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Innovation, Science and Economic Development Canada
235 Queen St
Ottawa, ON K1A 0H5

RE: Enhancing Retirement Security for Canadians: Consultation Document

Dear Sir or Madam:

Morneau Shepell is pleased to comment on the national consultation on proposed approaches for enhancing security in the retirement income system.

General Comments

We welcome the federal government's attention to retirement security in a broad-based manner. We note that the review appears to have been spurred by recent high profile bankruptcies and insolvencies that resulted in losses to defined benefit (DB) pension plan members and retirees. While we believe that specific measures to address retirement security are welcome and necessary, it is also important to consider measures that will encourage the continuation of existing DB pension plans, to the extent possible, and the creation of innovative plan designs that balance risk and reward.

Specifically, we believe that it is important that the federal government continue to review more extensive pension reform measures, such as:

- Permitting the development of target benefit pension plans;
- Adopting broad-based DB funding reform measures, such as those already adopted in Quebec and Ontario and under review in other provinces such as British Columbia, Manitoba and Nova Scotia;
- Providing solvency funding exemptions for federally regulated negotiated contribution multi-employer pension plans;
- Providing solvency funding exemptions for federally regulated pension plans in the public sector and crown corporations, similar to the exemptions provided to public sector pension plans in many provinces; and
- Enhancing draw down options and exploring options for longevity protection for members of defined contribution pension plans and owners of Registered Retirement Savings Plans and Tax Free Savings Accounts.

We also note the possibility that an excessive focus on retirement security at the expense of benefit coverage could result in the even faster deterioration of DB pension plan coverage in the private sector. In particular, overly tight restrictions on dividend payments, even when a pension plan sponsor is fully compliant with

legislated funding rules, could potentially result in DB pension plans being frozen and wound up at an ever faster rate.

Pension Options

We make the following comments on the pension-related proposals.

1. Solvency Reserve Accounts (SRAs)

While we support SRAs in principle, our experience to date has been that there has been a negligible impact on employer behaviour and DB pension plan sustainability. We note that the ability to withdraw pension plan surpluses using SRAs in Alberta and British Columbia is at least somewhat uncertain, even with legislation providing for overrides of plan text language involving plan surplus. Such uncertainty means that plan sponsors could potentially face litigation over withdrawals from SRAs. The appeal of the solution is further diminished as sponsors typically create a separate trust account for SRAs, requiring additional annual fees to be paid to trust companies.

If such legislation is adopted, then it should clearly provide an override of any current or prior plan text, trust documents or any other funding agreement involving the plan to allow a clear, unequivocal access to surplus withdrawals by the plan sponsor. Furthermore, such legislation should be clear that benefit payments should be made first from the main portion of the trust fund, so that plan administrators cannot be subject to criticism for not paying benefits initially from the SRA.

2. Pension funding relief criteria

The consultation suggests that special funding relief could be available subject to additional conditions, such as not paying dividends while relief is in place. We note that this is likely to affect only a miniscule number of federally regulated pension plans. However, we suggest that such a blanket prohibition on dividend payments would distort capital allocation decisions and disincentivize funding relief being sought, possibly worsening retirement income security.

We would suggest that any funding relief or other regulatory actions should not be based on arbitrary criteria like dividends or executive bonuses. Rather, they should be based on genuine risks to the pension plan and the retirement security of plan members. Such measures should be clear and should be based on the employer's ability to contribute, using factors such as debt to equity ratios or sustainability of corporate interest payments.

3. Transfers to self-managed accounts

The consultation proposes allowing retirees in underfunded pension plans to transfer their benefits to self-managed accounts such as Life Income Funds. This option has been provided in limited cases in Quebec and Ontario.

As the appointed administrator of several pension plans that faced such requests for transfers, we make the following comments:

1. There are communication difficulties and risks in explaining the pros and cons to older plan members facing an irrevocable, life-altering decision.
2. There can be anti-selection issues, as retirees who face a lower life expectancy are more likely to remove their benefits from a pension plan.
3. It raises the cost of administration for an underfunded pension plan to offer and process the lump sums. Administrative complexity increases significantly where there are marriage breakdowns, divorces and remarriages after pension commencement.

