. Unfortunately, there is ample evidence that suggests that personal investment management is inefficient in terms of investment allocation and selection, cost, and the inability to pool longevity risk, and is therefore unlikely to provide the desired outcome. It may be that these issues can be addressed through group arrangements that provide professional investment management, large scale to reduce costs, and some form of annuitization, and transfers to such successor instruments may provide enhanced efficiencies relative to the original pension plan. Such transfers, particularly when provided in bulk to all

plan members, can provide significant consumer value, and it may be that restricting transfers to such arrangements may be warranted. The competing value proposition of "retail" management options with "hands on" consumer direction of investment decisions would appear to be very limited and may not serve either consumer objectives or the mandate of pension benefits legislation to protect retirement incomes.

The cost of pension benefits impacts different sponsors differently. While comparability between plans is helpful for prospective, existing and retired plan members, it seems inappropriate to force all pension arrangements to adopt identical benefit formulae. This would include the strength of the pension "promise" with respect to non-reduction of accrued benefits. Allowing **conditional future benefit levels** based on whether the plan is ongoing or terminated may be one area where plan members would, with appropriate understanding of the "pension promise", be prepared to accept conditional benefits. While such flexibility may increase litigation risk for plan sponsors and administrators, CLHIA sees no reason why such customization should be prevented if appropriate information is provided to new plan members at time of entry into the plan.

Corporate Governance Options

The consultation paper suggests that **certain payments** from a corporation subject to the *Canada Business Corporations Act* **could be restricted** where a defined benefit pension plan of which that corporation is a sponsor is materially underfunded. In particular, the paper suggests such actions could apply to payments to executives and shareholders.

While intuitively reasonable, this may be operationally and legally complex, since it could be viewed as creating a targeted priority for the non-executive members of the pension plan (and possibly, for other funded benefit arrangements) prior to or in an insolvency of that corporation that would conflict with access to necessary credit by the corporation, and repayment of any such borrowings. Assuming such a priority were considered reasonable, it would be essential to maintain a narrow scope for any such limitations, without impacting third parties with legitimate contractual expectations of payment from the corporation.

The consultation paper further suggests that **expanded reporting to reflect broader stakeholder interests**, beyond those of shareholders, could be mandated.

It is unclear whether such reporting would be restricted to shareholders, or be made more broadly available, as in the case of corporate social responsibility statements currently published by some federally incorporated entities. While such reporting may reflect a desirable best practice, it may be reasonable to first consider wider reporting of current shareholder disclosures under International

Accounting Standard 19 (Employee Benefits) and whether that standard provides appropriate information to address stakeholder concerns with respect to the sustainability of pension and other benefit obligations of the corporation.

Insolvency Options

The consultation paper also considers whether a court might set aside certain payments to senior executives within a prescribed period prior to a corporation entering insolvency or CCAA protection where unfunded pension liabilities exist. This does not appear to require that such pension underfunding be material; even a trivial unfunded liability could be the basis for **setting aside prior enhanced executive compensation payments**.

It is presumed that such a setting aside would only be possible if the unfunded pension liability existed at the time of the executive compensation payment, since it may be impossible to demonstrate that such enhanced compensation payments were made while no funding shortfall existed but in anticipation of such a shortfall arising.

The consultation paper correctly notes that the potential to set aside retroactive transactions creates uncertainty for executives and, by extension, for shareholders if executives' willingness to assume leadership roles is diminished for organizations with concerns regarding their potential insolvency. Consequently, the prescribed timeframe during which such setting aside of compensation enhancements might be possible might be required to be quite brief, and this could raise concerns about the utility of such measures.

The consultation paper also suggests that measures to increase the **transparency of court-supervised restructuring initiatives** under the CCAA may better balance concerns of employee and pensioner groups with the interests of the corporation and its creditors.

Among the approaches suggested is accelerating participation of employee and pensioner groups in court-supervised discussions. While CLHIA generally supports such "big tent" initiatives as an effective way of developing consensus, we can imagine that there may be proprietary issues raised during such discussions that might reasonably exclude participation of all stakeholders. Unfortunately, it is difficult if not impossible to enumerate all such matters, and it may be that imposing an express duty of good faith on all parties – regardless of their direct participation in any stage of the restructuring process – may be the most effective means of ensuring that all perspectives are respected.

Again, thank you for the opportunity to provide comments regarding this consultation process. CLHIA and its members would be pleased to expand on these concerns as necessary, and we look forward to continued dialogue with your Departments on these and other issues. Please feel free to contact me by telephone at 416-359-2021 or by email at rsanderson@clhia.ca should you or your colleagues wish to discuss any of the issues addressed in the consultation paper or in our comments, or those from other stakeholders.

Yours sincerely,

(Original signed by)

Ronald Sanderson
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