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

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ACPM Submission to the Public Consultation on Bill 68: An Act Primarily to Permit the Establishment of Target Benefit Pension Plans

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FOREWORD

THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT (ACPM)

ACPM (The Association of Canadian Pension Management) is a national, non-profit organization acting as the informed voice of plan sponsors, administrators and their service providers in advocating for improvement to the Canadian retirement income system. Our membership represents over 400 organizations and retirement income plans that cover over three 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 Third Pillar and mandatory First and Second Pillar components.

Third Pillar Coverage
Third Pillar retirement income plan coverage should be encouraged and play a meaningful ongoing role in Canada's retirement income system.

Adequacy and Security
The components of Canada's retirement income system should collectively enable Canadians to receive adequate and secure retirement incomes.

Affordability
The components of Canada's retirement income system should be affordable for both employers and employees.

Innovation in Plan Design
Canada's retirement income system should encourage and permit innovation in Third Pillar plan design.

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 be harmonized.

INTRODUCTION

We are writing to provide you with the comments of the Association of Canadian Pension Management ("ACPM") on Bill 68: An Act to primarily permit the establishment of target benefit pension plans.

First of all, the ACPM welcomes the introduction of Bill 68 and the expansion of the target benefit concept in Quebec. This bill is an important step forward in preserving and improving Quebec's retirement system.

Since its inception, the ACPM has been promoting flexibility and innovation in pension plan design to address the significant issues facing Quebec's retirement system and to better meet the financial security needs of Quebecers in retirement. The ACPM regularly invites the various governments in Canada to facilitate the creation of new pension plans whose features are likely to encourage worker participation in a plan. In the findings of a 2012 study, the ACPM already identified target benefit plans as a viable solution which should be permitted under pension legislation:[1]

> [W]e believe that [target benefit] plans have the potential to play an important role in addressing the issues now facing Canada's retirement income system, including plan coverage and retirement income adequacy. We urge governments to take immediate action to ensure that single-employer [target benefit] plans can be made available to Canadian workers to enhance Canada's retirement income system.

The ACPM therefore strongly encourages the National Assembly to pass Bill 68. However, we wish to bring to the attention of parliamentarians certain recommendations which would improve the proposed legal framework for target benefit plans and further promote the adoption of the concept in Quebec.

1. EQUITY PRINCIPLE

(a) In the event of a shortfall in contributions

In the event of a shortfall in contributions for recognized service at the date of the actuarial valuation, Bill 68 states that the remedies embedded in the plan text may provide for an increase in employee contributions, an increase in employer contributions (subject to a limit), a reduction in benefits related to recognized service at the valuation date, or a combination of these measures.

In the interest of maintaining a principle of fairness, it is provided that no adjustment shall have the effect of reducing, on a funding basis, the value of entitlements of inactive members and beneficiaries by more than the value of entitlements of active members that have accrued to the date of the actuarial valuation that identified the deficiency.

In its current form, this principle of fairness could preclude the implementation of remedies that would combine both a reduction in benefits related to credited service and an increase in employee contributions for active participants, since the adjustment effort for active participants would be greater than that for non-active participants and beneficiaries.

[1] ACPM Report on Target Benefit Plans, March 30, 2012: https://www.acpm.com/ACPM/media/media/resources/7/media/AGR/Publication_FR/ACARR_Rapport_sur_les_regimes_a_prestations_cibles(finale).pdf

Another approach could be through the allocation of the contribution deficiency in proportion to the value of the entitlements of non-active participants and beneficiaries relative to the value of the entitlements of all participants. This would allow for separate and equitable remedies to be applied to all participants based on their respective contribution deficiencies.

The ACPM recognizes the importance of establishing a principle of equity to protect the rights of non-active members and beneficiaries. However, we encourage the National Assembly to adjust the Bill to allow for flexibility in implementing appropriate remedial measures.

(b) In the event of the allocation of surplus assets

In order to maintain a principle of equity, it is also provided that the allocation of surplus assets shall not, under the funding approach, increase the liability for the entitlements of inactive members and beneficiaries by more than the liability for the entitlements of active members.

The ACPM sees two potential problems with this rule:

- The allocation of surplus assets to reduce employee contributions does not represent an increase in liabilities. Therefore, any allocation of a portion of the surplus assets to this reduce employee contributions does not appear to be consistent with the principle of equity.

- Where pensioners have experienced pension cuts in the past, reinstatement of benefits must have occurred before surplus assets can be allocated. In our view, this is a good measure. However, the reinstatement process does not require pensioners to be compensated for amounts they have not received since the cut. The unpaid amounts represent a real loss to retirees, while active members do not suffer a real loss once benefits are restored. In a subsequent allocation of surplus assets, it should be possible to offset the unpaid amounts due to reduced pensions before equity principles are applied.

