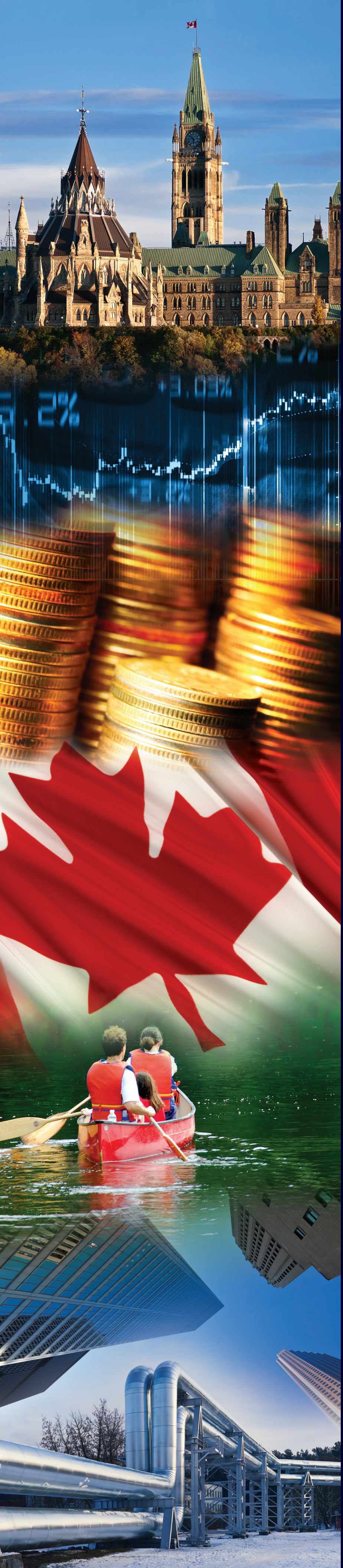

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Target-Benefit Plans in Canada – An Innovation Worth Expanding

Target-benefit plans can deliver the cost predictability of defined-contribution plans combined with a defined-benefit-type pension to retirees, and enable pooling of longevity and investment risks.

Jana R. Steele, Angela Mazerolle
and Mel Bartlett

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Finn Poschmann

Finn Poschmann
Vice-President, Research

About The Authors

Jana R. Steele
is a Partner in the Pensions and Benefits Department of Osler, Hoskin & Harcourt LLP.

Angela Mazerolle
is the Superintendent of Pensions, Financial & Consumer Services Commission, New Brunswick.

Mel Bartlett
is Managing Partner for Morneau Shepell's Atlantic Canada practice.

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The Study In Brief

The limitations inherent in the traditional pension models – defined contribution (DC) and defined benefit (DB) – are facing increased scrutiny and new models are developing in response to these pressures.

Due to extremely low interest rates and the volatility of equity markets, over the past several years many DB pension plans have suffered significant solvency deficits. As a result, plan sponsors have sought relief from higher contributions required under pension laws. Temporary relief measures granted in certain jurisdictions have not addressed the underlying issues but have provided merely short-term solutions.

At the other end of the spectrum, DC plans incorporate both predictable contributions and an alignment of risk and reward for plan members, but they leave complicated investment decision-making to plan members who frequently have no investment expertise. Furthermore, DC plans fail to capture substantial value available from pooling of costs, investment risk and longevity risk among plan members.

We need to move beyond the DB versus DC debate towards a middle-ground option that incorporates some of the positive attributes of both designs. Target-benefit plans (TBPs) can deliver the cost predictability of DC plans combined with a defined-benefit-type pension to retirees, with predictable contribution levels, and enable pooling of longevity and investment risks.

This *Commentary* reviews the recent New Brunswick shared risk pension legislation and draws lessons that can be applied to the design of similar TBP legislation elsewhere. In most Canadian jurisdictions, pension laws do not currently accommodate single-employer TBPs – although several provinces have taken initial steps. Existing legislation generally prohibits reduction of accrued benefits outside of the multi-employer unionized environment, and a key element of TBPs is their ability to let benefits vary as a function of the funding status of the plan.

Tax rules must be changed to accommodate single-employer TBPs. As well, clear and logical accounting guidance for TBPs must be established to facilitate the emergence of such plans.

Also, if a jurisdiction wishes to permit conversion of accrued benefits to target benefits, legislative change is required. In New Brunswick, accrued benefits may be converted, which can promote intergenerational equity. Pension standards laws across the country will have to be changed in order to facilitate the emergence of new design options such as single-employer TBPs.

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The pension landscape in Canada and around the world is changing. The limitations inherent in the traditional pension models – defined contribution (DC) and defined benefit (DB) – are facing increased scrutiny and new models are developing in response to these pressures.

This *Commentary* focuses on a new design option – target-benefit plans (TBPs), also sometimes referred to as defined ambition plans. Target-benefit plans combine elements of both DB and DC plans in order to address the limitations of each.

Pension rules in Canada are established by the provinces (and by the federal government for the territories and federally regulated industries). In most Canadian jurisdictions, pension laws do not currently accommodate single-employer target-benefit plans. Existing legislation generally does not allow reduction of accrued benefits outside of the multi-employer unionized environment, and a key element of TBPs is the ability to reduce benefits if there are insufficient assets in the plan to fund the targeted benefits. However, most provinces do permit target benefits for multi-employer plans, which are plans with two or more participating unrelated employers contributing to the plan for their employees.

In this *Commentary*, we first discuss the issues confronting defined-benefit and defined-contribution plans. Second, we examine the status of target-benefit plans across the country and how they have the potential to address some of the issues faced by traditional defined-benefit and defined-contribution plans. Finally, we examine the New Brunswick shared risk model, as an example of a specific type of target-benefit plan. The New Brunswick model serves as a useful example, as this province has paved the way for single-employer target-benefit plans in Canada.

Background: The ABCs of Retirement Savings Programs

The basic mechanics of all retirement savings programs – both pension plans and Registered Retirement Savings Plans (RRSPs) – are similar. Funds are set aside in a dedicated account during members' working lifetimes and then paid out to them after retirement. Throughout both the accumulation phase (while working) and retirement period (while benefits are paid), the funds are used to earn investment income. The investment income increases the benefits paid to members and/or reduces the contributions required to pay for the benefits provided.

The only sources of benefits paid out to members are contributions made into the account and its investment income. This is true of all retirement programs – the various models differ only in the mechanics of how contributions and benefits are balanced. A key issue is that we cannot predict the

The authors wish to thank several anonymous reviewers for their comments on an earlier draft as well as Alexandre Laurin, Associate Director of Research at the C.D. Howe Institute. Responsibility for any remaining errors rests with the authors.

future with certainty, whether it relates to fund investment returns or individuals' longevity and retirement-income needs. Accordingly, the ideal retirement model needs to be flexible and adapt over time.

Challenges Facing DB and DC Plans

Defined-Contribution and Other Capital Accumulation Plans

Defined-contribution pension plans are plans where the contribution amounts are specified, but the benefit is not. The pension at retirement will vary based on the amount of money in the member's defined-contribution account. These plans operate similarly to other capital accumulation plans, such as group registered retirement savings plans (Group RRSPs) and deferred profit sharing plans (DPSPs).

