December 21, 2018

Mark Schaan
Director General
Marketplace Framework Policy Branch
Innovation, Science and Economic Development Canada
235 Queen Street, 10th Floor
Ottawa, ON K1A 0H5

Re: Enhancing Retirement Security for Canadians

Dear Mr. Schaan,

The Canadian Institute of Actuaries (CIA) welcomes this opportunity to offer input to the consultations on retirement security, issued by Innovation, Science and Economic Development Canada (ISED), Finance Canada, the Minister of Seniors, and Employment and Social Development Canada on November 22. Our comments build on the roundtable discussion that took place in Toronto on December 6, which Joe Nunes, FCIA, was pleased to join on behalf of the CIA.

A significant number of our members practice in the retirement area, so as a profession, we take a particular interest in this topic. The following comments address four areas:

1. Our view on the **public policy** aspects associated with retirement income security;
2. Suggestions on potential changes to **pension legislation**;
3. **Insolvency law**; and
4. **Corporate governance**.

1. Public Policy

At the outset of our comments, we believe it is important to be clear on the goals of the private sector pension plan and the role of actuaries within Canada's retirement income system (RIS). Existing pension regulation is designed to encourage full funding of defined benefit (DB) pension promises but allows for underfunding at times. Implicit in the design of the legislation is the understanding that the long-term delivery of pension benefits in an underfunded DB plan is dependent on the continued solvency of the plan sponsor.

1740-360 Albert, Ottawa, ON K1R 7X7 ☎ 613-236-8196 🖷 613-233-4552
head.office@cia-ica.ca / siege.social@cia-ica.ca **cia-ica.ca**

Although it may not be well understood by plan members and beneficiaries, under the current legislative framework in Canada there is no guarantee that every pension promise will be paid without the continued solvency of the sponsor (Ontario's Pension Benefits Guarantee Fund provides some guarantees). In this submission, we assume that the government wishes to continue with this type of framework as a policy matter. Should the government be seeking to ensure that all pension promises are guaranteed to be paid, even in the absence of a solvent plan sponsor, then our response would be different.

Actuaries do not make the public policy decisions on how to balance the interests of stakeholders, which include among others pension plan beneficiaries, employees, shareholders, and lenders, in a private sector DB plan. Actuaries report on the funded status of the plan and the minimum and maximum contribution requirements based on the applicable legislation. With that said, as mentioned below, one of the guiding principles of the CIA is to serve the public interest. We believe that the public interest is well-served if the legislative framework supports pension promises being fulfilled and also encourages plan sponsors to continue to offer DB plans. 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.

2. Pension Legislation

Current pension legislation in Canada does not guarantee the delivery of promised pensions. If that were the goal of government, pension plans would be regulated more similarly to insurance companies. One rationale for allowing this approach to pension funding is rooted in an era where the value of benefits paid on the wind-up of a pension plan was most often considerably less than the value of benefits expected to be paid should the plan remain in operation.

Changes in minimum benefit requirements on wind-up, declining interest rates, and freezing of benefits promised under DB plans have all served to bring the wind-up liability of a pension plan closer to the going-concern liability—and in many cases over the past decade the wind-up liability has been greater.

If the government is concerned that the current RIS does not perform effectively in securing pension promises, there are several changes to pension legislation that could be considered and implemented:

- Introduction of solvency reserve accounts (or other terminology that may not refer to solvency, such as a banker's clause being used in Québec) have long been promoted by the CIA as one tool to encourage plan sponsors to provide greater levels of funding without the risk of losing control of those assets if they ultimately become surplus.

- Letters of credit could play a more prominent role in securing unfunded benefits, not only on a solvency basis but also on a going-concern basis, and a sponsor who can obtain a letter of credit from its banker can be seen as a safe provider for the plan members' pension promises.

- Greater restrictions on taking investment risk could be placed on plan administrators of underfunded plans.

