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Towers Watson Submission – Consultation Paper on Pension Innovation for Canadians: The Target Benefit Plan

Towers Watson welcomes the opportunity to provide comments on the Consultation Paper on Pension Innovation for Canadians: The Target Benefit Plan (Consultation Paper).

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. Towers Watson employs about 14,000 associates worldwide, with approximately 350 engaged in providing services to Canadian pension plans.

I. Summary and Broad Principles

Towers Watson supports the introduction of single employer target benefit plans. They will add another plan design option — one that combines some of the characteristics of defined benefit and defined contribution plans. In particular, like defined benefit plans, target benefit plans take advantage of longevity and investment risk pooling, but they would avoid some of the short term solvency funding issues and funding volatility that often affect defined benefit plans.

Before addressing the specific questions set out in the Consultation Paper, we would like to articulate the broad principles that underpin our submission. Furthermore, in preparation for this submission, Towers Watson conducted sessions with federally regulated employers in Toronto, Calgary and Montreal, as well as some interested, large, provincially regulated employers, to review and solicit their ideas on the proposals in the Consultation Paper. The feedback from those sessions informs both the broad principles and some of our responses to particular questions.

Our vision is that the new regime could enhance both the quantity and quality of pension coverage in the federal jurisdiction. We are convinced that this vision will be seriously hampered by an overly complex, prescriptive regime.

Governance

The parties to a target benefit plan, namely the employer, members and retirees (the "Sponsors"), will, by necessity, make all of the key decisions and own all of the plan policies (except as noted below). The administration of the plan will be conducted by the Board of Trustees (the "Board"). As members and retirees will bear all or most of the risk under a target benefit plan, the plan should be jointly governed on an ongoing basis, with Board representation from members and retirees. Also, every Board should be required to have at least one independent trustee who, ideally, has some pension expertise.

The role of the Board is to administer the plan in accordance with the plan policies. There is one policy, namely the investment policy, where the Sponsors should have the freedom to delegate that policy to the Board, if the Sponsors believe that the Board will need the flexibility to react quickly to market conditions.

Prescriptive versus flexible

The target benefit plan regime should reflect a balance of prescription and flexibility. The Sponsors are unlikely to all be pension experts. Therefore, the basic parameters of a target benefit plan, the process for creating a plan, and the ground rules for managing it properly should be set out in the legislation. However, the Sponsors should have the freedom to negotiate the details. For example, the regulations should require a deficit recovery plan and list certain issues that it must cover, but the Sponsors should determine the specific details such as which benefits would be reduced first. We list below certain features of a target benefit plan and indicate whether they should be prescribed by the government or negotiated by the Sponsors. As noted above, investment policy should be initially negotiated by the Sponsors but ongoing changes could be determined by the Board. Further details on many of these features are set out in our answers to some of the specific questions below.

Terms of conversion	Minimum standards prescribed, details negotiated
Governance framework	Minimum standards prescribed, details negotiated
Contributions and mechanism for adjustment	Negotiated
Funding policy	Negotiated
PfAD	Minimum standards prescribed, details negotiated
Investment policy	Negotiated (at least initially)
Deficit recovery policy	Minimum standards prescribed, details negotiated
Surplus utilization policy	Minimum standards prescribed, details negotiated
Definition of base and ancillary benefits	Minimum standards prescribed, details negotiated
Plan terms	Minimum standards prescribed, details negotiated
Disclosure	Prescribed
Plan termination	Prescribed

Accrued benefits

Accrued benefits under a current defined benefit plan should be allowed to be transferred if a plan is converted to a target benefit plan. Our clients have suggested that, without this, there will be very little interest in target benefit plans.

OSFI's role

Because of the complexity of target benefit plans, OSFI needs to play an important role through advice, education, having flexible policies and, in some cases, by refusing to accept a target benefit plan's policies, valuation report or amendments. To do this, the legislation should set out the principles that OSFI should operate under.

Safe harbour protection

In addition to the protection from statutory liability that is noted in the Consultation Paper, Board trustees, who have followed certain prescribed rules, should be protected from litigation with respect to their decisions about the plan. Employers and other parties who become the Sponsors should be similarly protected from legal challenges regarding the conversion to a target benefit plan and any ongoing amendments that they make to the plan structure.

