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Is Bigger Better ... It Comes to Pen

There are too many variables to say with certainty that "bigger is better" when it comes to consolidation, but this much we know definitively: Trends toward consolidation will continue to grow, and it's best to be prepared for the legal details.

When
sions and Benefits?

by | **Michael Mazzuca** and **Mark Firman**

In the wake of industry consolidation, new plan designs and increasingly complex tax rules governing health and welfare benefit arrangements, we, two pension and benefit lawyers, have been asked the following question: "Is bigger better?" The answer is: "It depends."

The purpose of this article is to canvass, however briefly, four areas of existing or potential consolidation: pension and benefit industry service providers, industrywide target benefit plans, existing multi-employer pension plans (MEPPs) and health and welfare trusts. Even if the answer in each case is not a definitive "yes" or "no" to the question "Is bigger better?," we hope the discussion forms a springboard for further debate. One thing, after all, is definitive: The trend toward consolidation is not going away anytime soon.

Industry Consolidation

In recent years, there has been increased consolidation within the pension and benefit industry, including among consultants,[1] insurers[2] and even law firms. Consolidation can bring about a number of efficiencies. For example, mergers among consultants have made it easier for a single consultancy to provide services in a number of areas, from pension consulting to actuarial services and recordkeeping, from health and welfare plan design to absence management and from employee assistance to payroll services. Similarly, consolidation among insurers promises to streamline investment options available under member-directed capital accumulation plans such as defined contribution pension plans, group retirement savings plans and deferred profit-sharing plans. It may also bring about premium reductions. Many employers, plans and boards of trustees appreciate the "one-stop shop" that consolidated industry players arguably can better offer.

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Mark Zigler, D. Cameron Hunter, Murray Gold, Michael Mazzuca and Roberto Tomassini.
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From a legal perspective, however, the question is not "Is bigger better?" It is instead: "Is bigger still prudent?" For boards of trustees of pension and health and welfare funds, as well as other administrators of pension plans, the courts will look at the reasons for and processes leading up to a particular decision, not at the decision itself. While it is not necessarily intuitive to conceive of in this way, the act of remaining with a service provider following a consolidation is, in and of itself, a kind of decision. Likewise, choosing to switch service providers, or at least to migrate some services, following a consolidation is also a potential decision. Both decisions could be subject to scrutiny from members, regulators and, ultimately, courts.

Accordingly, trustees and other pension plan administrators will need to be able to show that their decision to remain with a newly consolidated incumbent or to move some or all services to a new provider following a consolidation was prudent and in the best interests of beneficiaries. While the law is less clear regarding sponsors of nonpension plans, such as group retirement savings plans and insured health and welfare benefit plans, it would generally be judicious to act as if the higher fiduciary standards applicable to trustees and other pension plan administrators also applied to them.

Factors that trustees and other sponsors might consider following the consolidation of one or more service providers include:

- Changes, if any, in key staff, including fund managers and relationship managers
- Changes, if any, in fees. If the consolidated company promises more efficient operations, the consolidation may be an opportunity for trustees and administrators to renegotiate fees or premiums. In other words, ask the consolidated company to put its money where its mouth is.
- The risk of redundant services and offerings. In the case of investment options under retirement savings plans, for example, ask whether the newly consolidated provider offers two or more versions of the same kind of investment under different legacy branding. Importantly, if two or more differently branded options have the same fundamental mandate (including if one simply invests in the other), ask if one has higher fees than the other and/or a different track record of failing to meet benchmarks.

- Market presence, including, in particular, consolidation that reduces a front-line presence in the trustees' or administrators' home market. For example, if a Vancouver, British Columbia–based insurer acquires a smaller Halifax, Nova Scotia–based insurer and plans to consolidate operations in British Columbia, trustees and administrators of a Nova Scotia–based plan with plan members who mainly live in Nova Scotia will want to consider the newly consolidated company's ability to service plan members. Will the call centre's hours, for example, work for plan members in the Atlantic time zone? Can the new company provide comparable services in both French and English?

There may well be a range of reasonable decisions that trustees and administrators make based on a consideration of all the factors. Put differently, there may not be (and often is not) a clear "right" answer. What will be important for trustees, administrators and other sponsors facing a consolidated player is to be able to show how they reacted to the consolidation—and why.

Takeaways

- Consolidation must be prudent from a legal standpoint. Courts will look at the reasoning and processes behind a particular decision more than at the decision itself.
- If service providers consolidate, trustees should consider changes in fees and/or key staff, redundant services and market presence.
- It's still early, but target benefit plans could become the norm for pension coverage in the private sector.
- Further regulatory guidance may be needed before moving ahead with mergers for multi-employer pension plans as well as health and welfare trusts.
- Trends toward consolidation may get ahead of the existing legal framework, which could present impediments to moving forward with any particular consolidation.