Therefore, we caution that such transfers may raise difficulties and costs of plan administration, while increasing risk for retired plan members.

4. Clarify benefit entitlements on plan termination

The consultation proposes that making benefit entitlements conditional on plan continuation or on full funding upon plan wind up be prohibited. Our view is that methods that share risk between members and plan sponsors are not inherently problematic. We do not recommend that plan designs be restricted in this way.

Governance Options

We make the following comments on the corporate governance-related proposals.

1. Restrictions on corporate behaviour

The proposal suggests that dividend payments, share redemptions and executive compensation packages could be restricted when an employer has a large pension deficit. Our view is that this proposal is not based on the risk to the pension plan, and accordingly should not be adopted as proposed. A large pension deficit in itself is not problematic if the plan sponsor has the ability to finance it. Such a proposal would likely result in disincentives for plan sponsors to continue to offer DB pension plans, as not only would their behaviour be restricted, but it would be put under the spotlight. The proposal also creates a linkage between two issues that is not necessarily valid.

We also question who would be responsible for regulating such proposals and who would bear the cost. We suggest that the cost and effort that would be required to implement such proposals would be better directed elsewhere.

2. Increased corporate reporting and disclosure requirements

We repeat our previous concerns about compliance costs and disincentives to pension coverage.

Bankruptcy Options

Generally, employers facing financial distress may attempt to restructure their business affairs under the *Companies' Creditors Arrangement Act* (CCAA) process. Failure to successfully restructure invariably leads to the insolvency of the employer and commencement of the bankruptcy proceedings under the *Bankruptcy and Insolvency Act* (BIA). Apart from a very small portion of the employer's pension obligations (i.e., current

service costs or "CSC") the CCAA and BIA processes provide limited protection for unsecured creditors; pension plans and employees are considered to be in the class of unsecured creditors under the BIA. For example, except for CSC, the vast majority of an employer unfunded obligation is unprotected. It is within this context that we make the following comments on the bankruptcy-related proposals:

1. **Enhanced "look-back" period**

Notwithstanding the foregoing, in the event of an actual bankruptcy or insolvency, we believe enhancing the "look-back" provisions within a fixed period under the CCAA or BIA to include executive bonuses and compensation increases makes sense and would be consistent with the existing discretion afforded to the courts. Although the period that would be covered by the enhancement is not defined in the paper, we would suggest that all "look-back" periods be treated similarly. More precisely, and based on our experience as a regulator appointed administrator of underfunded pension plans that must be wound up as a consequence of plan sponsor insolvency/ bankruptcy, we believe a 1 year "look-back" period may not be sufficient, even in the case of dividend payments or share redemptions. For example, in the case of the Sears Canada Inc., transactions, including dividend payments, within 5 years of the CCAA protection date in June 2017 are currently under review.[1] Ultimately, the contemplated enhancement would serve to force board of directors to properly assess the merits of making dividend payments in the face of a corporate insolvency, particularly where such payments could adversely affect underfunded pension plans that are at risk of being wound up. Lastly, the government may wish to consider extending this protection beyond pension plans to health and other non-pension related benefits.

2. **Enhanced transparency in the CCAA process**

While we believe any improvements to the CCAA process in favour of pension plan members are a laudable goal, particularly if the intention is to level the playing field between the interests of plan members and shareholders or secured creditors, the amendments outlined in the paper are ambiguous. In order to properly comment on the meaningfulness of these amendments, we would request greater clarity around the concepts of "limiting the scope of initial orders", "real economic interests" and "express duty of good faith".

In keeping with the spirit of the amendments contemplated in the paper, the federal government may wish to consider the appropriateness of allowing the Superintendent of Financial Institutions to appoint an independent administrator of a registered pension plan at the onset of CCAA in order to properly represent and protect the interests of plan members.

Conclusion

We appreciate the opportunity to provide comments on the consultation and we hope that these comments are helpful in furthering the review of retirement security in Canada. If you have any questions regarding our comments, please do not hesitate to contact us.

[1] Morneau Shepell Ltd. is the regulator-appointed administrator of the Sears Canada Inc. Registered Retirement Plan.

Sincerely,

Andrew Zur, LL. B.
Principal
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