Board duties to employer

Section 8 of the PBSA should apply to the Board. Section 8(3) would make the members of the Board trustees for the employer as well as for members and former members. It is important that this duty apply to a target benefit plan because the employer will be an important stakeholder. The Consultation Paper only refers to the Board acting in the best interest of the plan membership.

Member communications

Although the Sponsors will develop and agree on a target benefit plan's investment and funding policies and the Board will oversee it, some of our clients are concerned that plan beneficiaries will still hold their employer responsible if poor investment performance leads to increased contributions or reduced benefits. (Interestingly, this is generally not the case with employer-provided defined contribution plans.) Furthermore, there is a concern that, if a market correction causes poor investment performance for many target benefit plans, the government could be pressured by the Sponsors to change the rules to defer or limit benefit cuts or contribution increases, which may undermine intergenerational equity or the long-term sustainability of such plans.

This highlights the need for clear communications on an ongoing basis, between the Sponsors and the Board, from the Board to individual members and retirees, and from the government to all parties, regarding the risks and potential actions under a target benefit plan.

II. Questions

We have responded to the questions in the order in which they appear in the Consultation Paper.

4.1 Administration and Governance

- **Is this governance framework appropriate for federally regulated private sector and Crown corporation pension plans wishing to convert to a target benefit plan?**
  We believe that a joint governance framework is generally appropriate, given the shared risks inherent in such plans. We note that the Consultation Paper allows employer participation on the Board but does not require it, and we agree that it is appropriate to provide this flexibility in the legislation, though it is generally a good practice for employers to have Board representation.

  Sponsors should be allowed to negotiate the process for naming representatives to the Board. However, it would be useful if a default voting process similar to that used to elect the members of a pension council under section 5 of the PBSA regulation is prescribed. Applicable unions should be allowed to name the representatives for members in their bargaining units.

- **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 regulations should give Sponsors the ability to establish the Board that suits their circumstances. However, we think that the regulations should set minimum requirements regarding the composition of the Board, including a minimum of at least one representative for each distinct group of members (such as unionized actives, non-union actives, former members and retirees). The total number of trustees each party can choose should not be prescribed. Instead, the Sponsors should be able to determine the number which may vary, depending on the nature of the plan's membership.

  Each Board should have at least one voting trustee who is independent of the Sponsors. The Sponsors should be free to select an appropriate candidate who may bring particular expertise or experience (e.g., legal, actuarial, financial) and who can facilitate informed discussion and decision making. The Sponsors should also be able to define maximum terms of office and remuneration for such trustees.

- **Should the Board of Trustees have powers to amend plan documents?**
  The Sponsors should establish the target benefit plan's "fundamental deal" through a Sponsorship Agreement, and the Board should not have the power to amend it. The Sponsorship Agreement should include the following elements that represent the driving mechanisms for the plan:
  - Plan text;

- Funding policy, including the initial employer and member contributions and future variability, (if any);
- Benefits policy, including the treatment of targeted base and ancillary benefits;
- Deficit recovery plan;
- Surplus utilization plan; and
- Governance policy.

The Board should, however, be able to amend the plan to implement changes to benefits or contributions, provided such amendments are consistent with the Sponsorship Agreement. In particular, the Board should not be able to increase contributions for either the employer or members unless it is necessary to implement actions required under the plan's deficit recovery plan. The Board should also be able to amend the investment policy if it has been delegated that right by the Sponsors.

As well, an employer should be able to terminate its future participation in a target benefit plan by following a prescribed notice process.

- **What should be the plan member support level requirement for making substantial amendments to the plan text?**
  The process to change the Sponsorship Agreement should involve the Sponsors. If there are organizations that can represent the Sponsors (such as a union, or an employee or retiree association) then the representatives can negotiate proposed changes. In the absence of representative organizations, the employer can propose changes. In either case, the Board should then notify the members and retirees of the proposal, who can accept or reject the change based on the process set out below.

