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Pension legislation should balance DB sustainability with pension promise: CIA

Jann Lee | January 15, 2019

Any modifications to federal pension legislation should encourage plan sponsors to continue offering defined benefit pension plans, while helping them fulfil their pension promises to plan members, according to the Canadian Institute of Actuaries.

“Fulfilling pension promises is especially important for those plan members who can least afford the risk of benefit reductions, such as those with a modest monthly pension and those who are at an age where pension losses cannot easily be made up with new savings,” wrote the CIA in its submission to the federal government’s 2019 pre-budget consultations.

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“It’s obviously difficult [to maintain that balance] and that’s why the different governments, in my view, have been coming up with different solutions because there is no one right answer,” says Jason Vary, president of Actuarial Solutions Inc.

Target-benefit plans, or shared-risk plans, are a good compromise, which is why the government is working on a legislative framework for those type of plans, he says.

In its submission, the CIA suggested several changes to pension legislation that aim to make the current retirement income system more effective in securing pension promises. It suggested the government consider solvency reserve accounts in order to encourage plan sponsors to provide more funding without the risk of losing those assets.

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It also asked the government to consider requiring plan sponsors to obtain letters of credit; increasing restrictions on taking investment risk for administrators of underfunded plans; providing regulators with more authority to intervene in the administration of an underfunded plan; and prioritizing certain groups of beneficiaries, such as retirees, when a plan is wound up.

As well, the CIA suggested allowing plan stakeholders to agree in advance that certain benefits, such as indexing and early retirement subsidies, will be paid in the event of a windup only if there are sufficient assets available.

Current pension legislation states that plan members receiving their benefits are dependent on the continued solvency of their plan sponsor, noted the CIA. However, many plan members and beneficiaries don't understand this implication and believe plans will fulfill their promise, even if an organization becomes insolvent.

Read: Canadian pensions end 2018 with solvency decline
"People had the perception in the past that DB plans were 100 per cent guaranteed," says Vary. "But with experiences like Nortel and Sears and many, many others, some people have slowly realized that's not the case."

Indeed, plan members should receive disclosure that full pension payments are reliant on the ongoing solvency of the plan sponsor and whether the plan is fully funded, wrote the CIA.

"Company employees holding a pension promise are very similar to bond holders," noted the submission. "However, where bond holders can negotiate the terms of lending to enforce repayment and to determine the appropriate level of compensation for the risk of default, pension plan members do not generally have the knowledge or the tools to do so. As a result, pension plan members rely on the government and pension regulators to play this role."

Read: Sears pensioners reach settlement, without priority creditor status
Legislation that prompts companies to consider current and former employees with pension entitlements as stakeholders could ensure plan members receive their pension promise, wrote the CIA. It also suggested limiting the plan sponsor of a poorly funded pension plan in withdrawing capital beyond regular dividends.

The CIA also cautioned the government about introducing guarantee funds in other provinces. Currently, Ontario's pension benefits guarantee fund provides protection, with certain conditions, to plan members and beneficiaries of private, single-employer DB plans in the event of plan sponsor solvency.

Read: Nortel pensioners face decision on payment options
But a guarantee fund's sustainability is debatable, says Vary. "It's hard to predict future bankruptcies. It's hard to predict how underfunded the pension plans will be when those bankruptcies happen. And it's hard to have enough money in the pot available for when that will happen. Over the years, the PBGF has been around, the Ontario government has been forced to provide it with loans and grants . . . expanding [it] across Canada. I don't think it's recommended."