Blake, Cassels & Graydon LLP
Barristers & Solicitors
Patent & Trade-mark Agents
199 Bay Street
Suite 4000, Commerce Court West
Toronto ON M5L 1A9 Canada
Tel: 416-863-2400 Fax: 416-863-2653

June 23, 2014

Pensions, Benefits & Executive Compensation Group

VIA E-MAIL - pensions@fin.gc.ca

Consultations and Communications Branch
Department of Finance Canada
19th floor, East Tower
140 O'Connor Street
Ottawa, Ontario
K1A 0G5

RE: Consultation Paper - Pension Innovation for Canadians: The Target Benefit Plan

Dear Sirs/Mesdames:

I. INTRODUCTION

We are pleased to provide this submission ("**Submission**") with respect to the federal government's Consultation Paper - *Pension Innovation for Canadians: The Target Benefit Plan* concerning a federal Target Benefit Plan ("**TBP**") framework which was released by the Department of Finance Canada on April 24, 2014 (the "**Consultation Paper**") on behalf of the Pension, Benefits and Executive Compensation Group ("**Pension Group**") at Blake, Cassels & Graydon LLP ("**Blakes**"). The Pension Group consists of 25 lawyers in Toronto, Montreal, Calgary and Vancouver whose practices are devoted to pension, benefits and compensation law. The Pension Group is supported by lawyers with pensions and benefits sub-specialties in the employment, corporate tax, litigation and securities law practice groups at Blakes.

We appreciate the opportunity to comment on the Consultation Paper. Our Submission has been made from the perspective of practicing lawyers in the pension law field. Accordingly, much of our Submission is focused on the legal and regulatory aspects of the Consultation Paper. The views expressed in this Submission are those of the partners in the Pension Group. We are not writing on behalf of, or to express the views of, any client of Blakes. Nothing in this Submission is intended to express any legal opinion or legal interpretation of existing or proposed legislation.

Our comments in respect of a number of issues and questions identified in the Consultation Paper, but not all of them, are set out below.

22556415.3

II. GENERAL

We welcome the introduction of regulatory measures that would increase the options available to employers and employees in respect of pension plan design. This is another step that helps address the retirement income security of Canadians employed in federally regulated industries.

In our view, a crucial component to how attractive these types of plans will be for employers is the extent that legislation is harmonized as much as possible across jurisdictions. As you are aware, New Brunswick has already introduced legislation for its 'shared risk plans' and other jurisdictions have indicated that they will be introducing legislation to govern target benefit plans in the near future, and the federal government has the opportunity to steer the direction of target benefit plan legislation in Canada.

We are aware of significant interest from sponsors of existing defined benefit ("**DB**") plans. In our view, the key to increasing pension coverage will be for the TBP model to also be attractive to employers who do not have existing plans. Their interest is subject to the framework being not overly prescriptive and sufficiently flexible so as to permit employers to reflect their compensation philosophies and objectives in the plan and / or so as to allow employers and employees to strike a "pension deal" appropriate to their circumstances.

III. QUESTIONS FROM CONSULTATION PAPER

4.1 Administration and Governance

Questions

- *Is this governance framework appropriate for federally-regulated private sector and Crown corporation pension plans wishing to convert to a target benefit plan?*

Our view is that the difficult decisions regarding the financial aspects of the TBP should be agreed by the applicable stakeholders (discussed in Section 4.8 below) and incorporated into the constating documents (plan text, deficit recovery plan, and surplus utilization plan) when establishing or converting a plan, and be subject to the applicable rules for amending those documents. Once this is done, the entity responsible for administering the plan would simply need to administer the plan and invest the assets in accordance with the legislation and the plan documents. The plan administrator would have very little, if any, discretion regarding the plan (other than in respect of the investment policy).

On this basis, it would be useful for the TBP governance model to be structured in a flexible manner so as to permit:

- A range of possible governance structures – from 100% union/employee governed, to joint governance, to 100% employer governed – in order to reflect the circumstances of the applicable employer(s) and employees and the desired terms/structure of the plan (as discussed further below).

- A multi-employer TBP structure in which employers may participate without any requirement of corporate relationship or particular industry participation.

- Plan "administrators" to be something other than a board of individual trustees comprised of beneficiaries and contributors under the plan. There is no clarity in the Consultation Paper around what "similar bodies" might suffice, but a corporate entity with a board of directors acting in that capacity would facilitate both the ability to attract qualified individuals and permit establishment of the type of multi-employer structure suggested above.