  Plan member support for changes to the Sponsorship Agreement should be similar to the procedure and threshold under the distressed pension plan workout method. Specifically, a proposed amendment will be approved unless one-third or more of the total number of members and retirees object to it within a specified period of time following delivery of the notice. An objection by a union would count as an objection by all the members the union represents. It will be important for the government to consider whether a higher threshold should apply upon conversion of a defined benefit plan to a target benefit plan.

- **Should there be different governance framework provisions applicable to federally regulated pension plans in unionized and non-unionized environments?**
  There is no reason to differentiate between unionized and non-unionized workplaces except, as noted above, a union could exercise certain functions on behalf of its membership.

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

We have recommended above a process where either organized Sponsors can negotiate a proposed amendment or, if none, the employer can propose an amendment, after which the proposed change is effective unless at least one-third of the membership objects to the proposal. This would apply to non-union members and former and retired members as well.

4.2 Funding Policy

Before responding to the specific questions, here is our view of the key principles of a successful target benefit plan funding regime, based in part on our recent client discussions:

- The funding regime should not be overly complex so that it can be understood by all of the stakeholders to a plan.
- Sponsors need to balance the objectives of long-term sustainability and affordability against a minimum level of benefit security and low likelihood of future benefit increases. They need the flexibility to determine where in that spectrum their policies should lie.
- The ability to defer indexing when the plan approaches a deficit position is a very important lever for the long term sustainability of a target benefit plan. Consequently, the funding regime should allow for a lower degree of confidence for the payment of future conditional ancillary benefits than for the payment of basic benefits.

No client expressed any support for a mandatory probabilistic test. Indeed, we believe that such an approach would be a major barrier to establishing target benefit plans. The success of the New Brunswick regime may well be explained by the financially stressed environment that was faced in that province, and is not necessarily prevalent in other Canadian jurisdictions. Accordingly, our submission focuses mainly on the margin regime, which utilizes a Provision for Adverse Deviation (PfAD).

We note that Alberta is known to be planning a margin-type regime. Our ideas (set out below) are independent of Alberta's possible direction, and of course it will be important to contrast our ideas with those that will ultimately be proposed by Alberta.

With the above key principles in mind, a potential funding framework could be driven by two elements:

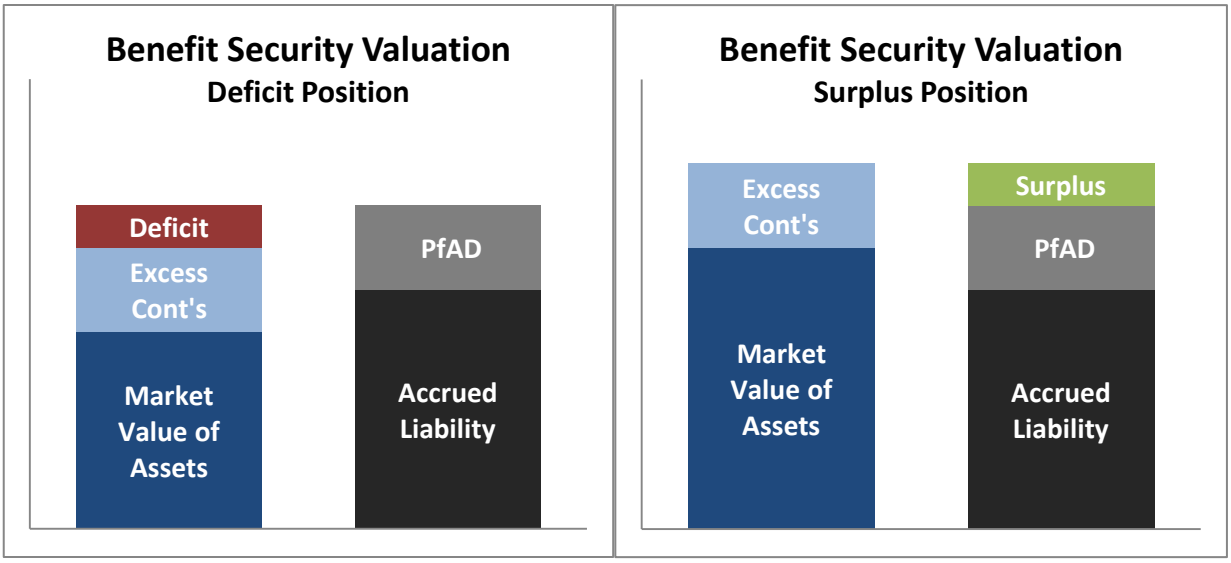
- a "Benefit Security Valuation" performed regularly, in conjunction with
- a supplementary "Ancillary Benefit Test" performed when the plan is established or if a major change to base benefits or contributions is contemplated.