The accumulation phase for all DC plans, including Group RRSPs, incorporates both predictable contributions and an alignment of risk and reward for plan members. However, DC plans leave complicated investment decision-making to plan members, who frequently have no investment expertise. Furthermore, while risk and reward may be aligned (100 percent of both is with plan members), a DC plan is not a completely economically efficient model because it fails to capture substantial value available from pooling of risks and costs among plan members as described below.

The first issue with DC plans and other capital accumulation plans is that the drawdown phase can be fraught with peril for members. Members may be uncertain as to how much they can withdraw each year after retirement and concerned about outliving their retirement savings. Basing withdrawals on average life expectancy ignores the fact that roughly one in four individuals retiring at age 60 will die five or more years earlier than the average and that a roughly equal number will survive five or more years longer than the average. In the former case, the "risk" is that the member will have drawn less income than he or she could have while living, although this means of course there will be money remaining for the member's beneficiaries or estate.

The risk in the latter case is more significant as the member will have outlived his or her retirement savings by five or more years. This survivorship risk could be pooled if the member purchased an annuity upon retirement from an insurance company. However, annuities are generally seen as being comparatively expensive, particularly in the current low-interest environment, which has limited the popularity of annuities among retirees.[1]

Still, annuity purchases need not be seen as an all-or-nothing option. A retiree can potentially address a significant portion of longevity risk through the purchase of annuities with only a portion of one's retirement savings.

Another issue for members in DC plans is that they may be significantly exposed to market corrections either just before or just after retirement – depending on their investment strategy and tolerance for risks. If market corrections shrink a member's defined-contribution account balance, there is no ability under the current tax regime to manage the losses in the plan (other than by choosing to work longer and delay retirement or accept a reduced standard of living in retirement). Of course, the member may have time to save extra money outside his or her pension plan, but it may not be tax sheltered, depending on the individual's available tax-sheltered savings room.

1 For more information, see. Nielson (2012).

If the market drops within a few years after retirement, thereby impacting the member's defined-contribution account balance, the member has no ability to re-coup the losses.[2] The traditional advice to deal with this investment risk near retirement is to adopt a more conservative investment strategy. While this approach can alleviate retirement investment volatility, it comes at the price of reduced expected returns at the time when an individual's pool of invested assets is at its peak.

Another concern with DC plans is that they may be subject to higher investment fees.[3] Because members generally direct the investments in their accounts and pay the associated fees, these fees may be higher than those levied by a large pooled plan where the employer or plan pays the fees. Over time, the accumulated impact of even modest annual fee differences can be substantial. For example, when a fixed percentage of earnings is invested over a 30-year working career, even a 0.5 percentage point reduction in annual fees/net increase in investment return would produce 9 percent to 10 percent more assets at retirement. Clearly, this represents a significant difference in economic outcomes for plan members.

Finally, DC plans are disadvantaged under the current tax regime because contributions are limited.[4] By contrast, for DB plans it is not the contribution amount that is limited under the tax rules, but rather the benefit that is to be provided. Accordingly, for a generous DB pension plan, the contributions to fund the plan may be significantly greater than would be permitted for a DC pension plan.[5] Unlike a DC plan, additional contributions can (and must) be made to a DB plan to recover any value lost due to a market correction.

2 This issue is further discussed in Pierlot and Siddiqi (2011). The authors discuss a lifetime retirement savings limit as a possible solution to the inequities between defined-benefit pension plans and other retirement savings vehicles such as defined-contribution plans or RRSPs.

3 Cost depends largely on the size of the plan, the nature of the investments and whether they are actively managed. For smaller DC plans, the fees may be closer to retail fees. For larger DC plans, the fees can be closer to those of a DB plan. We note that while retail fees are high, there are many exchange-traded fund options and indexed funds with low fees. Dr. Vijay Jog (2009), notes that a private-sector DB plan's costs on average are anywhere between 30 to 45 basis points (bps) and between 25 and 35 bps for a public sector plan. Jog also notes that the overall cost for all capital-accumulation-type plans is approximately 70 bps, with the cost of registered DC plans being approximately 60 bps and RRSP plans being approximately 92 bps. He also notes that the larger the plan and higher the asset value per member, the lower the costs. Plans with 25 members and average asset value for each member of $25,000 would have costs of about 1.25 percent. For a plan with 7,500 members and average asset values of $50,000, the costs would be approximately 0.44 percent.

4 Annual contributions to a money purchase (or DC) pension plan may be the greater of the money purchase limit ($24,930 for 2014) or 18 percent of the member's annual compensation (up to the money purchase limit). "Money purchase limit" is defined in subsection 147.1(1) of the *Income Tax Act* (ITA) and subsection 147.1(8) describes where a plan becomes a revocable plan.

5 The contribution limits for defined-benefit pension plans relate to the benefits – that is, as long as a contribution is an eligible contribution, it can be made to the plan. The benefits are limited to the lesser of 2 percent of an employee's best three years of earnings or the defined-benefit limit (which changes each year - for 2014, $2,770) multiplied by years of service. In addition, a specified level of ancillary benefits is also permissible under the ITA. The act includes a mechanism, known as the "pension adjustment" or "PA," which puts a value on the amount of pension an individual earns in the year. An individual's RRSP contribution room for the next year is reduced by the amount of the individual's pension adjustment for the year. For a defined-contribution plan, the pension adjustment will be the contributions (up to the tax limits). For a defined-benefit plan, the pension adjustment is based on a formula set out in the *Income Tax Regulations* that purports to value the benefit accrued in the year.

Defined Benefit

In contrast to DC plans, DB pension plans provide a specified benefit at retirement. Contributions vary according to what amount is required to fund the specified benefit.

Generally a plan sponsor is required to fund a DB plan on the greater of a solvency basis (which assumes the plan is terminated on the date of the valuation) or a going concern basis (which assumes the plan will continue indefinitely). Solvency deficits generally must be paid off within five years.[6]

Due to extremely low interest rates and the volatility of equity markets, over the past several years many pension plans have suffered significant solvency deficits. As a result, plan sponsors have sought relief from the substantial solvency contributions required under pension laws. The longer-term trends of increasing life expectancies and maturing pension plans (i.e., a higher portion of a plan's liability being driven by pensioners rather than by working members) have also contributed to the rise in DB funding costs.

In response, various jurisdictions have implemented a variety of temporary solvency relief measures. In certain jurisdictions, these measures have had to be re-introduced when the initial relief time frame expired. In general, however, these measures have not addressed the underlying plan issues but rather have provided merely short-term solutions.

The drawdown phase for traditional defined-benefit structures includes pooling of longevity and investment risks with a stable and predictable schedule of benefit payments after retirement. However, the accumulation phase for DB plans usually includes significant volatility in funding ratios and contributions by the plan sponsor. (In reality, the "accumulation phase" for DB plans extends into retirement as the sponsor's funding requirement persists throughout members' retirement). This volatility arises due to the unwillingness of plan sponsors (and members) to pay the real costs of providing a guaranteed benefit by selecting low-risk (and low-expected-return) investments. Guarantees are expensive and stakeholders are generally not prepared to pay the higher costs of providing such a guarantee.[7]

In order to reduce expected costs, plan sponsors typically mismatch the plan's assets and liabilities by investing a portion of fund assets in the capital markets to achieve higher rates of return and lower pension cost. The result is substantial volatility (deficits and surpluses) in the funded position of pension plans. Where the plan is well funded, the plan sponsor may take contribution holidays over an extended period of time and/or benefit improvements may be negotiated.