- Bicameral governance structures contemplating (1) a sponsor level in which participating employer, members and retirees have representation (i.e., a sponsors committee), and (2) a professional administrative entity responsible for operation of the plan (i.e., the plan administrator), as contemplated above.

We support a flexible regime in respect of the governance structure of target benefit plans. For the balance of this submission we have used the term 'Board of Trustees' to refer to the governing body responsible administering the plan since this is the phrase used in the Consultation Paper.

- *Should the federal legislation or regulations be prescriptive regarding the composition of the governance body (e.g., proportion of plan members and retirees, presence of independent trustees)?*

The appropriate composition of the governance body or bodies, in our view, ultimately depends on the role of that the body or bodies. Being overly prescriptive about how the governance body must be structured may create issues and limit the TBP's potential attractiveness to employers. It is questionable whether a single employer would want to establish a TBP and then turn over control to a member/retiree dominated Board of Trustees - particularly if that Board of Trustees has the power to financially impact the employer. As noted above, providing flexibility in the legislation to permit various compositions for the governance body (or bodies) would be an attractive feature for employers. In particular, some employers may be reluctant to adopt a joint governance model and may prefer to retain decision-making authority over such matters, with the attendant duties that go along with such role.

For example, if there is a bicameral governance structure in place whereby the "administrator board" simply administers the plan in accordance with the agreed upon documents (including the deficit recovery plan and surplus utilization plan) and has very little, if any, discretionary power then it is simply a matter of having members with the appropriate skills on the "administrator board" (be it a board of trustees or a corporate board). In this type of governance arrangement, the "sponsor board" has the authority to make decisions that could directly impact benefits (e.g., amending the deficit recovery plan etc.) and representation of all of the stakeholders on the sponsor board makes sense. The legislation should be flexible enough to permit a variety of governance compositions in order for stakeholders to establish the appropriate arrangement in their circumstances.

Where non-professionals or lay persons are to be involved in plan administration, there is also a potential challenge for such individuals in developing the necessary knowledge or expertise needed to properly administer the plan, particularly if there is regular turnover of such representatives. In a structure where the administrator body does not control sponsor-level decisions (e.g., plan and funding policy amendments), the case for professionals or experts is even stronger. In our view, if joint governance is required, member/retiree representation is more suited to a role in the sponsor body.

We support the encouragement of independent trustees if joint governance is mandated by the legislation. However, the presence of independent trustees may not be appropriate in all cases.

Appointment Process

If the government decides to prescribe a certain number of representatives on the Board of Trustees from different member groups (actives, deferred vested members, retirees), the legislation should be detailed on how this appointment process would work. In a non-unionized environment, it may be difficult to organize employees and it should be clear in the framework what constitutes a proper appointment (e.g., Majority of members who actually vote? Majority of members who are eligible to vote?) and what happens if there are no volunteers to be representatives.

It is also unclear how retiree representatives would be selected, given that retiree populations are often spread out geographically and do not typically have representatives appointed to act on behalf of the group as a whole. Retirees may also have very different interests and pension promises within their group – for example, a retiree population may span +30 years and the promises made by employers when those retirees were working may differ significantly (e.g., some retirees may have automatic indexation while others have ad hoc or no indexation).

It may also be difficult to find individuals who are willing to take on the personal fiduciary obligations associated with being a trustee – particularly in a non-unionized environment. As such, we would support broad legislative protection from liability for members of the administrative body except in the case of fraud, gross negligence or wilful misconduct. This protection should be broader than what is currently provided under the *Pension Benefits Standards Act, 1985* ("**PBSA**"), which is limited to relying on professional advice in certain circumstances.

- *Should the Board of Trustees have powers to amend plan documents?*

The Board of Trustees should not have the power to amend the plan text. The power to amend the plan text should remain a sponsor power, as it currently is under the PBSA for single employer pension plans. The role of the Board of Trustees should be limited to making recommendations to the plan sponsor regarding changes to the plan documents. We would, however, support the ability of the sponsors to delegate the power to amend certain documents other than the plan text – such as the Statement of investment Policies and Procedures or underlying funding agreement (e.g., trust agreement) – to the Board of Trustees.

We would also like to highlight the fact that the power to amend plan documents is separate from the power to implement the deficit recovery plan. Under the proposed structure, the Board of Trustees is responsible for implementing the deficit recovery plan when triggered and plan amendments would not be required to do so.

The Consultation Paper suggests that the Board of Trustees will be required to act solely in the best interest of plan members. We would recommend that the federal government follow the approach taken in New Brunswick where the legislation states that "The sole obligation and fiduciary duty of a trustee is to carry out the purposes of the shared risk plan" (s100.5(5), *Pension Benefits Act* (NB)).

