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Common myths associated with target benefit plans and defined benefit pension plans

This is our four-part series originally posted on our blog, **pensionsbenefitslaw.com**, where we address common myths associated with target benefit plans and defined benefit pension plans.

Before we get started on the myths, it is important to understand what target benefit plans (TBPs) are and how they differ from, but also share the attributes of defined benefit (DB) and defined contribution (DC) plans.

DB plans provide a pension payable for life at retirement and the employer is responsible for funding the benefit, subject to any fixed required employee contributions. Where there are funding deficits in the plan, the employer is required to make additional payments to address the deficiency.

DC plans are similar to group RRSPs and provide a capital accumulation savings-type vehicle. Employer contributions (along with any employee contributions) are fixed, but the ultimate benefit for the employee is uncertain, being subject to contributions and investment performance. Because longevity risk is not pooled and each individual has to rely on his or her own savings account, there is a risk of a member outliving his or her retirement savings.

Like DC plans, contributions to a TBP are fixed (or variable within a narrow range). Like DB plans, target benefit plans provide a DB-type pension at retirement and pool both longevity and investment risks. However, under a TBP, benefits may be adjusted, up or down, in response to the plan's funded position from time to time. The goal of TBPs is to deliver the targeted benefit, but at the same time ensure sustainability and maintain intergenerational fairness. If there are insufficient funds in the plan to deliver the targeted benefit, the benefits may be decreased. Allowing benefit adjustment is another lever in addition to payment of additional contributions where there are funding concerns.

Myth #1: Target Benefits are a New "Untested" Concept

By Jana Steele and Ian McSweeney on November 6th, 2014

TBPs have recently been implemented in New Brunswick and Alberta, and the federal government has indicated that it also intends to introduce legislation to permit these plans for federally-regulated employers. In doing so, these governments are providing a new pension design option for sponsors of single employer pension plans. It is important to remember, however, that target benefits have existed in other forms for many years.

Target benefits – while not generally permissible for single employer pension plans – have existed for many years in the multi-employer environment (i.e., plans in which two or more unrelated employers participate). Multi-employer pension plans providing target benefits, which are often sponsored by unions, have been permissible and existed in most Canadian jurisdictions for some time. These multi-employer plans are typically administered by a board of trustees, at least half of whom are representatives of the members.

What is new for target benefits is prescribed risk management to help with benefit security. In New Brunswick, there are prescribed risk management goals that have to be attained and risk management procedures that must be followed. In Alberta, there are requirements for a provision for adverse deviation as well as stress testing. Some form of risk management for target benefit plans is desirable.

In addition to multi-employer pension plans, in Ontario, there are several large public jointly sponsored pension plans (JSPPs) where costs are shared 50/50 between plan members and plan sponsors – thereby, a category of target benefit plans that existed prior to the recent changes to introduce target benefit plans in certain jurisdictions. Some of these JSPPs are hailed as being some of the best run pension plans in Canada.

Thus, while the introduction of target benefit plans as an option for single employers is a welcome change, these types of plans have been operating in the multi-employer context for some time.

Myth #2: Limiting Employers' Pension Design Options Means Continued Defined Benefit Plans

By Jana Steele and Ian McSweeney on November 11th, 2014

In this post, we respond to the suggestion by some that if you do not offer employers the option of implementing a TBP, they will simply choose to continue their existing traditional DB plans.

One of the key flaws with this suggestion is that it appears to overlook the fact that the private pension system is a *voluntary* one. Subject to notice requirements and/or applicable collective agreements, employers can generally prospectively change or eliminate benefits provided to employees, including pensions as long as accrued benefits are preserved. Employers have been exiting traditional DB pension plans in droves over the last few decades. This shift has been as a result of numerous factors, including employers' desire for cost predictability, concerns over funding volatility and long term affordability given escalating longevity risks. For single employers, most pension standards legislation provides only one other pension design option for an employer wishing to change from DB – DC pension plans. Often times negotiations will result in the preservation of DB plans for those employees who have them, with new employees being placed in a DC plan. Sometimes employers will exit the registered pension plan regime altogether in favour of Group RRSPs for new hires.

Shouldn't there be an alternative to DC plans where an employer decides to exit the traditional DB model in favour of a less volatile pension arrangement? In the right circumstances, isn't a targeted DB pension for the entire workforce better than a "guaranteed" DB pension for some and a DC for future service and new hires?

