KOSKIE MINSKY
JUSTICE MATTERS

Pension and Benefits

This is a summary of Pension and Employee Benefits matters of interest.

Bill C-27: Federal Framework for Target Benefit Plans

With little fanfare, the Federal Government has introduced legislation to amend the *Pension Benefits Standards Act* ("PBSA") to regulate "target benefit" plans. These are plans that offer a formula-style "target" benefit that looks much like a defined benefit but that is not assured. Target benefit plans do not require past service funding guarantees from the plan sponsor; rather they are typically funded under contractual terms that fix the level or range of contributions.

Bill C-27 seeks to accomplish two things in relation to target benefits ("TBs"). First, it creates a new structure that allows for single employer TB plans. In addition, Bill C-27 also creates a process for converting member entitlements in defined benefit ("DB") plans into target benefits ("TBs").

Both aspects of Bill C-27 – its framework for establishing new target benefit plans, and its process for converting existing DBs into TBs – will no doubt be controversial. The design of Bill C-27 reflects important choices about the funding and benefit security objectives for members of TB plans.

The key challenge of any TB arrangement is how to reconcile a formula style 'target' benefit promise with a fixed funding commitment from the plan sponsor. It looks like the best of all worlds – the employee gets an apparently secure formula style benefit from a plan that pools investment and mortality risks, while the employer gets a fixed 'defined contribution' funding obligation. But these are opposing objectives, and the balance between them is the objective of any regulatory regime.

From a member point of view, retirement income is most desirable if it is stable, predictable and secure. But a "target" benefit is, by its nature, not a guaranteed promise, and there is necessarily a level of unpredictability as to whether the member will in fact receive the target level of benefits. The purpose of any regulatory rule is to ensure that target benefit promises have a high likelihood of being delivered, that members understand the contingent nature of their retirement income promise and that employer sponsors of the plan have confidence that their funding costs are predictable and under their control.

Unfortunately, however, there is no established way to accurately or precisely measure or manage the level of insecurity implicit in a TB promise. And it is easy to mislead people about the security of their retirement income.

It is possible to develop models in which future economic and demographic assumptions in relation to a TB plan are projected over the course of years or decades to generate 'probabilities' that a TB's assets will be sufficient to support its benefit promises. However, these models make projections into an unknown future, based on historic relationships and patterns. As the standard cautionary note invariably concludes, "Past performance is no guarantee of future results" – and this is certainly true for the multi-decade TB style promises.

As many others have noted, projection models are highly sensitive to the assumptions and relationships that are built into them, and small changes to those assumptions and relationships can produce significant swings in projection model results. Accordingly, projection models, though potentially helpful, are not useful benchmarks to evaluate the security of a TB promise.

A more productive way of regulating benefit security in a TB plan is to integrate the TB plan with collective bargaining. When the level of contributions to a TB plan can be collectively bargained, then members may divert an increased share of their overall compensation to fund any deficiency in relation to their accrued benefits. Without collective bargaining, there is no effective way for TB plan members to allocate their incomes between current wages and future pensions. The collective bargaining mechanism has been an important way for TB plans to mitigate the potentially serious adverse consequences of funding shortfalls.

The integration of collective bargaining with TBs has been a standard feature of most multi-employer TB plans in Canada for many years. In New Brunswick, by contrast, public sector employees are expressly prohibited from collective bargaining *vis-à-vis* their target benefit plans. In the case of Bill C-27, the relationship between collective bargaining and the funding of a TB plan is left unclear. This is a significant deficiency in the existing proposals.

Under Bill C-27, TB plans will be required to have a "funding policy" and a "governance policy". The administrator will be required to adopt a funding policy; it appears as though the sponsor may create a TB plan's governance policy. The PBSA, and perhaps future Regulations, will regulate the content of those policies, and thereby regulate TB plans themselves.

Bill C-27 proposes that each TB plan's funding policy must set out the initial benefit formula as well as any changes that are subsequently made to it. As well, it will describe employer contributions and member contributions (if any). It will also have to contain a deficit recovery and a surplus utilization plan, details of which may be prescribed by Regulation. Perhaps most important, a funding policy will have to set out its "...objectives... with respect to pension benefits stability". Once a TB plan's "pension stability" objectives are set, they cannot be changed. Apparently, the level of benefit security in a federally regulated TB plan will depend on each plan's 'pension benefits stability' objectives.

It will be important to see whether Regulations place any parameters around the benefit stability objectives for a TB plan. Will it be possible, for example, for a funding policy's benefit stability objectives to be expressed in a way that is not sensible or intelligible to its members? Will it be possible to express the objectives in terms of probabilities produced by a projection model whose results are inherently unreliable as predictors of the future? Will it be possible for the board of a TB plan to adopt any approach at all to benefits stability, or will there be minimum benefit security standards that any TB will be required to achieve? The answers to these questions, which are not apparent from the text of C-27 itself, will be important to evaluating the value of any TB regime under the PBSA.