These are defined as follows:

<u>Benefit Security Valuation</u>

- This valuation would determine if the plan's Deficit Recovery Plan or Surplus Utilization Plan should be triggered on a given date.

- At each valuation date, the plan's financial position would be A less B, where:
  - A is the plan's market value of assets plus present value of future excess contributions ("Excess Contributions") over an appropriate time horizon (we address the time horizon later in this submission); and
  - B is the plan's accrued liability plus a PfAD.



- The accrued liability in B would be determined for current members (on a *closed group* basis) as the actuarial present value of the accrued base benefits and ancillary benefits using the projected unit credit cost method and best estimate going concern assumptions but ignoring future conditional ancillary benefits that have not yet been granted (e.g., future conditional indexing).
- The Excess Contributions in A are equal to the present value of the sum of the future expected contributions over the present value of the future normal costs (i.e., the present value of base and ancillary benefits accruing in each future year, using the projected unit credit cost method and excluding any ancillary benefits not yet been granted) over a specific time horizon. This is determined on an *open group* basis (allowing for future expected new entrants), where the time horizon is the same horizon used to establish the PfAD.

<u>Ancillary Benefit Test</u>

- This supplementary test would assess the likelihood that targeted indexing and other ancillary benefits will be provided. It is an important piece of information to help manage stakeholder expectations.
- This test would be performed:
  - At plan inception or conversion, or

  - When the plan is permanently amended by the Sponsors (e.g., renegotiating the target benefit formula or changing contributions beyond the amount specified in the funding policy), unless the circumstances clearly render the test to be of little practical value.

- This test starts with the methodology of the Benefit Security Valuation, except that:
  - The PfAD for this test would likely be lower than that used for the Benefit Security Valuation if, under the plan terms and policies, ancillary benefits have a lower degree of confidence than base benefits; and
  - The accrued liability and the Excess Contributions would both include the ancillary benefits being targeted over the relevant period. It would be intended that the level of ancillary benefits that can be afforded, based on a specific contribution rate and base benefit, be communicated to the Sponsors, the Board and OSFI.

There is also a need for stress testing. We suggest that the requirement to perform stress testing is prescribed in a manner satisfactory to OSFI, based on OSFI guidance on material factors that should be considered, and OSFI should have the ability to require additional stress testing when needed.

- **Is the going concern valuation sufficient to measure and fund target benefits?**
  Yes. It reflects the fact that, under a target benefit plan, benefits and contributions can be adjusted. Therefore, a solvency approach is not necessary or appropriate.

- **Which approach should be adopted under the federal legislative and regulatory framework: the margin or the probability test?**
  We and our clients strongly prefer the margin or PfAD approach. The probability test approach is complex and can lead to:
  - Difficulty for all plan stakeholders to understand;
  - Communication challenges with plan members and retirees;
  - High administration costs; and
  - An illusion of precision.

  However, a plan could, as a good supplemental practice, use the probability test approach to stress test their funding model or to establish or justify the PfAD chosen.

- **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)?**
  Generally, the PfAD approach is appropriate but a plan should be allowed to use another approach in some circumstances. Alternative approaches could require the approval of the Superintendent.

The method to determine the PfAD would be set out under the funding policy adopted by the Sponsors. If the Sponsors want to later change the PfAD, they should be required to conduct a thorough examination of the contribution and benefit levels and the rest of their policies, as set out in their Sponsorship Agreement, to ensure they are internally consistent and follow the plan's guiding principles and the PBSA regulations.