Permitting TBPs as a design option means that there is another viable option for employers with non-union workforces to consider and for employers and unions to negotiate in respect of unionized employees. In the context of unionized workforces, employers would still have to negotiate the establishment and terms of any TBP with employee bargaining agents.

Pension legislation that permits plan design options other than the traditional choices should be encouraged as a progressive alternative that could, in many circumstances, be preferable to exiting DB for future service and/or future hires, creating an ongoing DB legacy issue for the sponsor and intergenerational benefit differences among members.

Myth #3: Unions and Employees are Opposed to Target Benefits

By Jana Steele and Ian McSweeney on November 19th, 2014

In this post, we consider another myth – unions and employees are opposed to target benefits.

First, as pointed out in an earlier post, unions have embraced multi-employer pensions plans, which often provide target benefits, for many years.

Second, although there are some unions or branches of unions that have recently voiced opposition to legislative changes to permit single employer TBPs, it appears that much of this opposition is directed at legislation which permits the conversion of past benefits to target benefits, as is permissible in New Brunswick. On a plan conversion from defined benefit to shared risk in New Brunswick, all accrued benefits are converted to base benefits which are afforded a higher level of protection than ancillary benefits, but which are, nevertheless, subject to the shared risk rules.

Notwithstanding the opposition of some unions or union branches, there can be some advantages to members if past benefits are converted in conjunction with moving to a TBP. Of course, from the employer's perspective conversion is preferable because it includes legacy DB benefits within the scope of TBP risk management and there would only be a single plan design to administer going forward. From the affected member perspective, all benefits are subject to prescribed risk management rules to help achieve improved benefit security and address potential inter-generational inequities. In addition, to the extent TBP conversion is linked to joint sponsorship/governance, members participate in plan sponsor and administration decisions through their selected representatives.

It is notable that the majority of the conversions from defined benefit to shared risk in New Brunswick were done with the consent and support of the applicable unions.

Myth #4: Defined Benefit Plans are "Guaranteed"

By Jana Steele and Ian McSweeney on November 26th, 2014

In this final post of our series on the myths surrounding TBP and DB plans, we address probably one of the biggest myths surrounding DB plans – that their benefits are guaranteed.

What is truly guaranteed in life other than death and taxes?

The answer is "nothing". The traditional DB pension plan – where the employer "guarantees" the pension benefits – may not be sustainable in some public and private sector cases and could lead to crisis situations that TBPs could help avoid. Generous DB plans may, in adverse circumstances, put both the members and the employer at risk. There have been many high profile instances over the last decade or so where the pension solvency issues threatened the continued operation of an organization. And, there have been other high profile instances where a company has gone under and pensions have been permanently reduced. Ultimately, the so called "guarantee" comes down to the employer's willingness and ability to pay.

Maybe "guaranteed" by the employer is not the way all DB pension plans should operate. Maybe this so called guarantee has contributed to the general decline of occupational pension plans and the current concerns over declining private sector pension coverage. Perhaps design change that facilitates a flexible DB pension type vehicle is a more sustainable alternative for some employers and workforces. TBPs allow for adjustment of benefits as an additional lever to increasing contributions. That is, where a DB plan has funding issues, the only lever available in respect of past service is additional contributions. TBPs may permit a minimal contribution increase where permissible, but may also permit adjustments to ancillary and base benefits to address the funding concerns.

TBPs can provide a pension that has many of the DB attributes, without the "guarantee". For some employers and workforces this may be a desirable alternative, and legislation across Canada should permit target benefits as a design option for all employers.

About Osler's Pensions & Benefits Group

A market leader in pension law in Canada, Osler's Pensions & Benefits Group provides wide-ranging expertise on everything from pension investments, de-risking, plan restructuring, and shared risk and target benefit plans. Our cross-disciplinary team includes tax professionals and litigators as well as advocates for pension reform who are known for their hands-on experience, thoughtful analysis and solutions-driven approach. Together, they advise national and multinational employers, pension plan sponsors and administrators, public sector pension funds and financial institutions with respect to the Canadian and U.S. legal and regulatory approaches to pension plans and employee benefit plans.

For more insight into the evolving pension landscape in Canada, visit our Pensions & Benefits blog **pensionsbenefitslaw.com**.

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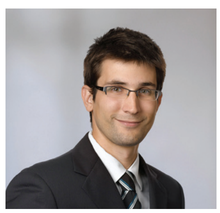

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