Willis Towers Watson

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Mark Schaan
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**Re: Willis Towers Watson Submission on *Enhancing Retirement Security for Canadians: Consultation Document***

Dear Mr. Schaan,

Willis Towers Watson welcomes the opportunity to comment on Innovation, Science and Economic Development Canada's *Enhancing Retirement Security for Canadians: Consultation Document*.

Willis Towers Watson designs and delivers solutions that manage risk, optimize benefits, cultivate talent and expand the power of capital to protect and strengthen institutions and individuals. Willis Towers Watson employs over 40,000 colleagues on a worldwide basis, with approximately 450 being engaged in providing services to Canadian pension plans.

The undersigned have prepared our response with input from others in the company.

Before discussing the Consultation Document's specific proposals, we would like to make a few comments with respect to the prior proposal relating to changing the priority of claims in bankruptcy and insolvency proceedings. In our October 2010 communication, "Granting Higher Priority to DB Plan Deficits: Solving Problems or Creating Them?" (a copy of which is attached with this submission), we analysed the implications of granting higher priority for employee and pension claims in insolvency. Without repeating all the details here, we would strongly discourage the resurrection of these proposals given the impacts on:

- Corporate bond spreads which would be expected to increase, with resulting downgrades to credit ratings, particularly for entities rated just above investment grade
- Defined benefit plan sponsors, by reducing their access to, and increasing the cost of, credit
- Defined benefit plan members, by reducing the ability of distressed plan sponsors to restructure

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## Pension options

### Solvency reserve accounts

The *Pension Benefits Standards Act, 1985* (PBSA) should be amended to allow solvency payments to be remitted to a solvency reserve account (SRA), as is currently the case in Quebec, Alberta, and British Columbia. This would partially alleviate the asymmetrical risk that employers generally face because of the combination of current defined benefit (DB) funding requirements and surplus rules. That is, plan members are not directly responsible for any solvency deficit funding but can often benefit from any surplus. Employers, on the other hand, are generally responsible for the plan's solvency deficit but have an uncertain entitlement to any surplus that develops from the contributions that the employer was required to make toward a solvency deficit. Many employers fund their plans only to the minimum extent required by the PBSA because of this asymmetrical risk, leaving their plans more vulnerable to changes in interest rates or negative market performance.

SRAs, by allowing employers to recoup prior deficit payments once a plan is in surplus, will partially alleviate the asymmetrical risk which, in turn, would address concerns from sponsors who may then fund beyond the minimum, thereby strengthening the overall funding position of plans.

SRAs should be in addition to other methods of addressing asymmetrical risk and, in particular, should not replace letters of credit.

### Pension funding relief criteria

The PBSA could be amended to specify the criteria or conditions that the Minister may place on employers seeking special pension funding relief, but the mechanism should be discretionary so that the Minister can determine the particular conditions on a case by case basis; a broad and more prescriptive approach could have negative unintended consequences. We urge caution in the use of such conditions. For example, prohibiting dividend payments while funding relief is in effect may be appropriate in some instances, but prohibiting all dividend payments could be seen as a sign of financial distress which may discourage some employers from seeking funding relief, even in cases where that might be in the best interest of the plan members.

Other Canadian jurisdictions that grant pension funding relief tend to impose conditions on the treatment of the pension plan itself (such as restricting benefit improvements while a plan is receiving funding relief or for some period thereafter), rather than on other transactions of the employer.

### Transfers to self-managed accounts

Where retirees' pensions have been reduced due to employer insolvency on plan windup, we support giving them the option to transfer a lump sum amount to a locked-in self-managed account in lieu of the purchase of an annuity. However, high fee levels and poor investment choices can make this a sub-optimal choice, so we recommend appropriate communication to retirees about the risks associated with this approach. Also anti-selection issues presented by such an option could increase the cost of annuitization, as insurers might expect retirees who expect to live longer to prefer an annuity to a lump sum.

### Clarify benefit entitlement

We strongly support amending the PBSA to allow plan sponsors the flexibility to offer benefits that would be different on plan termination as compared to while the plan is ongoing. This additional flexibility could encourage a plan sponsor to provide or maintain a benefit that it would not otherwise consider. We believe, however, that the lifetime pension payable at pensionable age is a fundamental promise; therefore, benefits that can be adjusted on plan termination should be limited to certain ancillary benefits such as early retirement subsidies, bridge benefits and indexation. To some extent, this treatment is analogous to certain pension benefits being subject to consent, which is already allowed under the PBSA.

Benefits subject to this distinction in treatment should be funded on a going concern basis, but the plan sponsor could specify that on an actual plan termination these benefits would be limited to the level that could be provided by the remaining assets on plan termination, after provision for other benefits.