- **What is the appropriate time horizon for the purposes of calculating the PfAD?**
  The time horizon should be consistent with the target benefit plan's objectives. In general, these objectives should be to provide members with relatively predictable and secure, but not guaranteed, retirement benefits through an arrangement that is expected to be sustainable over the long term. As a guiding principle, a horizon of 10 to 15 years or even longer would likely be appropriate in most situations, but additional testing would be required to determine the appropriate horizon. If the time horizon is prescribed under the legislation or regulations, we recommend that OSFI be able to accept alternative time horizons negotiated by the Sponsors.

- **Should going concern valuations be required on a closed group or open group basis?**
  Certain critical elements of the valuation should reflect an open group methodology, as set out above under our suggested Benefit Security Valuation and Ancillary Benefit Test. Otherwise, it will be difficult to accurately measure the extent to which future expected contributions (in excess of the normal cost) can be used to build up the PfAD or deliver future conditional benefit increases. This aspect of the target benefit framework is critical to reducing volatility in a plan's financial position and, as a result, reducing the frequency of reductions to base benefits. It is also an important way to allow for the effect of the gradual maturing of a plan.

- **How frequently should valuations be required?**
  Ideally, annual valuations would be required to ensure frequent monitoring of the plan's financial position. However, funding differences between these annual valuations should be permitted to be smoothed to avoid triggering benefit adjustments because of short term volatility. Related comments are provided under the deficit recovery plan section below, whereby the rules could permit a "buffer" before the plan administrator must take corrective actions.

- **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?**
  The appropriate level of PfAD will depend on many factors including the plan's characteristics and the economic environment at the relevant time. An overly conservative PfAD for accrued benefits will reduce current accruals (or increase contribution requirements). Conversely, an overly aggressive PfAD will reduce benefit security and increase benefit volatility. In either case, the PfAD has the potential to create inter-generational equity issues between cohorts of plan members.

Consequently, the federal legislation or regulations should not prescribe the PfAD rates. Instead, the Sponsors should negotiate the rates with the support of the plan actuary. Furthermore, while CIA guidance will be very useful, basing the size of PfADs on tables of numbers produced by the CIA will depend on there being stable economic circumstances and expectations. Once these change, such tables will become unreliable. It is far more effective for OSFI to provide guidance on how to determine the appropriate PfAD and for OSFI to have the authority to refuse reports that diverge from such guidance without appropriate rationale.

4.3 Contributions

- **Is the approach under the Consultation Paper to contributions for federally regulated plan appropriate?**
  The approach is appropriate.

- **Should some of the specifics concerning contributions be determined by plan members or more fully prescribed in legislation or regulations?**
  The specifics should not be fully prescribed. However, they should be determined not by plan members alone, but by negotiation between the Sponsors—employer, members and retirees—to the plan.

4.4 Benefit Structure

- **Is the approach of categorizing benefit in two classes appropriate?**
  Benefits categorized as "ancillary" could have, at the Sponsors' discretion, a lower PfAD threshold.

  We agree that benefits should be categorized between base benefits and ancillary benefits. However, the Consultation Paper's categorization of what comprises a base versus ancillary benefit should be clarified because it differs from the definition of a lifetime retirement benefit and ancillary benefits under the federal *Income Tax* Act (ITA). For example, under the Consultation Paper, past indexation is a base benefit, while death or disability benefits, early retirement or bridging benefits, spousal benefits or indexing could be either base or ancillary benefits, depending on such factors as the plan's financial situation or demographics. Such a malleable and plan-specific approach is very different from the standard definitions of "lifetime retirement benefits" and "ancillary benefits" under the ITA and the ITA may have to be amended to accommodate them.

- **Should base and ancillary benefits be determined by pension plans or more fully prescribed in federal legislation or regulations?**
  We recommend a balanced approach in which the federal legislation or regulations would:
  - prescribe the types of benefits that could be considered ancillary benefits;

- require that the plan document clearly identify which provisions, if any, are considered ancillary benefits; and
- require that the plan document specify at what point ancillary benefits would be reclassified as base benefits. For example, early retirement subsidies may be considered ancillary benefits until a member becomes eligible for early retirement (e.g., age 55) at which point they become base benefits.