2. REINSTATEMENT OF BENEFITS

Bill 68 provides that benefits that have already been reduced may be reinstated when assets exceed liabilities by an amount at least equal to the stabilization provision. It should be noted that the stabilization provision is based on the parameters of the investment policy in effect. With a typical benchmark portfolio, the stabilization provision amounts to approximately 17% of liabilities.

It is expected that the recovery measures that will be applied by the target benefit plans will restore benefits to the target, i.e. the degree of funding at 100%. It could therefore take many years before the plan is in a financial position with a funding ratio of more than 117%, and retirees whose pensions have been reduced will have time to die before their pensions can be restored.

The ACPM does not believe it is necessary to wait until the stabilization provision is fully funded before restoring benefits. The ACPM suggests that reinstatement of benefits can be made when the degree of funding exceeds 105% or 110%, with the understanding that this minimum ratio must be maintained after reinstatement of benefits.

3. PURCHASES OF ANNUITIES IN PROGRESS

Under the *Supplemental Pension Plans Act* ("SPP Act"), annuities in payment may be purchased in accordance with an annuity purchase policy. In the case of a target benefit plan, several issues arise since the annuity purchase crystallizes the amount of the annuity purchased.

- Is the amount of the annuity being paid out at the time of purchase being purchased, which could create losses for the plan? Or is the annuity being purchased based on the value of the pension benefit entitlements?
- What if the pension has been reduced in the past and reinstatement of benefits has not been made?
- Is the retiree being shortchanged by depriving him or her of a possible reinstatement of benefits or a future allocation of surplus assets?

The ACPM recognizes that annuity purchases are an attractive risk management tool, but this should not be at the expense of equity in a target benefit plan where the members have assumed the risk.

The ACPM suggests that the purchase of annuities during the life of the plan be based on the value of the pensioner's entitlement at the time of purchase, as is the case with plan terminations.

The ACPM suggests that the regulatory provisions regarding the mandatory content of annuity purchase policies stipulate the following rules for target benefit plans to ensure fair treatment:

- The individual consent of the retiree should be required before the pension committee can pay the pension benefit entitlements by way of annuity purchase or transfer.
- In addition to individual consent to proceed with an annuity purchase, the pensioner should also have the option of requesting a transfer of the value of the pension benefit entitlement to an authorized vehicle.

4. AMENDMENTS AND TERMINATIONS OF TARGET BENEFIT PLANS

Bill 68 states that the plan text of a target benefit plan must prohibit the employer from unilaterally amending or terminating the plan. The ACPM understands that the increased sharing of risk between members and employers in a target benefit plan results in a greater degree of member control over the design and future of the plan. However, employers and administrators who will be called upon to manage the member consultation process must have the benefit of clear rules in this regard or they may face insurmountable obstacles once a few members object to plan amendment or termination.

Section 146.45 of the SPP Act proposed in Bill 68 does not address this need for clarity and flexibility. The section, as drafted, could lead to litigation to invalidate amendments or terminations that have been adopted through a process that a member may find inadequate. In order to avoid this type of problem, the SPP Act should, at a minimum, specify the following rules:

- Any changes required to comply with the legislation may be adopted without consultation.

- Unless the plan provides for a different consultation process, any amendment or termination should be deemed to be approved if less than 30% of the members object by written notice.[2]

- Unions should be able to consent on behalf of all participants they represent.

5. PAYMENT ON TERMINATION OF A TARGET BENEFIT PLAN

In the event of termination of a target benefit plan, the value of the pension benefit entitlements of participants and beneficiaries whose pension payments are in progress or suspended at the date of termination must be paid either by purchasing an annuity from an insurer with the value allocated to their entitlements or by transferring the same value to another plan permitted by the SPP Act.

We understand that the value of their entitlements at the termination date will be the same regardless of which payment option is chosen, and that it will be based on the assumptions determined by regulation. However, by using the expression "degree of solvency", the addition to section 66 proposed by the Bill already seems to indicate that the basis used will be the Canadian Institute of Actuaries ("CIA") transfer value basis that is already used for traditional defined benefit pension plans.

The ACPM would like to reiterate its position that the preferred basis for payment of benefits on plan termination is the funding approach and assumptions used in the going-concern funding approach as set out in subsection 3570 of the CIA Standards of Practice. Discussions should be held with the CIA to agree on the best approach to be incorporated into the regulations.

6. MULTI-JURISDICTIONAL PLANS

We are encouraged by the opening in Bill 68 to the creation, under certain conditions, of multi-jurisdictional target benefit plans. The creation of such plans is essential, in our view, to foster the growth of target benefit plans. Multi-jurisdictional target benefit plans will be more attractive to plan sponsors (including unions), will reduce administration costs, and will also have the advantage of pooling the assets of a larger number of members, which can help improve plan stability and benefit security.

We are concerned, however, about the lack of any principle in the proposed legislation to guide the conditions that may be imposed by regulation. It is important that the rules that will be enacted by the government remain flexible, balanced and applicable to as many plans as possible.