- *What should be the plan member support level requirement for making substantial amendments to the plan text?*

Substantial amendments to the plan documents should be limited to: (a) amending the formula for accruing benefits; (b) amending the deficit recovery plan or surplus utilization plan; (c) reducing employer contributions; or (d) increasing member contributions. The definition of substantial amendments should exclude any amendments to these documents that are required to comply with changes to legislation.

We would support a "negative consent" approach for obtaining support for a substantial amendment whereby the change could be made unless 1/3 or more of affected members object. This would help address the potential lack of member engagement.

- *Should there be different governance framework provisions applicable to federally-regulated pension plans in unionized and non-unionized environments?*

In a unionized environment, the union should be included in appointing representatives for its members on the Board of Trustees. Otherwise, there should not be different governance frameworks for unionized and non-unionized environments. As noted above, employers should be given clear guidance on how a valid appointment process works in a non-unionized environment.

- *What type of process could be used for negotiating provisions of the plan with employees in federally-regulated non-unionized environments?*

Subject to our comments above regarding substantive amendments, the provisions of the plan should not be negotiated with employees and should be left to the plan sponsor or sponsor board.

As discussed above, in our view, member/retiree representation is more suited to a role in the sponsor board that makes decisions regarding the plan documents, rather than an administrator body that is solely responsible for running the plan. With this type of governance arrangement, it would be useful to require the plan documents to contemplate a dispute resolution mechanism for decisions made by the sponsor board.

4.2 Funding Policy

Questions

- *Is the going concern valuation sufficient to measure and fund target benefits?*
- *Which approach should be adopted under the federal legislative and regulatory framework: the margin or the probability test?*
- *Is the PfAD approach appropriate as a funding margin or should a different margin calculation be provided for or allowed (e.g., through a discount rate margin)?*
- *What is the appropriate time horizon for the purposes of calculating the PfAD?*
- *Should going concern valuations be required on a closed group or open group basis?*
- *How frequently should valuations be required?*

- *Should some of the specifics on the funding policy (e.g., PfAD rates) rely on guidance from sources such as the Canadian Institute of Actuaries (CIA) or should they be more fully prescribed in legislation or regulations?*

We are not in a position to comment on whether the proposed funding requirements are appropriate and will leave these points to the actuaries for comment. However, from our perspective the most important aspects of the funding requirements will be:

- funding based on the going concern valuation alone is sufficient;
- harmonizing the funding requirements across jurisdictions;
- ease of communicating the measures to members; and
- a clear process for an actuary to follow within the regulatory framework and compliance with CIA Standards of Practice.

4.3 <u>Contributions</u>

Questions

- *Is this approach to contributions for federally-regulated plans appropriate?*
- *Should some of the specifics concerning contributions be determined by plan members or more fully prescribed in legislation or regulations?*

We support the flexible approach proposed for determining contributions. Plan sponsor and participants may have different priorities and tolerances for contribution volatility. In our view, allowing the parties to establish the appropriate range of volatility and the triggers for adjusting contribution rates is appropriate.

4.4 <u>Benefit Structure</u>

Questions

- *Is the approach of categorizing benefits in two classes appropriate?*
- *Should base and ancillary benefits be determined by pension plans or more fully prescribed in federal legislation or regulations?*

We support the flexible approach proposed for determining whether benefits are categorized as "base" or "ancillary". In our experience, the relative importance of certain types of benefits to plan members varies between plans and classes of plan members. Further, having flexibility to change what is considered initially to be a base benefit to an ancillary benefit (and vice-versa) is important because as a plan evolves the priorities of plan members may also change. Changing the categorization of a benefit (and thereby changing the level of protection it receives) would be a significant change to the plan and subject to the appropriate consent requirements discussed earlier.

The Consultation Paper indicates that a reduction of accrued benefits would be allowed but not required in a TBP. We agree that reducing accrued benefits should typically be a last resort, but, in our view, the possibility of reducing accrued benefits is an integral component in ensuring that a target benefit plan structure works properly. As such, the legislation should require a target benefit plan to reduce accrued benefits if the circumstances require such action.