4.5 Funding deficit recovery plan

- **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?**

  We recommend a balanced approach in which the federal legislation or regulations would:

  - require that all target benefit plans adopt a deficit recovery plan (DRP);
  - list the potential actions that a DRP could include, including a provision granting OSFI the discretion to approve other actions;
  - prescribe the minimum trigger for implementing a DRP, not as a specific dollar amount or percentage, but rather along the lines of when the plan moves into a deficit;
  - prescribe the maximum period of time following the DRP trigger for actions to be implemented;
  - prescribe that a DRP must:
    a) specify the trigger for implementing actions (would have to respect the prescribed minimum);
    b) list the actions that must be taken when the DRP is triggered;
    c) indicate the order of priority for implementing such measures; and
    d) specify the time period for implementing such actions (would have to respect the prescribed maximum)

  The deficit recovery measures and their prioritization should not be prescribed. They should be determined, not by plan members alone, but through negotiation between the Sponsors. This will ensure that, if there are funding issues, the priorities will already be determined. It will be easier to make difficult decisions of this nature before the parties actually face them. Otherwise, for example, retirees will always want contributions to increase since this will not affect them and this may lead to a stand-off at the Board.

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

  To reduce unnecessary administration costs and communication challenges associated with frequent benefit adjustments, the rules could permit a “buffer” before the plan administrator must take corrective actions. For example, instead of an immediate trigger, the DRP could only be

triggered if the plan is in a deficit position (i.e., Assets less than Actuarial Liability plus PfAD) under two successive annual valuations.

4.6 Funding surplus utilization plan

- **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?**
  We recommend a balanced approach in which the federal legislation or regulations would:
  - require that all target benefit plans adopt a surplus utilization plan (SUP)
  - prescribe that the reversal of past benefit reductions and past contribution increases would have first priority and the granting of conditional ancillary benefits would have second priority
  - list the potential actions that a SUP could include, including a provision that would grant OSFI the discretion to approve other actions
  - prescribe the minimum trigger for implementing a SUP, not as a specific dollar amount or percentage, but rather along the lines of when the plan moves into a surplus (after allowing for the PfAD)
  - prescribe that a SUP must:
    a) specify the trigger for implementing actions (would have to respect the prescribed minimum);
    b) list the actions that must be taken when the SUP is triggered (would have to respect the prescribed priority actions);
    c) indicate the order of priority for implementing such measures (would have to respect the prescribed priority actions); and
    d) specify the time period for implementing such actions.

  The surplus utilization measures and their prioritization should not be prescribed, other than what is set out above. They should be determined, not by plan members alone, but through negotiation between the Sponsors.

  The Sponsors should also agree, at the outset, on which party owns any surplus or deficit when a plan is wound up.

- **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?**
  Similar to our comments on the level of PfAD rates above, the appropriate margin or cap on the utilization of surplus should be established through negotiation between the Sponsors with the support of the plan actuary. However, OSFI should have the discretion to reject valuation reports or amendments.

4.7 Disclosure and Communications

- **What are your views on the proposed additional disclosure requirements listed in the Consultation Paper?**
  We accept most of the additional disclosure requirements with the exception of the requirement to give 180 days notice to members of any contributions changes and to members and retirees of any benefit changes. We feel this is an unnecessarily long notice requirement which will lengthen the period from recognizing a funding problem to implementing the solution. We suggest, instead, that a 90 day notice period is sufficient.

- **What are your views on the timing, frequency, and sequence for communicating these additional disclosure items?**
  We generally accept the timing, frequency and sequence except, as noted above, the 180 days notice of contribution or benefit changes.

- **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?**
  It is reasonable to require that the solvency funding ratio be reported on a target benefit plan's annual reports for informational purposes only.

4.8 Conversion of Pension Plans to Target Benefit Plans

- **What are your views on how benefits are treated upon conversion?**
  Accrued benefits should be able to be converted under a target benefit plan. Otherwise, there is little incentive for defined benefit plans to convert. In Section 4.4 above, we have commented on the different treatment of base vs. ancillary benefits.