Bill C-27 also deviates from Canada's historic practice *vis-à-vis* TB plans by not requiring that TB plans be jointly governed. Joint governance has been a mechanism to tie TB plans to collective bargaining and to member representation. But joint governance has also been a way for TB plans to create a dynamic balance between employer and member interests, and so prevent any sponsor's self-interest from controlling plan decision-making. Under Bill C-27, however, the employer may retain majority control over the fiduciary board of a TB plan. It need only provide for the appointment of a single representative for active plan members and a "prescribed number" of representatives of the plan's former members and survivors. While this provides for nominal representation for members and former members, it does not ensure that the fiduciary boards of TB plans have the checks and balances between competing interests that have historically guided most of Canada's successful TB plans in the multi-employer sector.

As noted, Bill C-27 also permits individuals to convert their DBs into TBs.

Under Bill C-27, a conversion of a member's or former member's DB pension requires that members or former members consent to the conversion. A union may consent to such a conversion on behalf of unionized members where the union is authorized to do so. It is not clear from C-27 what type of authority a union requires in order to provide such consent.

Where a member does consent to convert their DB benefit to a TB benefit, then their pension benefit is transferred from the DB plan to a second TB plan sponsored by the employer. The amount of assets to be transferred in relation to the conversion will be prescribed by Regulation. In the event that the TB plan fails within five years of the conversion, then Bill C-27 will require that the DB promise be honoured. Bill C-27 imposes minimal successor plan requirements on the second TB plan, requiring that it recognize periods of employment under the original DB plan for pension eligibility purposes under the second TB plan.

Because the trade-off between a DB and a TB is generally unfavorable for plan members, it is doubtful that members and former members would provide their consent to conversion under normal course circumstances with full disclosure. Accordingly, the consent mechanism is only likely to be used under extreme circumstances, including insolvencies. In the past, DB plan members have compromised pension funding requirements, but have not compromised their accrued benefits. The possibility of converting a DB plan into a TB plan generally weakens the position of DB plan members in insolvency or pre-insolvency situation by exposing them to the additional risk that accrued benefits would be reduced. While this is to the advantage of other creditors, it is difficult to see how such a pension-only compromise is in the interests of members and pensioners; yet, without the protections afforded by the law as it currently stands, the conversion option will no doubt expose pension plan members to significant additional risk in the event of insolvency.

Ontario Enacts the Financial Services Regulatory Authority of Ontario Act, 2016

On December 8, 2016, the *Building Ontario Up for Everyone Act (Budget Measures), 2016* ("Bill 70") received Royal Assent. Among other things, the omnibus budget legislation enacts the ***Financial Services Regulatory Authority of Ontario Act, 2016***, (the "FSRA Act") setting out the framework for the creation of the new Financial Services Regulatory Authority ("FSRA").

By way of background, the Minister appointed an expert advisory panel to review the mandates of both FSCO and the Financial Services Tribunal. In a final report released to the public in June 2016, the panel concluded that "radical change" was necessary to establish a world-class financial services and pensions regulator in Ontario, and made 44 recommendations which focused on the creation of a single integrated organization that would replace FSCO.

Under the FSRA Act, the FSRA will consolidate various regulatory functions related to pensions, insurance, trust companies, credit union, caisses populaires, co-operatives, and mortgage brokers into one body, just as FSCO did. This structure is in stark contrast to what was proposed by the 2008 expert commission in Ontario, which urged the creation of an independent single-purpose pension regulator. It remains unclear from the FSRA Act whether the FSRA will have an independent division which regulates pension administration, as well as separate divisions which regulate market conduct and prudential oversight. Subject to the approval of the Minister, the FSRA Act provides the board of directors of the FSRA with powers to make by-laws governing the management of the FSRA, among other administrative and structural issues.

A separate division focused on pension administration recognizes the unique nature of pensions, and courts have repeatedly recognized the need for specialized expertise in the pension field. However, under the proposals of the expert advisory panel, these divisions would still function within one regulatory authority that is tasked with overseeing a number of mandates. There remain concerns that the authority of the pension regulator may be constrained by the FSRA's overall mandate. If implemented, the proposed creation of various divisions within the FSRA, while a positive structural change to the current regulation of pensions in Ontario, falls short of the recommendations of the 2008 expert commission.

While the final report also outlined recommendations for changes to the FST, these were not addressed in Bill 70 and it is unclear whether these will be implemented in addition to the FSRA Act establishing the new FSRA.

The FSRA Act lacks sufficient detail on a number of things, including the FSRA's mandate and principles by which it operates, and the tools and means the agency will have at its disposal. These will likely be set out in the by-laws made by the board of directors of the FSRA. As such, more details are required before the actual impact of the FSRA on pension regulation in Ontario can be determined.

This edition of Pension and Benefits was produced and edited by the following members of the Pension and Benefits Law Group at Koskie Minsky LLP

Murray Gold, Partner

Amy Tang, Associate

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