In some cases, contribution holidays are required due to the excess surplus rules under the *Income Tax Act* (ITA). (Although this is not as much of an issue today, it certainly impacted many pension plans in the past prior to the 2010 change in ITA rules). We also note that due to the surplus ownership issues that have plagued many DB plans, employers often target a 100 percent funded ratio (i.e., no buffer) to avoid building up surpluses in the plan that they might have to pay out to members in the future.

By contrast, when a DB plan is in a deficit position, additional funding by the employer is required. This additional funding is a substantially larger burden relative to pensionable earnings in a mature plan with a large base of retired members.

6 Going concern deficiencies are generally required to be paid off within 15 years.
7 See Hamilton (2014).

DB plans have also been confronted with other significant issues. One key challenge is increased longevity.[8] Although this trend has been apparent for some time, many pension plans have delayed recognition of its impact on their funding requirements. People living longer is fabulous news, unless you are responsible for funding a DB pension plan. For such a plan, this means that the mortality assumptions used in determining the plan's liability in the past are now inadequate.

Unlike life insurance companies, pension plans until recently have generally used static mortality assumptions instead of anticipating yearly improvements. Accordingly, over the life of a plan, as valuations were done and special payments[9] were made (as required), the estimated liabilities were less than the actual liabilities. In short, the estimated pension payout liability is more today than had been anticipated in the past.

To the extent that defined-benefit plans may not have fully reflected updated mortality expectations, many such plans that are currently reporting an underfunded position may, in fact, be in a materially worse position. For single-employer private-sector plans, this means that the plan sponsor will be required to make increased contributions. For public-sector plans, this generally means both members and the government sponsor will have to make increased contributions, potentially translating into increased taxes and/or reduced services for the general public.[10]

Traditionally, when a DB plan's liabilities exceeded its assets, the only option available to the plan sponsor, outside of increased contributions, was to amend the benefit formula to decrease future benefits.[11] When pension plans were comparatively "younger" (i.e., smaller asset base and cash-flow positive), balancing deficits accumulated on accrued past service benefits by varying future contributions and/or benefit accruals was mathematically possible at an affordable cost for sponsors and active plan members. But deficits in today's larger, more mature plans impose a much larger financial burden on plan sponsors relative to the usual measuring stick

8 The Canadian Institute of Actuaries released updated mortality tables in 2014 (CPM 2014 Mortality tables with projection scale CPM-B). These tables show that the life expectancy of a 60-year-old male in 2014 has increased by 2.4 years (from 24.3 to 26.7 years) compared to the prior standard pension mortality tables (UP94 with projection scale AA). The life expectancy of a 60-year-old woman has increased by 2.5 years (from 26.7 to 29.2 years). http://www.cbc.ca/news/business/story/2013/08/06/business-pesnions-longevity.html See also "Leadership in pension funding innovation: Adapting to today's demographic reality," an address by Jim Leech, the former President and C.E.O., Ontario Teachers' Pension Plan to the C.D. Howe Institute of Canada, at http://www.otpp.com/documents/10179/20932/Speech_CD_Howe_Luncheon_2012.pdf/9886cb42-c1b1-4496-88e1-5b17ca566668. In addition to increased longevity, there has also been a significant demographic shift in many plans, resulting in a dramatic drop in the ratio of active members to retired members as compared to several decades ago.

9 Special payments are the required "extra" payments where an actuarial valuation for a defined-benefit pension plan discloses a solvency deficit or going concern unfunded liability. In the case of a solvency deficit, special payments would be required for up to five years to pay off the deficit. In the case of a going concern unfunded liability, special payments would be required for up to 15 years to pay off the deficit.

10 This has also been a significant issue for many US public sector plans. See for example, "Public Pensions After Detroit" at http://www.nytimes.com/2013/08/04/opinion/sunday/public-pensions-after-detroit.html?_r=0 and *Pensions in Peril* at http://insight.kellogg.northwestern.edu/article/pensions_in_peril.

11 In a unionized environment, any such decrease to future benefits would be subject to the collective agreement. In the non-unionized environment, there may be notice and/or other contractual requirements.

of covered payroll. Stated simply, the risk involved today in continuing with the mismatching strategy used in the past is substantially underestimated by many plan sponsors, and the range of potential costs involved may not be affordable in today's world.

Defined-benefit programs also face cost pressures due to changing accounting practices, particularly in the private sector. The trend has been toward "mark-to-market" (MTM) accounting in which assets and liabilities are recognized at current market value. When the volatility in the funded level arising from the asset/liability investment mismatch is combined with MTM accounting, the sponsor's income statement and balance sheet can both experience substantial variability. Many plan sponsors prepared to fund the average cost of a DB plan over a long-term horizon may nevertheless find it difficult to absorb the magnitude of variability in short-term cash flow and accounting results.

A New Approach: The Target-Benefit Plan

A target-benefit plan is a pension plan with the following key characteristics:

1. The contribution amounts are fixed (or variable only within a narrow, predefined range) and are generally not subject to traditional DB going concern or solvency funding standards.
2. Plan members receive a targeted defined-benefit-type pension at retirement.
3. Benefits may be adjusted (both up and down) to balance the plan's funding.

Of the above items, we would consider the third to be the defining characteristic of TBPs.

These plans can be designed to avoid much of the contribution volatility associated with traditional DB plans because accrued benefits can be reduced if the plan's funding deteriorates. In addition, TBPs largely maintain the cost savings and risk pooling advantages of DB plans versus DC plans because the basic benefit structure is established on a pooled basis for all members using a defined-benefit-like structure.

Pension standards legislation generally prohibits the reduction of accrued or earned benefits, subject to limited exceptions.[12] That is, once a plan member has accrued or earned a benefit under a pension plan, it cannot be reduced. Benefit changes may be made only on a prospective basis.

Multi-employer pension plans are the primary exception to this general rule in most provinces.[13] Target-benefit plans have existed in the multi-employer arena for some time, but traditionally have not been permissible in the single-employer environment. Multi-employer plans are typically administered by a board of trustees, where at least 50 percent of the trustees represent plan members.[14] There are many examples of well-administered, multi-employer target-benefit plans that have existed for many years. There are also notable examples of multi-employer target-benefit plans where governance has been a significant issue.[15]

12 See, for example, section 14 of Ontario's *Pension Benefits Act*, RSO 1990, c. P.8.

13 Quebec's and New Brunswick's (outside of the shared risk pension model) legislation does not permit the reduction of benefits under a multi-employer pension plan.

14 See, for example, paragraph 8(1)(e) of the *Pension Benefits Act* (Ontario), which requires that the administrator of a multi-employer pension plan be a board of trustees of whom at least 50 percent represent the plan's members.