4.5 Funding Deficit Recovery Plan

Questions

- *Should the deficit recovery measures and their prioritization be determined by plan members or more fully prescribed in federal legislation or regulations? If the latter, what measures should be prescribed and what should be their order of priority?*

The deficit recovery measures and order of priority should not be set out in legislation, but should be required to be included in the deficit recovery plan that is established by the parties. The deficit recovery plan should form part of the plan or at least be filed with the Superintendent. The legislation should be clear that the Superintendent has the power to enforce the deficit recovery plan. We support an approach that is not overly prescriptive and provides flexibility to plan sponsors and plan members to agree to a funding deficit recovery plan that meets the specific needs of their plan. Once a funding deficit recovery plan is established, there should be no need for any negotiation or the exercise of any discretion when it is triggered as the measures should be implemented automatically by the Board of Trustees.

- *Should deficit recovery measures be triggered as soon as the PfAD starts to be depleted or the probability test is not met?*

Since plans have different risk tolerances, the determination as to when deficit recovery measures are triggered should be established by the plan sponsors and members as part of the deficit recovery plan. We would, however, support including a minimum standard in the legislation setting out when the implementation of deficit recovery measures would need to commence. Further, the ability to only implement measures to the extent necessary to improve the funding ratio to the appropriate level should be permitted.

4.6 Funding Surplus Utilization Plan

Questions

- *Should the surplus utilization measures and their prioritization be determined by plan members or more fully prescribed in legislation or regulations? If the latter, what measures should be prescribed and what should their order of priority be?*

As with the funding deficit recovery plan, we support an approach that provides flexibility to plan sponsors and plan members to agree to a surplus utilization plan that meets the specific needs of their plan. Again, once a surplus utilization plan is established, there should be no room for any negotiation or any discretion when it is triggered as the measures should be implemented automatically by the Board of Trustees.

- *What would be an appropriate margin (over the fully-funded level) to allow surplus utilization? What would be an appropriate cap on the utilization of surplus?*

In our view this question is more appropriate for the actuaries to address, but we would assume that the funding level under the PfAD approach or the probabilistic approach already builds in a margin and the requirement for an additional 'buffer' seems excessive.

4.7 <u>Disclosure and Communications</u>

Questions

- *What are your views on the proposed additional disclosure requirements listed above?*

We believe that clear and concise communications regarding participation in a TBP are important to ensure that members understand the risks associated with participating in a TBP. That said, too much information can be overwhelming and confusing, which defeats the objective.

- *What are your views on the timing, frequency, and sequence for communicating these additional disclosure items?*

We believe that the legislative framework should include clear timelines that apply to providing members and employers with notice of changes to benefits or contribution rates. However, the proposed requirement to provide 180 days advance notice of any changes in contributions or benefits will significantly inhibit the ability of a Board of Trustees to react in a timely manner to changes in circumstance. Depending on the preparation time and frequency of actuarial reports, there could be a lag between events and information provided to the Board of Trustees – adding an additional 6 months will impair the Board of Trustee's ability to take corrective measures to avert funding problems.

We recognize that retirees need advance notice of changes to their pensions already in pay as changes will have an immediate financial impact on these individuals. In our view, this is the only situation where 180 days advance notice may be appropriate. A shorter period of 60 or 90 days would be appropriate for other changes to contribution rates or benefits for active or deferred vested members.

- *What are your views on requiring the plan administrator to report the solvency funding ratio of the plan in its annual reports for informational purposes only?*

Since TBPs are not required to fund on a solvency basis and commuted values are not dependent on solvency calculations, we see no reason for the plan administrator disclosing the solvency ratio in its annual reports. Further, including this information would potentially be confusing for members. In respect of annual statements to members, we would suggest disclosing the benefit a member would receive if the plan were to wind up on the date of the notice, rather than the solvency ratio of the plan. In our view, this information would be more useful for plan members.

4.8 Conversion of Pension Plans to Target Benefit Plans

Questions

- *What are your views on how benefits are treated upon conversion?*
- *Do you have any other views on how accrued benefits should be calculated at the time of conversion?*

Our main concern about conversion is the significant barrier to entry that is present due to the consent requirement. If a particular level of positive consent from members and retirees is required, this will make most, if not all, conversions practically impossible.

What would be attractive for employers is a consent model that employs a "negative consent" approach (as discussed above in respect of substantial amendments) whereby the conversion could occur for all members provided that, for example, not more than 1/3 of the members object. This would also help address a potential lack of member engagement and is similar to what is used in the context of surplus sharing and solvency relief.

We agree that in the context of a conversion it should be possible to reduce accrued benefits. However, on this basis, it is unclear to us why a retiree who currently has a fully guaranteed DB pension would not object to converting his or her DB pension plan into a target benefit pension. In order to increase the likelihood of the conversion not being rejected, the employer will likely need to negotiate with each affected group. In the case of retirees, employers could offer them higher priority in the benefit reduction formula or additional indexing of benefits. One option would be for an employer to buy-out retiree benefits through an annuity purchase or permit portability of benefits out of the plan. However, this would require changes to the PBSA.