- **Do you have any other views on how accrued benefits should be calculated at the time of conversion?**
  A target benefit plan success will depend on how the PfAD is selected and financed. When transferring accrued benefits where the benefit amount depends on future pay increases (because of best average earnings) or future guaranteed indexing, part or all of those future increases will be removed because the target benefit is no longer guaranteed, but is now conditional. The liabilities will, therefore, decrease (all things being equal) and the assets transferred may create additional funding that can be used for the PfAD. If, however, the additional assets are insufficient to fully fund the required PfAD, the PfAD will also have to be funded by future contributions, thus increasing the burden on future contributors. Therefore, in the interest of intergenerational fairness, some regulatory prescription will likely be needed.

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

Federally regulated DC plans should also be able to convert to a target benefit plans as some employers may want this option.

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?**
  No, it is acceptable for the regime to stipulate that target benefit plans should have the same portability and locking-in provisions already in place for other plans.

4.10 Individual Termination

- **What are your views on the methodology used to calculate the individual termination value?**
  We generally agree with the methodology proposed except that the funded ratio used to calculate the termination value should not exceed 100 percent. Terminating members should only benefit from surplus under a target benefit plan if they choose to continue participating in the plan through a deferred pension. Permitting immediate access to surplus funds upon individual termination, as presented in the Consultation Paper, would introduce the risk of anti-selection by terminating plan members and would likely add to administrative costs.

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?**
  The proposed formula for calculating termination value is acceptable. It would not be more appropriate to use the solvency funding ratio when calculating termination value. Target benefit plans are run on a going concern basis and, therefore, the solvency funding ratio is irrelevant.

- **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 is a reasonable “anti-avoidance” clause. The federal legislation or regulations would need to establish clear rules for dealing with pre-conversion and post-conversion benefits.

4.12 Application to multi-employer plans

- **To what extent could the proposed elements of the federal TBP framework apply in a multi-employer context?**
  We have not considered this.

- **What elements of the plan design would need to be different from the single employer environment?**
  We have not considered this.

III. Related comments

Other Types of Plans

The introduction of target benefit plans, with the far reaching changes required to the PBSA and its regulations, provides an opportunity to consider other popular plan designs. In line with our vision of enhancing pension coverage, the government should strongly consider amending the PBSA and the ITA and its regulation to allow for cash balance plans in Canada, in light of their popularity in the United States.

Accounting Rules

Many employers indicated that they would only consider converting to target benefit plans if pension accounting rules treat a target benefit plan like a defined contribution plan. Depending on certain constraints, this may well be feasible under IFRS rules. However, United States Generally Accepted Accounting Principles, which govern some of the employers who sponsor federally regulated defined benefit plans, appear to prohibit such treatment.

Tax Issues

The Consultation Paper does not address the need to amend the ITA regulations to accommodate target benefit plans in an equitable manner, particularly with respect to the pension adjustment (PA) regime under Part LXXXIII and the maximum transfer limits under Section 8517. The normalized pension assumptions which inform the pension tax rules will need to accommodate, in a fair and appropriate fashion, the reality that target benefits are, by their nature, subject to change and more difficult to project in a standardized way than a defined benefit entitlement. The “factor of 9” underlying the current PA rules is based on a final average defined benefit design with rich ancillary benefits and should not be used for a target benefit plan where both ancillary and base benefits can be reduced. Arguably, there should be an alternative approach to PAs, as is currently provided for Specified Multi-Employer Plans.

To the extent that target benefit plan members will have their RRSP room reduced by PAs based on assumed pension entitlements that are not realized in retirement because base benefits were reduced, the pension adjustment reversal provides a mechanism to restore RRSP room, although some taxpayers may view such restoration of savings opportunity as too little, too late. Similarly, the government would have to consider whether a PSPA is appropriate if benefits are temporarily or permanently increased.

The federal government should also consider the recent amendments to the maximum transfer rules that address situations where defined benefits have been permanently reduced, suggest the need to rethink the application of such maximum limits to target benefit plans.

The ITA rules for tax-deferred retirement savings are an important consideration in the development of a target benefit plan regulatory framework and we encourage the Department of Finance to consult stakeholders in the near future on this important technical aspect of the regime.

We greatly appreciate the opportunity to comment on the Consultation Paper and participate in the process of improving Canada's retirement income system. We would welcome the opportunity to address any questions you may have regarding our submission.

Sincerely,

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