Rethinking plan design & funding: pension innovation in Canada

Author(s): Jonathan Marin, Jana Steele

Pension plan design possibilities are evolving in various jurisdictions across the country. This is happening at a time when many plan sponsors have been considering pension risk management and recognizing plan design as a key risk management tool.

Over the past several years, single-employer defined benefit (DB) plans have become increasingly unpopular among private sector employers as their sponsors respond to funding, investment, longevity and other risks associated with the traditional DB model. In view of these risks, legislatures across Canada have made some changes to facilitate pension design changes and innovation. This article will summarize some of these recent legislative changes.

CHANGES AROUND FUNDING

Alberta and British Columbia introduced Solvency Reserve Account (SRA) rules. SRAs are designed to help address plan sponsor concerns around “trapped capital” acting as a disincentive to maintaining DB plans. SRAs hold solvency deficiency payments made under the DB component of a pension plan, and are designed to remove the disincentive to fully fund plans by making it easier for plan sponsors to withdraw excess funds (surplus) in the SRA. In particular, certain excess assets may be withdrawn, subject to approval by the superintendent and compliance with the regulatory regime. The enhanced flexibility fostered by SRAs should prove beneficial to both plan sponsors and members.

In Québec significant changes to the funding rules for DB pension plans came into effect January 1, 2016 with the passage of Bill 57, An Act to amend the Supplemental Pension Plans Act. The most significant feature of Québec’s overhaul is the elimination of the solvency funding requirement, which will be replaced by a stabilization provision. A stabilization provision is a reserve account funded by actuarial gains, additional current service contributions and special amortization payments. The target level will be prescribed by regulation, based upon the level of investment risk posed by the asset mix in the plan’s investment policy. While stabilization contributions may increase plan current service costs, such costs could be offset by the removal of solvency contributions. These changes are expected to help reduce funding volatility for plan sponsors.

Certain other Canadian jurisdictions are in the process of evaluating the solvency funding framework. In Ontario, the intent to consider this framework was first announced in the 2015 Ontario Economic
As you can imagine, the current tax regime is not one that easily accommodates new plan designs.
Essentially, if a pension plan is not a SMEP or money purchase, it will be treated as defined benefit for tax purposes. Depending on the plan design, this tax treatment may be far from ideal.

The federal government’s April 2015 budget committed to considering amendments to the Tax Rules “to appropriately accommodate Target Benefit Plans within the system of rules and limits for Registered Pension Plans.” Thus far, no such amendments have been introduced.

While tax changes to appropriately accommodate single employer target benefit plans are needed and welcome, more significant changes are arguably needed to overhaul the tax regime regarding registered pension plans to better facilitate and accommodate design innovation.
CONTACT US

For more information, please visit osler.com or contact the following individual(s):

TORONTO
Jonathan Marin, Partner,
Pension & Benefits
416.862.5935
jomarin@osler.com

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