Given the nature of this type of benefit, additional disclosure requirements should apply to inform affected members about the distinction in the treatment of these benefits. Such disclosures could include:

- An initial notice when a plan is amended to provide this type of benefit
- Annual pension statements while the provision is in effect

Such disclosure would be similar to, for example, Ontario legislation, where jointly sponsored pension plans (JSPPs) must provide additional disclosures on annual pension statements, including a statement that, on windup of the pension plan, pension benefits may be reduced if plan assets are not sufficient to meet plan liabilities.

Where a plan amendment to implement this type of benefit affects past service, there will need to be appropriate regulatory approval mechanisms. The Superintendent currently has the authority to approve a reducing amendment under section 10.1 of the PBSA. However, specific consent thresholds for members affected by the amendment could be required as part of the regulatory approval process. The member approval process under the distressed pension plan workout scheme is a useful model for approving this type of amendment.

As well, to facilitate the use of annuities for risk management, the PBSA should be amended to allow changes to accrued benefits under an ongoing plan, provided that the overall value of the benefits does not decrease. In particular, a plan that indexes its accrued pensions in line with CPI (which is a very costly benefit to hedge) would be allowed to change the indexing formula to one based on fixed percentage increases (which could reference the break-even inflation rate). Given that the value of the benefits would be comparable, the regulatory approval mechanisms should be less onerous than the situation above where prescribed benefits on plan termination would be limited to the level that could be provided by the remaining assets.

We note that Canadian pension actuarial standards explicitly allow an actuary to "incorporate assumptions as to the exercise of regulatory discretion, a change in law, or a plan amendment which would be required to enable a practical settlement of benefits", provided that "when making such assumptions, the actuary would consider any relevant regulatory policy, guidance, or precedent", with the example of CPI-indexed pensions being cited. Regulatory flexibility in this area would be a welcome change for federally registered pension plans.

## Corporate governance options

### Restrictions on corporate behaviour

We do not support amending the *Canada Business Corporations Act* to allow restrictions on dividend payments, share redemptions or executive compensation packages where a company has a large pension deficit. The goal of such restrictions may be to influence corporate behaviour and align the interests of executives with plan members, but, for the reasons below, we do not believe that such restrictions will advance this goal and could have unintended consequences that will negatively affect plan members:

- Large pension deficits can arise due to factors beyond the control of the company or its executives, such as an economic downturn or a decrease in long-term interest rates. Because, in these situations, the actions of the company and its executives are not connected to the pension deficit, the proposed restrictions will have no effect on these actions, but would be unfairly punitive.
- Similarly, a large pension deficit is not necessarily connected to a company's financial status. However, restricting dividend payments could incorrectly signal to the market that a company is in financial distress and make it more difficult and expensive for the company to borrow.
- Executives may know of financial risks to their company, including the possibility of a pension deficit, early on. To avoid any possible losses with respect to their past and current vested compensation, executives may decide to resign before any restrictions are imposed. Furthermore, it will be more difficult for companies with material pension deficits or that are at risk of such deficits to attract new executives, especially those with a proven track record of turning around underperforming companies and who can, therefore, command a compensation premium, often highly contingent on performance via incentive programs. In these circumstances, a company facing financial or operating difficulties, which are ordinarily temporary or manageable, could lose its executive team at a critical time, and the resulting business disruption and inability to replace that talent could significantly exacerbate the company's difficulties, further reducing its ability to fund any pension deficit.

We note that the UK government recently consulted on improving corporate governance surrounding corporate transactions, including possible restrictions on payment of company dividends if the pension scheme is in deficit, and concluded that "It agrees with strongly held views that there should be no automatic bar on companies paying dividends in these circumstances."[1]

[1] Paragraph 1.54 of *Government response: Insolvency and Corporate Governance*

### Increased corporate reporting and disclosure requirements

We have no comment on this proposal.

## Insolvency options

### Enhanced "look-back" period

We can see merit in expanding the look-back provisions of the *Bankruptcy and Insolvency Act* or the *Companies' Creditors Arrangement Act* to include the ability to review and possibly set aside executive bonuses and compensation increases that occur during the look-back period. However, any expanded look-back provision should only apply to compensation-related actions taken after the expanded provision comes into effect.

### Enhanced transparency in the CCAA process

We have no comment on this proposal.

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Given the strong similarities between some of the issues raised in the Consultation Document and the review of these same issues currently underway in the UK, you may find it useful to consider the March 2018 White Paper (*Protecting Defined Benefit Pension Schemes*) which was issued by the UK government in the wake of a number of corporate failures. We note that, although the UK Pensions Regulator already has strong "moral hazard" powers to impose financial arrangements on an employer if the Pensions Regulator believes the employer is attempting to avoid its funding obligations, the UK government is considering strengthening those powers to require companies and trustees to provide the Regulator with timely information. We suggest that you review the direction the UK government is heading and consider the merits of that approach, possibly also bringing it to the attention of your provincial counterparts.

We greatly appreciate the opportunity to comment on the Consultation Document, and would welcome the opportunity to address any questions you may have regarding our submission.

Sincerely,

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