15 See, for example, *R. v. Christophe* (2009 ONCJ 586) and *Deans v. Thachuk* (2005 ABCA 368).

New pension standards legislation recognizing single-employer target benefits has been introduced in several provinces, including Alberta,[16] British Columbia,[17] Nova Scotia,[18] Ontario[19] and Prince Edward Island.[20] However, none of the legislative changes permitting these plans is yet in force and there are no regulations. For its part, Saskatchewan is of the view that target benefits are permissible under the current legislation.[21]

Quebec has introduced a "member-funded" target-benefit pension plan with fixed employer contributions for workplaces with collective agreements or employee associations.[22] These plans are generally not considered as "real" target-benefit plans, as base benefits under these plans cannot be reduced. Under member-funded plans, only inflation-indexed benefits are target benefits. These plans are required to be funded as if benefits were fully indexed, but indexation may not be granted if the plan would not be fully funded after the payment of the indexation. Another feature is that no plan improvements may be adopted unless full indexation has been first granted.

Quebec also introduced target-benefit rules for the pulp and paper industry in 2012.[23] As the new rules apply only to one sector, they have very limited scope. In addition, the province does not permit targeted benefits for multi-employer plans, as is generally permissible in other provinces.

On April 24, 2014, the federal government released a Consultation Paper on target-benefit plans.[24] In this paper, the government requested submissions on the elements of a proposed federal TBP framework set out in the paper. These submissions were due by June 23, 2014. The proposed framework would provide for a voluntary TBP regime to be incorporated in federal pension standards legislation. It would be available to federally regulated private sector and Crown corporation pension plans. Following the close of the consultation perod, the federal government indicated that it would likely begin drafting a bill to introduce shared risk pension plans next year.

Meanwhile, proposed single-employer target-benefit legislation in Ontario[25] and Nova Scotia requires that the employer's contribution obligation is limited to a fixed amount set out in a collective agreement. In this way, the legislation in these provinces only contemplates target-benefit plans where there is a union. However, the proposed

16 *Employment Pension Plans Act*, SA 2012 (1st Sess), c E-8.1 (Royal assent on December 10, 2012 but not proclaimed in force). Bill 10, *Employment Pension (Private Sector) Plans Amendment Act,* 2014, has received second reading and been referred to the Standing Committee on Alberta Economic Future.

17 *Pension Benefits Standards Act*, SBC 2012 (4th Sess), c 30 (Royal assent on May 31, 2012 but not proclaimed in force).

18 *Pension Benefits Act*, SNS 2011 (3rd Sess), c 41 (Royal assent on December 15, 2011 but not proclaimed in force).

19 Bill 120, *An Act to amend the Pension Benefits Act and the Pension Benefits Amendment Act*, 2010, S.O. 2010 (2d Sess), c 24, ss 12(1), 49(4).

20 Bill 12, *Pension Benefits Act*, 3rd Sess, 64th Leg, Prince Edward Island, 2012 (first reading November 21, 2012).

21 *Pension Benefits Act*, 1992, SS 1992, c. P-6.001, section 40.

22 OC 415-2004, 2004 GOQ II, 1543. Note that special tax regulations were also introduced for these plans. See regulation 8510(9) of the *Income Tax Regulations*.

23 Bill 15, *An Act to provide for the establishment of target-benefit pension plans in certain pulp and paper sector enterprises*, SQ 2012 (1st Sess) c 32.

24 See *Consultation Paper - Pension Innovation for Canadians: The Target-Benefit Plan* (the "Federal Consultation Paper".)

25 The 2013 Budget said that: "Ontario will be moving ahead on regulatory changes related to target benefits in eligible multi-employer pension plans, announced in 2010. Assuming outstanding federal tax issues will be resolved and in consultation with interested parties, the government will also develop a framework for single-employer, target-benefit plans, including funding rules, plan governance, the timing of necessary benefit reductions, permitted benefit improvements, and notice to members and retired members."

Alberta and BC legislation does not limit target-benefit plans to unionized workforces.

While the authors recognize that there may be some issues regarding the appropriate governance/administration regime for single-employer target-benefit plans in a non-unionized workforce, it is our view that these concerns can and should be addressed. As discussed below, New Brunswick's shared risk legislation requires that the administrator be a trustee, board of trustees or not-for-profit corporation.

Meanwhile, Ottawa's Consultation Paper contemplates a joint governance structure that would involve the participation of members and retired members and permit the participation of employers and independent parties. One of the questions posed for consideration in the Federal Consultation Paper is whether there should be a different governance framework in unionized and non-unionized environments.

As opposed to limiting TBPs to a unionized environment, there are other potential ways to address the governance issue. The first consideration is that administrators are under an overarching fiduciary obligation under the common law and pension standards legislation that applies irrespective of how an administrative body is composed. Other options include requiring a certain number or percentage of employee and/or retiree representatives on a TBP's board of trustees, mandating at least one independent trustee and prescribing minimum trustee knowledge and understanding requirements for board candidates.[26]

A related policy issue is whether past benefits may be converted to target benefits if a plan converts from defined benefit to target benefit. Certainly from the perspective of many stakeholders (plan sponsors along with new and future plan members), permitting conversion of accrued benefits would generally be preferable, as that could address any legacy issues. In addition, this would facilitate administration, as the administrator would have only one plan design type to oversee, instead of two.

Furthermore, intergenerational equity issues can be addressed such that the current active workforce is not bearing all the member risk and cost. However, specific legislation is required to permit conversion of accrued benefits and can be controversial, as discussed in more detail below. Opponents argue that accrued benefits are contractual rights that should not be removed.

If conversion of past benefits is, in fact, not permitted, we believe that there will be limited uptake of TBPs due to the persistence of legacy-defined-benefit design problems. On the other hand, it is likely to be seen to be to the advantage of most employees to adopt a TBP design instead of terminating the DB plan to join a DC plan.

As noted, the key feature of TBPs is that accrued benefits may be reduced if the contributions made plus the investment returns earned are not sufficient to provide the targeted benefits. However, as discussed further below, New Brunswick has taken the step of mandating certain risk-management requirements to mitigate the risk of future benefit reductions.

The Federal Consultation Paper also contemplates certain risk-management requirements.[27] It is not clear whether other

26 In the United Kingdom, there are knowledge and understanding requirements in the relevant pension legislation. (See Section 247 of the *Pensions Act 2004*, c. 25 (UK) for the knowledge and understanding requirements for individual trustees). The pension regulator also sets out a code of practices related to the trustee knowledge and understanding requirements. See http://www.thepensionsregulator.gov.uk/codes/code-trustee-knowledge.aspx#s1664.

27 For example, the Federal Consultation Paper proposes one of two funding test approaches: a going concern funding requirement with a provision for adverse deviation (PfAD); or a going concern funding requirement and a primary risk-management goal that provides a specific probability that base benefits will not be reduced and a secondary risk-management goal that provides a specific probability of delivery of the ancillary benefits.

jurisdictions will include similar prescribed requirements. Certainly, there are other risk-management options that could be implemented.[28] Alternatively, it may be that other jurisdictions will look to New Brunswick as a best-practices model in terms of risk management for target-benefit plans.