Industrywide Target Benefit Plans

Much has been written about the promise that target benefit plans hold as an alternative kind of pension plan design. At a high level, a target benefit plan is a plan that offers a target level of defined benefit, but future and accrued benefits may be reduced or member and employer contributions may be increased—or both—if the plan's funding level cannot support the target. In many jurisdictions, MEPPs under which contributions are fixed by collective agreement or trust agreement have already provided benefits on a target benefit basis for years. What these particular plans have often lacked has been a workable legislative regime that accommodates their unique design (discussed more in the next section).

The merits of a target benefit design over the traditional defined benefit and defined contribution models are a subject for another day.[3] What cannot be ignored, however—especially when the topic is "Is bigger better?"—is the promise that target benefit plans hold out to increase private pension coverage, especially among employers for whom pension plan sponsorship is otherwise uneconomical. If they succeed in that goal, they can be said to be better.

Recent legislative developments in some provinces now provide the tools to make such plans more prevalent—including on an industrywide basis.[4] The main reason is that new provisions governing what are called "target benefit provisions" under the new Alberta Employment Pension Plans Act and British Columbia Pension Benefits Standards Act and "shared risk plans" under the New Brunswick Pension Benefits Act facilitate large-scale plans under which employer contributions and, if any, employee contributions are fixed. Crucially, the new legislation exempts such plans from certain solvency funding requirements and provides administrators with the flexibility to reduce accrued benefits, at least temporarily, to respond to funding shortfalls.

Target benefit plans may give industry associations, chambers of commerce, unions and service providers the flexibility they need to offer affordable pension coverage to participating employers at a fixed cost and without the administrative obligations that go with single employer pension plan sponsorship. We are in the early days, but these "bigger" plans, when they are developed, may well become the norm for pension coverage in the private sector, as they have become in other jurisdictions like the Netherlands.[5]

Multi-Employer Pension Plans (MEPPs)

As noted earlier, many MEPPs are a form of target benefit pension plans that have existed for decades. The current legislative and regulatory focus on

target benefit plans often fails to address the status and needs of existing MEPPs. The establishment of new target benefit plans, either as MEPPs or as single employer pension plans, may provide some increased coverage, but that does not change the fact that current regulations in many jurisdictions fail to specifically and adequately address the status and needs of existing MEPPs. In particular, existing legislation and regulations often do not address the unique needs of MEPPs when dealing with plan mergers and consolidations.

The reasons for merging existing MEPPs are many and varied. Larger MEPPs tend to have a greater number of participating employers, thereby reducing the risk of wind-ups and also reducing the adverse consequences of reliance on any single large employer. Also, having 15 or more participating employers allows a MEPP to seek specified multi-employer pension plan status, which can provide a significant number of advantages under the Income Tax Act.[6] Larger MEPPs also can avail themselves of economies of scale, such as being able to negotiate lower pro-rata costs as well as opening up additional investment opportunities so as to promote asset diversification, including investments in infrastructure and private equity. In some cases, the merger of MEPPs may be required as a result of other consolidations within an industry or a trade union.

In most Canadian jurisdictions, no specific regulations are in place to address MEPP mergers. MEPPs must simply try to comply with the rules that exist and that have been drafted with only single employer plans in mind. In Ontario, until recently, the regulator took the position that MEPP mergers were not permissible as they were not specifically provided for under the regulations. Fortunately, in late 2015, the Ontario government amended the Ontario Pension Benefits Act to permit regulations that would provide for asset transfers between MEPPs.[7] Effective July 1, 2016, the Ontario government enacted amendments to the existing regulations that specifically address and permit asset transfers between MEPPs.[8] These regulations will now allow asset transfers where an existing MEPP is amended to be a successor to another MEPP and the participating employers cease to make contributions to the original MEPP. The asset transfer between MEPPs can only be effected with the prior consent of the Superintendent. For defined benefit MEPPs, the regulations require that, after the transfer of any assets, the successor pension plan have a solvency funded ratio of at least 1.0 or the solvency ratio of the successor plan be no more than 0.05 below the solvency ratio of the original plan before the transfer and no more than 0.05 below the solvency ra-

BIOS

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tio of the successor plan before the transfer.[9] The regulations also provide for notice requirements to members, and various statements must be filed by the trustees, certifying that the assets to be transferred are in compliance with the act.