- Legislation could provide regulators with broader powers to intervene in the administration of an underfunded pension plan as it pertains to investment, funding, and benefit policy to avoid perpetual underfunding of plans.

- Where a pension plan is wound up and the plan sponsor is insolvent, legislation could be modified to prioritize certain groups of beneficiaries, such as retirees. This is a public policy decision rather than an actuarial decision. Note that moving away from applying a single solvency funded ratio to all plan beneficiaries also moves away from the concept of providing plan members with the market value of their benefit.

- It may be a reasonable public policy to allow plan stakeholders to agree in advance that certain benefits such as indexing and early retirement subsidies will be paid only on wind-up to the extent that sufficient assets are available. This approach might better solve or partially solve the problem of insufficient assets as opposed to prioritizing different classes of plan beneficiaries.

- Where a plan sponsor becomes insolvent, there may be an opportunity for the government or other impartial entity to take over the administration of the plan and undertake a "work-out" process to minimize benefit reductions rather than forcing the immediate liquidation of all pension investments for either lump sum settlements or annuity purchases, thereby crystallizing benefit reductions. We note that there have been several examples of such an approach with positive outcomes, especially in Québec. Given the possibility that this approach could result in subsequent investment losses (or other experience losses such as unexpected variations in longevity or expenses), any such arrangement should be clear on who bears the risks; to the extent it is the plan members, they should be given the option to opt out of such an arrangement in favour of taking a reduced pension in the form of an annuity.

- We caution the government on the difficulty of expanding the concept of a guarantee fund beyond Ontario. It is challenging to price the risk of employer default, and the size of a future deficit to be guaranteed is a moving target. In addition, contributions to a guarantee fund are diverted from contributions that could be made to the pension fund to facilitate higher funding levels, and these guarantee fund premiums are another disincentive to establishing and maintaining a DB plan.

3. Insolvency Law

Canada's insolvency laws are not the domain of actuarial practice. While we recognize that placing pension deficits in a higher priority during an insolvency or bankruptcy might improve the security of a pension promise, any change in the legislated priorities might have unintended consequences such as discouraging the continued operation of a DB plan or eliminating a plan sponsor's access to borrowed capital.

At the same time, recent legislative efforts in some provinces to ease funding requirements are in direct opposition to the goal of securing pension benefits without further recourse to assets of the plan sponsor and may provide a rationale for improving the priority of pension plan beneficiaries.

4. Corporate Governance

Canada's laws on corporate governance are not the domain of actuarial practice. As a general comment, we support requiring plan sponsors to disclose that the full payment of pensions is subject to a fully funded status of the pension plan or the ongoing solvency of the plan sponsor.

Company employees holding a pension promise are very similar to bond holders. 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. Requiring that companies consider workers and former workers with pension entitlements as stakeholders similar to bond holders could be effective in providing workers with greater protection of pension promises. Also, limiting the ability of a sponsor of a poorly funded pension plan to withdraw capital beyond regular dividends might better balance the interest of all stakeholders including pension plan beneficiaries.

In closing, we would like to note that, increasingly, retirement income is being provided to workers through defined contribution pension plans, which pass all of the investment and longevity risks to plan members. In this regard, an imperfect system for DB pension plans may still achieve better outcomes than a defined contribution alternative. As a final note, Target Benefit Plans may offer the best compromise between risk sharing and guaranteed benefits, and we recommend that work continues on the legislative framework for these plans in Canada.

The CIA appreciates the opportunity to engage on these important issues, and we would welcome further discussion with you and your stakeholder group throughout this process.

If you have any questions, please contact Chris Fievoli, CIA Staff Actuary, Communications and Public Affairs, at 613-656-1927.

Sincerely,

[original signature on file]

John Dark, FCIA
President, Canadian Institute of Actuaries

cc. Joe Nunes

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Its members are dedicated to providing actuarial services and advice of the highest quality. The Institute holds the duty of the profession to the public above the needs of the profession and its members.