It is also unclear what other jurisdictions will mandate with respect to funding and governance requirements for TBPs. As contributions are fixed (or variable within a limited range), solvency and going concern special payments are irrelevant. However, valuations are still needed for tax compliance purposes and also to assess the plan's position and need for benefit adjustments, if any.

How TBPs Address Certain Issues Associated with DB and DC Plans

Target-benefit plans address some of the issues associated with the designs of DB and DC plans by incorporating predictable and stable contributions similar to a DC plan. As a result, plan sponsors and plan members can have cost predictability.

Since TBPs provide a targeted pension benefit at retirement, similar to DB plans, members understand the pension level they can expect to receive upon retirement. This is in contrast to a DC plan, where members are aware of their account balance, but uncertain as to their monthly retirement pension.

Similar to DB plans, TBPs allow for pooling of longevity risk. This means that an individual does not have to guess how long he or she will live and save accordingly. The lives of all the members in the plan are pooled, so some may live to be 60 and others to 90, but the risk is shared. Much like a DB plan benefit, monthly pensions will continue for the lifetime of the member.

Investment risk in a target-benefit plan is also shared through the commingling of retiree and active member assets. This "whole plan" approach facilitates a longer-term investment perspective than would be appropriate for individual plan members, particularly those in retirement. As noted previously, the pooling of factors such as expenses and longevity risk provides substantial added economic value versus an individual member account defined contribution structure (i.e., benefits are higher and/or cost is lower).

The accounting treatment for target-benefit plans in the multi-employer world is well established. Consistent with the employer's fixed-contribution cost, the annual expense for participating employers is equal to the contributions made to the plan (i.e., it is a defined contribution cost).

It would seem logical that single-employer target-benefit plans should be treated consistently, as they are a benefit design that does not guarantee a specific benefit outcome. However, because these structures are quite new, formal accounting guidance does not exist at this time. It is important that the accounting profession agree upon an

28 For example, legislation could require risk-management and there could be policies from the regulator on acceptable risk-management techniques. New Brunswick's system mandates targets for the expected outcomes. The province has prescribed that there must be at least a 97.5 percent probability that base benefits will not be reduced over 20 years. The threshold could be a different number in other legislation, for example 95 percent or 99 percent. Another option may be for the parties in a bargained plan to determine the appropriate threshold. Other techniques could include minimum margins – for inputs (i.e., discount rate, mortality assumption, etc.), minimum funded ratio (e.g., must be 110 percent funded), or other techniques.

29 Regulation 8510 of the *Income Tax Regulations* contains a specified multi-employer plan definition, including qualifications and special rules.

30 This is in addition to the special rules for Quebec member-funded pension plans referred to above.

31 See Regulation 8503(2)(a) of the *Income Tax Regulations*.

accounting treatment that appropriately reflects the reduced risk level inherent in TBPs versus DB plans. Understandably, plan sponsors may be reluctant to adopt a target-benefit structure before definitive accounting guidance is established.

Target-benefit plans are designed to be flexible and adaptive. They are designed to pay out more money when the plan performs well and has excess funds and to pay out less money in years where the plan does not perform well, often using conditional cost-of-living adjustments (COLA) as the balancing mechanism. Alternatively, they could be based on career average earnings, indexed or not to inflation, instead of the traditional best five years or "fixed average". In extreme economic circumstances, target-benefit plans permit benefit reductions.

Potential Tax Issues for TBPs

Current tax rules are often cited as one of the impediments for single-employer target-benefit plans. The federal government should be encouraged to amend the tax rules to accommodate these plans, which may result in some of the provinces enacting legislation to permit single employer target-benefit plans.

At present, the tax regime is not designed for single-employer target-benefit plans.[29] Instead, the tax regime is set up for DC plans, DB plans and specified multi-employer plans.[30] Accordingly, absent changes to the tax regime, new plan designs, which may differ across the country, will have to fit within the current rules. For example, one change that is needed to accommodate single-employer target-benefit plans is an exception to the requirement that benefits are payable in equal periodic amounts.[31]

Under the current rules, the pension adjustment[32] in respect of a shared risk plan would likely be a defined-benefit pension adjustment. This defined-benefit pension adjustment is based on a formula set out in the *Income Tax Regulations* and impacts the amount of available RRSP room for the plan member. One issue with applying a defined-benefit pension adjustment to target-benefit plans is determining what happens if there is a permanent reduction in the benefits. In New Brunswick, the regime contemplates that any reduction in base benefits will be reversed as a priority once the funded status improves sufficiently. However, if other regimes do not contain similar requirements, it is possible that benefits could be permanently reduced. Under the current tax regime there is no remedy for the impact such a change would have.

The *Income Tax Regulations* limit member contributions to 9 percent of compensation and provide for a waiver mechanism if the limit is to be exceeded.[33] In order to obtain a waiver for a DB plan, it must be demonstrated that, on a long-term basis, the aggregate of the regular current service contributions made by all members will not exceed one-half of the amount that is required to fund the aggregate benefits in respect of which those

32 The pension adjustment (PA) amount is the value of the benefits a taxpayer earns under his employer's registered pension plans (RPP) and deferred profit sharing plans (DPSP), and possibly, some unregistered retirement plans or arrangements. (CRA website).Regulation 8301 of the *Income Tax Regulations* defines pension adjustment.

33 Regulation 8503(4)(a) to the *Income Tax Regulations* limits member contributions. Under regulation 8503(5), the minister may waive the conditions in 8503(4)(a).

34 See Ch. P-5.1 (the "NB PBA").

35 See New Brunswick Regulation 2012-75 under the NB PBA (the "Shared risk Regulations").

contributions are made.

If a new regime is to be implemented for target-benefit plans, this maximum on member contributions should be reviewed. If, for example, plan designers wished to require members to pay more than 50 percent of the contributions once they exceeded a certain threshold, arguably this should be permissible under the tax rules.

New Brunswick's Target Benefit Plan – the Shared risk Plan

In 2012, New Brunswick introduced shared risk pension plans (SRPs). The province's *Pension Benefits Act*[34] was amended to include a new Part 2 for shared risk plans and regulations.[35] The changes that have been implemented in New Brunswick have garnered attention both across Canada and in the United States.[36]

Shared risk plans are a specific type of target-benefit plan. The base benefits under a shared risk plan are determined by a base pension formula (usually a career average formula) with the objective of providing inflation protection via indexation that is conditional on the pension plan's financial status. Other ancillary benefits, such as early retirement subsidies and bridge benefits, will be provided when there are sufficient funds in the plan, subject to the legislative regime and the terms of the applicable funding policy. However, all benefits (base benefits and ancillary benefits, both past and future) under a shared risk plan may be reduced if the funding proves to be insufficient.

Critics of the shared risk design often comment that it does not involve shared risk, but instead shifts risk – from the employer to the employees. In fact, several elements of the design do, indeed, involve shared risk among various stakeholders.