In drafting the regulations, we also encourage the government to be guided by the principles underlying the *2020 Agreement Respecting Multi-Jurisdictional Pension Plans* recently entered into between the Governments of Quebec, Canada and six other Canadian provinces. In particular, we would like the registration, funding, investment, administration and supervision of a multi-jurisdictional target benefit plan to be governed entirely by the legislation of the major authority's jurisdiction, as is currently the case for traditional plans. Since the relief and reinstatement measures concern the individual rights of members, they could continue to be governed by the SPP Act with respect to Quebec members even when a target benefit plan is registered outside Quebec.

[2] For other examples where the legislature has introduced a similar principle of approval, see sections 146.33 to 146.36, 146.5, 196 and 311.1 of the SPP Act.

7. ESTABLISHMENT OF A SEPARATE TARGET BENEFIT PLAN

Bill 68 provides that a target benefit plan may not contain provisions specific to a Defined Benefit ("DB") plan that recognize service prior to the date of implementation of the target benefit plan. This approach raises a few application problems that we invite you to correct.

(a) Risk of forced plan termination

DB plan sponsors who wish to migrate to a target benefit plan for future service will therefore, in practice, have to set up a separate plan. Under the current regulatory framework, a pension plan that no longer allows for the accrual of new entitlements may be terminated by a decision of Retraite Québec. This entity has already published a policy under which exceptions could be made in certain circumstances and it is expected that a DB plan that has been replaced by a target benefit plan for future service will qualify as an exception and will not be terminated by Retraite Québec unless other circumstances justify it. However, we are concerned that these exceptions continue to be granted under an administrative policy that could be modified at any time by Retraite Québec. The consequences of a DB plan termination can be significant for an employer, particularly if the termination results in an obligation to fund a significant solvency deficiency.

In this context, it can be assumed that employers will want more certainty, before considering the option of a target benefit plan, that the existing DB plan will not be terminated by Retraite Québec. An exception to the termination power of Retraite Québec should be confirmed by legislation.

(b) Constraints on sharing the costs associated with past service

Another difficulty arises from the fact that some DB plans provide for cost-sharing with members, including costs associated with past service. It is difficult to see how this type of arrangement can be maintained in the context of a migration to a target benefit plan, which could be a disincentive to establishing such a plan.

(c) Additional Administrative Requirements

In addition, since the target benefit plan will in effect be a separate plan, duplication of compliance and governance requirements (e.g., actuarial valuations, annual information returns and related fees, pension committees, investment policies, funding policies, administration, etc.) must be anticipated. The consequence of this duplication will be a significant increase in overhead costs related to pension plan administration.

The ACPM encourages the National Assembly to allow DB plans to be amended to add a target benefit component rather than requiring the creation of a separate plan, or at least introduce administrative measures to address these issues.

8. CONVERSION OF EXISTING PENSION PLANS

The ACPM's 2012 Report on Target Benefit Plans[1] and a Supplementary Report dated September 8, 2014[3] set out its recommendations for the conversion of existing plans to target benefit plans. In these

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[3] ACPM Target Benefit Plan Supplemental Paper dated September 8, 2014: ACPM-Target-Benefit-Plan-Supplemental-Report-(Sept8-14).pdf

reports, the ACPM encouraged governments to adopt a framework for converting DB and DC plan accruals to target benefits, as it considers balanced conversion rules to be a key element in the growth of target benefit plans in Canada.

However, the ACPM recognizes the complexities and concerns with respect to the conversion of DB plan benefit entitlements and understands that the government has agreed with management and labour not to allow it in this proposed legislation. With respect to converting DC plan benefits to target benefits, the ACPM believes that such a conversion can facilitate retirement planning while pooling longevity and investment risks. The ACPM therefore supports the provisions of Bill 68 which move in this direction.

9. VARIABLE PAYMENT LIFE PENSIONS

The ACPM is very pleased to see the addition of a new group decumulation option for Defined Contribution ("DC") plans and voluntary retirement savings plans - the Variable Payment Life Pension.

When the federal government tabled its budget in 2019, it announced its intention to amend the *Income Tax Act* (Canada) and its regulations to allow for the introduction of variable payment life annuities and deferred annuities at an advanced age. These options are additional tools that offer the advantage of pooling investment and longevity risks during the payout period.

Bill 68 stipulates that certain requirements will be set out in regulations, particularly with respect to the determination of the amount of the pension that may be purchased with the transferred amounts, and its increase or decrease.

Considering that the amendments to the *Income Tax Act* (Canada) and its regulations have not yet come into force, we invite the legislator to exercise caution in order to ensure consistency between the rules that will be adopted and future federal measures.

CONCLUSION

We would like to thank the National Assembly for allowing us to share our comments and suggestions regarding Bill 68. We urge the National Assembly and the government to continue the dialogue on target benefit plans with the various stakeholders in the coming weeks, and hope that the government will move quickly to accommodate sponsors who are waiting for legislation to implement negotiated agreements. We remain available to support you in your efforts in this regard.