Given the potential difficulty of objecting retirees (or deferred vested members), it would also be useful to include flexibility in the legislation to permit an existing plan to 'split' and to only convert part of the plan into a target benefit plan going forward.

The information currently required by OSFI's policy on amendments to reduce benefits would be useful content to include in conversion notices.

- *What views, if any, do you have on converting federally-regulated DC plans to TBPs?*

We support the ability of defined contribution ("**DC**") plans to be able to convert to a TBP. Treating the value of the DC account as base benefits on conversion is reasonable.

4.9 Portability and Locking-In Rules

- *Are there any TBP-specific issues in relation to locking-in and portability that should be addressed in the federal legislative and regulatory framework?*

Subject to our comments in Section 4.8 above regarding the treatment of retiree benefits on conversion of a TBP, we support applying the current rules in the PBSA regarding locking-in and portability to target benefit plans.

4.10 Individual Termination

- *What are your views on the methodology used to calculate the individual termination value?*

We support adjusting the target benefits by the funded ratio of the plan for members who terminate employment and decide to transfer their benefit out of the plan. Termination values should be calculated on the new going concern basis. It is not appropriate, however, for top up payments over the following 5 years (as is required for existing DB plans) to be made to the member. This would put members who transfer their money out of the plan in, potentially, a better position than members who keep their money in the plan.

We do, however, have concerns with certain aspects of the proposed approach regarding valuing benefits on a member's termination. In particular:

- There is the potential for disputes about overpayments or underpayments from the plan, depending on the time period between a valuation and a termination.
- It is not appropriate in our view to distribute 'surplus' to individual members who terminate. Firstly, whether or not an on-going plan is in surplus is dependent on a number of actuarial assumptions and variables. Secondly, distributing surplus from an on-going plan could result in the creation of adverse incentives (e.g., a plan member is better off terminating than staying in the plan). Lastly, 'surplus' in a TBP is intended to be used to enhance benefits, reduce contributions or to provide a 'buffer' to weather difficult financial periods. The prohibition on sharing 'surplus' as part of termination values should be made clear in the legislation.

4.11 Plan Termination and Wind-Up

- *What are your views on the formula used for calculating termination value? Would it be more appropriate to use the solvency funding ratio?*

Since the plan is being funded on a going concern basis, it would be inconsistent to calculate the termination value using the solvency funding ratio. We suggest that termination values be calculated on the proposed going concern valuation basis. Benefits available to a member on termination should be driven by the priorities specified in the funding policy for the plan.

- *What are your views on applying solvency requirements in the case of plan termination within 5 years of conversion from a federally-regulated DB plan?*

This requirement would be very unattractive for employers who are considering converting an existing DB plan as they would not have the desired cost certainty over the initial 5 year period. Since this rule is intended as a disincentive to wind up a newly converted DB plan in order to avoid funding an existing solvency deficit, this rule should only apply if the employer winds-up the plan within the 5 year period after converting.

Otherwise, if a plan needs to be fully funded on a going concern basis at the time of conversion (as contemplated by the proposal), it seems that the requirement for an employer to continue making solvency payments for 5 years would likely trigger the surplus utilization plan immediately, defeating the purpose of additional funding, which we expect is to provide increased security for existing benefits.

The proposal is for members to be involved in the process to convert a plan and members will be aware of the risks associated with the change in plan structure.

4.12 <u>Application to Multi-Employer Pension Plans</u>

- *To what extent could the proposed elements of the federal TBP framework apply in a multi-employer context?*

- *What elements of the plan design would need to be different from the single employer environment?*

We think that there is great potential for this regime to be applied to permit target benefit plans in the non-unionized multi-employer context. Permitting this type of structure for non-unionized multi-employer arrangements would allow employers to take advantage of the more desirable elements of both the Pooled Registered Pension Plan (PRPP) structure (simplicity of participation, no obligation for any individual employer to be involved in running the plan) and the governance structures of successful broader public sector plans (sponsor representation in design decisions, professional administration).

In this context it would be useful for the TBP model to be structured so as to permit multi-employer plans without any requirement of corporate relationship or particular industry participation. In this context, the bicameral governance structure suggested above would be particularly important.

*****

We appreciate this opportunity to comment on the Consultation Paper.

Yours very truly,

(Original signed by)

BLAKE, CASSELS & GRAYDON LLP
Pensions, Benefits & Executive Compensation Group

22556415.3