First, both employee and employer contributions may be increased within a certain range in accordance with the funding policy. Second, there is the "risk" that interest rates will rise, plan investments will perform well as a result and the plan will be awash in funds. In this scenario, employer and employee contributions continue (subject to minor reductions in the required contribution amount in accordance with the funding policy and subject to the *Income Tax Act*), and any excess in the plan is used for the benefit of members in accordance with the funding policy. Third, there is the pooling of risk, investment and longevity among all plan members, as is the case with all TBPs. In this manner, the shared risk design is at the mid-point of the design and risk spectrum between DB plans (where the majority of risk resides with the employer) and DC plans (where the majority of risk resides with the individual employee).

There are many aspects of the shared risk design that are unique. We will focus on the following: (i) the ability to convert accrued benefits to shared risk benefits upon plan conversion; (ii) the fact all the contributions to a shared risk plan belong to the members; (iii) prescribed risk management and

36 See "Public Pensions After Detroit" at http://www.nytimes.com/2013/08/04/opinion/sunday/public-pensions-after-detroit.html?_r=0, "Adapting to today's demographic reality," an address by Jim Leech, former President and C.E.O., Ontario Teachers' Pension Plan to the C.D. Howe Institute of Canada, at http://www.otpp.com/documents/10179/20932/Speech_CD_Howe_Luncheon_2012.pdf/9886cb42-c1b1-4496-88e1-5b17ca566668, "How New Brunswick became a pension trailblazer," at http://www.thestar.com/opinion/commentary/2013/08/21/how_new_brunswick_became_a_pension_trailblazer_goar.html, *Munnell and Sass*. (2013), and Leech and McNish (2013). There has also been opposition to the shared risk model. See, for example, "Critic says pension reform a 'virus'," *Saint John Telegraph Journal*, November 20, 2013.

governance; (iv) the absence of a requirement to fund on a solvency basis; and (v) the need for an independent administrator. In our view, these key aspects help address some of the challenges faced by other pension plans.

Conversion of Accrued Benefits

As discussed above, pension standards legislation in Canadian jurisdictions generally protects accrued benefits, and changes can be made to benefits only on a prospective basis. One of the more controversial aspects of the shared risk plan model is its ability to convert accrued defined-benefit or defined-contribution pension benefits to shared risk on a plan conversion.[37] That is, when a plan is converted to shared risk, all the accrued defined-benefit or defined-contribution benefits become part of the shared risk plan and subject to the shared risk plan rules, including future conditional COLA and the potential for benefit reductions.

The New Brunswick legislation provides immunity to parties who elect to convert a pension plan to a shared risk plan. In New Brunswick, there has been controversy regarding the conversion of retiree accrued benefits, in particular.[38]

This conversion aspect of SRP legislation was included in order to maintain a reasonable level of intergenerational equity and to help ensure the long-term sustainability of shared risk pension plans. As discussed above, one of the issues with the traditional defined-benefit model is that people are living longer than anticipated when many of these plans were established. Accordingly, the pension liabilities are significantly more than anticipated in many plans.

In addition, as babyboomers age, the relative size of the active workforce is shrinking.[39] This means there are fewer active workers to contribute toward pension benefits or to fully fund the plan if there are a few bad years of investment returns.

Finally, while DB plans may have been described as being "guaranteed" in order to support lower estimated costs when the benefits were first accrued, the actual management of these plans was not consistent with a benefit guarantee. Critics of the conversion element of the model argue that accrued rights are contractual rights (in addition to being accrued rights under pension standards) and should not be changed by legislation.

In addition to the general prohibition under pension standards legislation regarding reduction of accrued benefits, the common law holds that once a pension right is vested, generally speaking, it cannot be divested or changed unilaterally by the employer.[40]

However, this rule is subject to the legislative powers of the government. A province can take specific legislative action that impacts vested pension rights, subject only to *The Canadian Charter of Rights and Freedoms* (the "*Charter*").[41] In fact, while there have been cases in Canada where pension rights have been amended by actions of a government, certain challenges under the *Charter*

37 See Section 100.52, NB PBA.

38 See "To be fair, any changes must be on a go-forward basis," Fredericton *Daily Gleaner*, November 14, 2013 and "Thousands protest pension reforms," CBC, November 11, 2013.

39 See Wong (2011).

40 See *Quinn v. New Brunswick (Minister of Finance)*, 2011 NBQB 182 at para 90. Note that "vesting" is a complex legal concept and the term can carry different meanings.

41 See *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act*, 1982 being Schedule B to the Canada Act 1982 (UK), 1982, c 11 and *Clitheroe v. Hydro One Inc*., 2010 ONCA 458 ["*Clitheroe*"].

have been unsuccessful.[42]

On June 30, 2014, the Pension Coalition of New Brunswick, a group of retirees, launched a challenge under the *Charter* regarding the conversion of the pension plan under the *Public Service Superannuation Act* (the "PSSA") to a shared risk plan.[43] Two unions, CUPE and the Professional Institute of the Public Service of Canada, have also indicated that they are considering legal options with regard to the PSSA conversion.[44] CUPE has filed a formal complaint with the New Brunswick Labour and Employment Board, arguing that the changes to the public service pension plan violate provincial labour laws.[45] However, one consideration is that if change is needed from the current DB plan, and if the only alternative is a DC plan, this would arguably be a significantly worse outcome for the union membership than a shift to a TBP.

Although target-benefit plans permit the reduction of benefits, no other provincial pension standards legislation in a Canadian province presently in force permits the conversion of accrued benefits to shared risk or target benefits when a plan is converted.[46] Under proposed target-benefit legislation in certain other Canadian provinces, it appears that any accrued benefits would be protected upon conversion and future benefits would accrue as target benefits. The issue with this is that where a mature DB plan is converted, the intergenerational equity issues would not be addressed as the legacy-defined-benefit obligations would remain intact, including any vested COLA obligations for retired member benefits. This means, in effect, that if plan changes were necessary to address sustainability issues, the cost impact would all be borne by the active workforce. Depending on the funded position of the plan and the demographics, this could mean significantly increased contributions for current active members and decreased future benefit accruals in order to sustain retired member benefits.

Meanwhile, public-sector plans in provinces other than New Brunswick have recently taken steps that impact retiree benefits. (We include below a brief discussion of the recent public-sector changes in the province of Prince Edward Island as a further example.)

42 Ibid *Clitheroe*. See also *Melanson et al. v. New Brunswick (Attorney General) et al.*, 2007 NBCA 12.

43 Pension Coalition NB and Koskie Minsky LLP bring court proceeding against Province of New Brunswick on behalf of 13,000 pensioners, CNW Newswire, June 30, 2014.

44 See "CUPE action plan defends defined benefits," Saint John *Telegraph-Journal*, November 13, 2013 and "Union considers court action on pension reforms," Saint John *Telegraph-Journal*, November 1, 2013. The New Brunswick government passed legislation, *An Act Respecting Pensions under the Public Service Superannuation Act*, to convert the PSSA to the shared risk model effective January 1, 2014, with some modifications. Under the conversion of the PSSA, there will be a protected base benefit floor for members and retirees at conversion. The legislation provides that if there ever has to be a reduction in base benefits in accordance with the funding policy, members and retirees at conversion are entitled to a base benefit under the converted plan that is no less than the value of his or her benefit under the PSSA immediately prior to conversion. If a reduction below this benefit floor is required, the Consolidated Fund will pay such shortfall.