Although many jurisdictions would permit the merger of MEPPs, there still may be obstacles standing in the way of such mergers. The regulatory funding requirements may require one or both MEPPs to be amended in order to alter either or both accrued and future benefits. Obviously, any merger that would require the reduction of accrued benefits could be controversial. Also, plan administrators, plan sponsors and plan members may be comfortable with the status quo and opposed to any significant changes that could be viewed as a loss of administrative control. However, the pressures toward consolidations likely will mean that Canada will see a greater number of MEPP mergers in the near future. Canada also may see a greater number of MEPPs moving to a master trust model whereby two or more MEPPs are invested through a single investment trust fund. This master trust model may be viewed as a more moderate step than a full plan consolidation.

Health and Welfare Trusts

The possible reasons and advantages of merging multiemployer health and welfare trusts are similar to those for MEPPs discussed above. In 2015, the Canada Revenue Agency (CRA) replaced a three-decade-old interpretation bulletin that addressed health and welfare trusts with a new income tax folio.[10] The income tax folio does not specifically address the merger of health and welfare trusts or asset transfers between health and welfare trusts. As a result, any merger or asset transfer between health and welfare trusts without further guidance from CRA could potentially give rise to adverse tax consequences.

The income tax folio does place limits on the use of the funds in a health and welfare trust and specifically provides that any funds of the trust and any of the income earned in the trust cannot revert to the employer or be used for a purpose other than providing health and welfare benefits under the trusts. Further, the income tax folio states that upon wind-up, any remaining funds in a health and welfare trust must be used only to provide additional benefits to the beneficiaries of the trust or be distributed to the employees or a registered charity. Again, there is no specific provision addressing the potential merger with another health and welfare trust.

A further structure that may be considered by some plan sponsors is the establishment of an employee life and health trust (ELHT). An ELHT is a structure contemplated under the Income Tax Act[11] that may provide the same type of health and welfare benefits as a health and welfare trust. An ELHT enjoys certain advantages as compared with a health and welfare trust, including specific rules that contemplate and address multiemployer plans. Unfortunately, there currently is no process under the Income Tax Act or under CRA policy for converting health and welfare trusts to ELHTs. In addition, ELHT rules currently apply only to trusts established after 2009.

Conclusion

Trends toward consolidation will no doubt continue in the coming years. Is bigger better? Maybe, but it is happening anyway. In some cases, though, as we hope to have highlighted above, the trend may get ahead of the existing legal framework, which could present impediments—or at least give rise to additional considerations and risks—to going ahead with any particular consolidation. Trustees, plan administrators and other sponsors are charged with being at the forefront of these issues. It's OK to think big, but don't forget the legal details!

Endnotes

1. See, e.g., BusinessWire, "Willis Towers Watson Merger Successfully Completed," available at www.businesswire.com/news/home/20160104006634/en/Willis-Towers-Watson-Merger-Successfully-Completed, viewed January 10, 2017; and "Morneau Sobeco Income Fund Announces Acquisition of Shepell-fgi and Concurrent $153 Million Equity Offering," available at www.marketwired.com/press-release/morneau-sobeco-income-fund-announces-acquisition-shepell-fgi-concurrent-153-million-tsx-msi.un-855256.htm, viewed January 10, 2017.
2. See, e.g., B. Shecter, "Manulife Buying Standard Life's Canadian Business in $4-Billion Deal," available at http://business.financialpost.com/news/fp-street/manulife-buying-standard-lifes-canadian-business-in-4-billion-deal, viewed January 10, 2017.
3. Of late, the debate around target benefit plans has focused on conversions of existing defined benefit plans and, to a lesser extent, defined contribution plans into target benefit arrangements, either on a go-forward basis or on a past basis with respect to accrued benefits. By focusing on existing plans, the debate has ignored the worthy objective of using target benefit plans to expand private pension coverage to those who do not have access to it.
4. R. Deraspe and L. McGlashan, "The Target Benefit Plan: An Emerging Pension Regime," Library of Parliament, available at www.lop.parl.gc.ca/Content/LOP/ResearchPublications/2016-20-e.html?cat=social, viewed January 10, 2017.
5. See, e.g., M. Williams Walsh, "No Smoke, No Mirrors: The Dutch Pension Plan," available at www.nytimes.com/2014/10/12/business/no-smoke-no-mirrors-the-dutch-pension-plan.html, viewed January 10, 2017.
6. Income Tax Regulations, SS. 8510(2) and (3).
7. Bill 144, Budget Measures Act, 2015, Schedule 17.
8. O. Reg. 239/16.
9. O. Reg. 310/13, as amended.
10. Income Tax Folio S2-F1-C1, Health and Welfare Trusts.
11. Section 144.1.