45 See "CUPE files complaint with labour board over pension reforms," Saint John *Telegraph-Journal*, December 6, 2013 and "CUPE: still fighting pension reform," Saint John *Telegraph-Journal*, December 9, 2013.

46 The Federal Consultation Paper contemplates the conversion of accrued benefits on "consent," without defining consent. Alberta's proposed Bill 10, which is currently at Committee, also contemplates conversion of accrued benefits.

Member Money

Once employer and employee contributions are made to a shared risk plan, the contributions may only be used in accordance with the plan's terms and funding policy to the benefit of plan members.[47] In good markets, this may be a significant benefit to plan members.[48] If a shared risk plan is terminated in the future, all the fund is used to benefit the plan members. As a result, there can be no surplus disputes while the plan is ongoing or on wind up. This is in contrast to traditional DB plans where there have been conflicts regarding surplus entitlements between plan members and the employer.[49] Many of these defined-benefit surplus disputes have resulted in protracted and complex litigation.

If a member terminates employment prior to retirement or death, the member may elect to take his or her termination value from the shared risk plan. Essentially, the termination value is the greater of the member's own contributions to the plan with interest or the value of the member's accrued benefits multiplied by the funded ratio of the plan at that time. Accordingly, if the plan is underfunded in accordance with shared risk rules, the member's portable amount will be reduced accordingly.

The member cannot take more from the plan than the plan can afford to pay at that time. This is in contrast to DB plans, where the commuted value is calculated using assumptions based on a guaranteed benefit, including a discount rate based on a spread over fixed-income returns. If a member elects to leave his or her money in a shared risk plan after he or she terminates employment, any future cost-of-living adjustments or other applicable enhancements (if any) will also benefit such member.

Similarly, if a shared risk plan is terminated, the funds remaining in the plan are for the benefit of the members. Accordingly, if there are insufficient funds in the plan, there would be a reduction in member benefits. Note that the New Brunswick rules provide for an anti-avoidance provision to prevent an underfunded plan from converting to shared risk and then winding up. If this is done within five years of conversion, the plan may be treated as though it were a DB plan and funding of the deficit may be required.[50] If there are excess funds in the plan on a wind up, this would be shared among all the members.

Prescribed Risk Management and Governance

When a shared risk plan is established, certain stress testing is required under the law. Contribution levels are set such that they are sufficient to pay for the projected benefits baseed on the stress testing. The stress testing is required to help ensure that there is a reasonable probability that the targeted benefits can in fact be attained. The testing done when the plan is set up is designed to match the contribution levels with the targeted benefits, using reasonable assumptions.

47 This is subject to any expenses with respect to the administration and investment of the plan and fund including, for greater certainty, trustee education and/or reasonable per-diem expenses in accordance with any declaration of trust. Under the Shared risk Regulations, plan expenses may be paid by the pension fund, the employer or both (section 10, Shared risk Regulations). The Funding Policy will set out who is responsible to pay administrative expenses (subsection 6(2), Shared risk Regulations).

48 Note that the Federal Consultation Paper does not contemplate that excess funds may be used only for member benefit. Instead, it contemplates that both employers and members may benefit depending on the surplus allocation measures.

49 See, for example, *Schmidt v. Air Products Canada Ltd.*, [1994] 2 S.C.R. 611.

50 The Federal Consultation Paper proposes a similar anti-avoidance rule.

Specifically, at the time the plan is set up, the stochastic testing must illustrate that there is at least a 97.5 percent probability that base benefits will not be reduced over a 20-year period (the primary risk-management goal) and that, on average, at least 75 percent of the value of targeted ancillary benefits will be paid over such period (the secondary risk-management goal). These risk-management requirements also have to be satisfied at certain other times, such as when a permanent benefit change is made.[51]

In addition to the risk-management requirements at inception, annual stress testing is required in conjunction with the annual funding policy actuarial valuation to determine whether actions under the funding policy must, or may, be taken in any given year. In order for COLA to be paid under a shared risk plan in a given year, the primary risk-management goal must be met. While the annual requirements for shared risk plans will increase the administrative requirements of the plans, they will also allow administrators to address any plan issues in a timely manner.

The annual testing that is done is to help manage the plan on an ongoing basis. Each shared risk plan is required to have a funding policy. The funding policy requirements in the *Shared Risk Regulations* are designed to set out when certain corrective actions must be taken in bad times and impose limits on spending in good times. The funding policy must contain a funding deficit recovery plan, which sets out corrective actions that must be taken when the plan fails the prescribed funding test.

Also required is a funding excess utilization plan, which sets out actions that may be taken when the plan has excess funds. For example, the *Shared Risk Regulations* require that if the funded position of the plan falls below 100 percent on an open-group basis in two consecutive years, the funding deficit recovery plan under the funding policy must be invoked. This aspect of the rules takes away the discretion of the plan trustees as to whether to take action where a shared risk plan's funded position falls below a certain level.

The *Shared Risk Regulations* further specify that the last corrective action under the funding-deficit recovery plan is the reduction of past base benefits. Again, the shared risk rules are designed so that reduction of past base benefits is a last resort corrective measure for plan trustees where a shared risk plan's funded position is in jeopardy.

As well, the *Shared Risk Regulations* require that the funding excess utilization plan under the funding policy must contain as a first priority the reversal of any prior reductions in base benefits or ancillary benefits that have not yet been reversed. This means that where a reduction in benefits had previously been required under the funding-deficit recovery plan, once the plan has sufficient assets, the first priority is to address such prior reduction.

The requirements are designed to set certain limits for the funding policy. The funding policy then becomes the operative guide for the administrator. Each year the funded position of the plan is measured (as discussed in more detail below), and the funding policy is reviewed to

51 See Section 7, NB PBA. The secondary risk-management goals must be attained at conversion and when a permanent benefit change is made. The primary risk-management goals must be attained when a shared risk plan is established, or at conversion, when a permanent benefit change is made, when a benefit improvement is made, as of the date cumulative increases or decreases occurring as a result of a change to the funding policy exceed the prescribed amount, and at the date any temporary contributions are removed or reduced if the date is before the expiry of the period specified in the definition of "temporary contributions."

determine what, if any, actions must (or may) be taken by the administrator.

The Federal Consultation Paper similarly proposes the requirement for a funding policy. In addition, it contemplates a funding-surplus utilization plan and deficit-recovery plan as roadmaps for dealing with excess funds or deficiencies. The proposed federal approach appears to be less prescriptive than New Brunswick's rules, leaving more leeway for negotiation of various components to the sponsoring parties.

New Brunswick's risk requirements and actions help address certain significant historical issues with DB plans. First, the contribution levels are set using reasonable assumptions and tied to the benefits to be paid.

Second, when times are good, surplus funds may be used to enhance benefits, but only up to a specified amount that may be spent each year (the excess must be held for future contingencies). This is to prevent plans with excess funds overspending in good times and not leaving in place a reasonable buffer for bad times.

Third, in bad economic times, the rules set out specific priorities for the trustees to address the funded situation of the plan in a timely manner.

No Solvency Funding Requirement

Unlike traditional DB plans, shared risk plans are not required to be funded on a solvency basis. Instead, shared risk plans are required to file annual funding policy valuations. The plan's funded level is measured on a 15-year open-group basis, which means that in determining the plan's "assets," the present value of the next 15 years of excess contributions (the difference between the annual contributions and the normal cost of the base benefit) are taken into account, assuming the plan's population is stable.

The assumptions used for valuation purposes include a discount rate that should be consistent with the plan's purposes and risk-management goals. The assumptions must also be consistent with plan experience, future plan expectations and accepted actuarial practice.

The shared risk-plan legislation is outcome oriented – that is, it requires that the plan funding and benefits be calibrated to achieve the expected average outcome and that "failures" (i.e., benefit reductions) occur in less than 2.5 percent of scenarios over a 20-year period. As yet, there are no specific standards that have been developed by the Canadian Institute of Actuaries to guide the selection of these assumptions and the specific modeling required under the shared risk plan legislation. The development of specific professional guidance will be valuable to both ensure greater consistency between various shared- risk plans and to provide a "safe harbour" for practitioners in the area.

Independent Administration

Shared risk plans must be administered by a trustee, board of trustees or not-for-profit corporation. Trustees are required to act independently of the party that appointed them. In this way, the plan administration is separate from the plan sponsor. Although New Brunswick's rules do not specify the particular constitution of the board of trustees, many of the plans that have converted to shared risk have jointly sponsored boards of trustees with the applicable unions and employer appointing equal numbers of trustees.

Recent Changes to Public-Sector Pension Plans in Prince Edward Island

Prince Edward Island has recently announced substantial changes to its two main public-sector pension plans covering the civil service, health employees and teachers. While several differences exist between New Brunswick's shared risk plan model and PEI's approach (different funding approach and valuation formulas), there are many common characteristics. The similarities include:

- The conversion of accrued benefits for past service to the new conditional COLA model for both active plan members and existing retirees;
- The use of future inflation protection as the primary lever to balance available assets with the cost-of-plan benefits;
- Overfunding of estimated costs combined with prudent spending limitations on plan surpluses to protect against the impact of downside investment scenarios; and
- Substantial limitations on the plan sponsor's ability to benefit from future plan surpluses (i.e., no cash withdrawals and limited availability of contribution holidays).

Thus, while the precise details of the PEI approach differ from the New Brunswick shared risk model, the basic principles are substantially the same.

Summary and Conclusions

There is increasing awareness of the need to move beyond the defined benefit versus defined contribution debate to include a middle-ground option that incorporates some of the positive attributes of both designs.[52] Target-benefit plans address a main concern of many plan sponsors by delivering cost predictability, similar to DC plans. Additionally, by providing a defined-benefit-type pension at retirement, capturing significant cost savings, and enabling pooling of longevity and investment risks, target-benefit plans respond to many concerns plan members have with traditional DC plans.

The middle ground defined by target-benefit plans is a fertile area to achieve improved outcomes for all parties involved in retirement programs. As mentioned above, several provinces are taking steps to bring in single-employer target-benefit legislation.

We discussed above the need for certain changes to the tax rules to accommodate single-employer target-benefit plans. We would encourage the federal government to amend the tax rules accordingly. We note that the Federal Consultation Paper unfortunately does not address the tax rules and the issues related to accommodating target-benefit plans under the current regime.

We also encourage CICA/CPA Canada to establish clear, logical accounting guidance for target-benefit programs. Clear guidance regarding taxation and accounting treatment would facilitate the emergence of target-benefit plans, as the tax rules would no longer be viewed by the provinces as an impediment to these plans and accounting uncertainty would not be an obstacle for plan sponsors.

The inclusion of risk-management requirements in the target-benefit regime can assist with ensuring benefit security. New Brunswick's shared risk model illustrates one way to achieve this end by including primary and secondary risk-management goals along with required risk-management procedures. There may be other risk-management options that could be considered appropriate for certain target-benefit designs.

Policymakers will also have to grapple with whether to require annual compliance requirements, as is the case in New Brunswick. As mentioned

52 The authors are also aware of numerous other design options that incorporate aspects of DB and DC. One such design, described as the defined alternative design, would have a fixed benefit but variable contributions. Both the employer and employees would contribute pro-rata amounts, but the amounts would be variable depending on the funded position of the plan. As with other design options, there are certain legal hurdles that would have to be addressed to accommodate this type of design. Governments should be encouraged to consider changes to pension standards legislation that accommodate alternative design options.

above, the annual requirements were included to help ensure that any issues could be addressed in a timely manner and assist with benefit security. However, the increased security does involve an added administrative obligation for these plans.

Specific legislative action is required if a government wishes to permit the conversion of accrued benefits to target benefit or shared risk plans. From a policy perspective, governments will have to consider whether allowing for target benefit or shared risk only on a go-forward basis is sufficient, or whether the conversion of accrued benefits should be permitted, as is the case in New Brunswick.

As discussed, allowing the conversion of accrued benefits has some merit from an intergenerational equity perspective. However, it is controversial and, if other jurisdictions intend to adopt this policy, some form of risk management should also be included in the regime to reduce the chance of future benefit reductions. In addition, significant communication and member engagement should be encouraged.

Some of the jurisdictions considering target-benefit plans have indicated that these plans will be limited to unionized workforces. Instead, these jurisdictions should consider some form of independent plan administration and expand the availability of target-benefit plans to all employers. Provinces should be encouraged to facilitate such plans as a true design option and not limit the availability of target-benefit plans to unionized workforces.

One other key policy consideration is that the registered pension regime is a voluntary one. Employers are not under an obligation, subject to any applicable collective bargaining agreement, to provide pension plans for employees. Recognizing that defined-benefit-type or target-benefit pension plans are a preferred means of delivering pensions, legislative change should be aimed at facilitating and expanding such pension coverage, not putting up roadblocks such that employers are reluctant to voluntarily provide such plans.

The merits of shared risk plans have been hotly debated in New Brunswick.[53] Being first to implement an innovative plan design, with some contentious aspects, is never easy and takes considerable political will. This type of brave pension reform is aimed at addressing some of the underlying pension issues, as opposed to providing stopgap measures.

As we have discussed, there are some issues with existing DB and DC pension design options, necessitating plan design alternatives. Accordingly, policymakers should be encouraged to move outside the pure DB versus DC debate and permit other design options. Pension standards laws across the country will have to be changed in order to permit such other design options.

53 See for example, "Pension Reform is not a virus," Saint John *Telegraph-Journal*, November 22, 2013, "Civil servants pledge pension reform reversal," Fredericton *Daily Gleaner*, November 21, 2013, "Mackinnon: shared risk pension better than disaster," Fredericton *Daily Gleaner*, November 1, 2013, "Public sector retirees vote to block reforms," Saint John *Telegraph-Journal*, November 1, 2013, "Pensions a Charter Right: retirees," October 15, 2013, "New Brunswick finance minister disappointed with threat of legal action; Higgs disappointed with position of retirees," Canadian Press, October 1, 2013.

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