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E-BRIEF

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PENSION POLICY

Target Benefit Plans: Improving Access for Federally Regulated Employees

by
Randy Bauslaugh

- Pension experts have hailed target benefit pension plans (TBPs) as an attractive alternative to defined-contribution (DC) and defined-benefit (DB) plans because they combine the best features of both. TBPs have been available to federally regulated employers for decades; but they are not used very much because of a fundamental flaw in federal law that puts in doubt the fixed contribution guarantee for employers.
- In federally regulated industries, such as banks, airlines and telecommunications, the pension standards regulator has a veto over the plan administrator's fiduciary decision to reduce benefits. Unlike a plan administrator that has a legal to duty to balance employer and employee interests, the federal regulator is legally required to "strive" to protect the interests of plan participants.
- Benefit reductions are rarely in the interest of plan participants. As a result, there is a significant risk the federal regulator will not approve a reducing amendment, with the result that an employer could be required to pay more than it bargained for. Unless this fundamental flaw is addressed, federally regulated employers are likely to continue to resist TBPs.

Target benefit plans (TBPs) have received considerable attention recently as a type of plan that allows financial risk to be shared somewhere between the polar extremes of defined-contribution (DC) plans, which have uncertain benefits but certain contribution requirements, and defined-benefit (DB) plans, which have certain benefits and uncertain contribution requirements. Despite

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the hype, TBPs are not a new type of plan – they have been around in Canada for decades.[1] They cover more than one-third of current pension plan members.[2] Unfortunately, they are rarely adopted by federally regulated private-sector employers because federal pension law casts doubt over the ability of employers to limit their financial exposure, a key attribute of TBPs for employers. As this paper will point out, this legal doubt can be easily addressed by minor wording changes to federal pension law.

TBPs combine the best features of DC and DB plans, namely fixed employer contributions and lifetime pensions for plan members. They do this by providing an aspirational defined benefit that can be adjusted up or down depending on plan assets and the agreed rate of plan funding. This is different than typical defined-benefit plans, which regulate financial sustainability by adjusting employer contributions up or down depending on the agreed benefit.

The other key characteristic of TBPs in Canada is that they tend to be multi-employer, rather than single-employer arrangements, with administration carried out by committees of employer and employee representatives or solely by employee representatives. Ceding some degree of control to other employers and/or to employees over the design, cost and continuance of benefits seems to have been a primary reason why TBP administrators have been granted sole discretion in other jurisdictions to reduce accrued benefits.

In making amendments to reduce accrued benefits, TBP administrators have a legal responsibility to act as fiduciaries. This means they must act reasonably and balance the interests of all stakeholders, including employers, employees and others entitled to benefits under the plan. TBP administrators must also respect any agreement or plan terms that provide a fixed or negotiated level of employer contribution.

Unfortunately, federal pension legislation, which applies to employers engaged in federally regulated sectors such as banking, railways, telecommunications and airlines, adds an additional layer to the process of amending TBPs to reduce benefits. The federal pension standards regulator must approve all amendments that reduce benefits. But in exercising its approval power, the regulator is legally required to "strive" to protect plan participants. It is difficult to imagine a situation in which a benefit reduction would ever be in the best interests of plan participants, except perhaps where an employer is about to go bankrupt. When regulatory approval power is combined with the requirement to protect only plan-member interests, employers are justifiably concerned that the regulator will not agree to benefit reductions.

If the regulator does not approve a reducing amendment, then the employer may fear it could be responsible for any funding shortfall, regardless of the terms of the plan, the trust or any collective agreement that would otherwise limit its contributions. Not surprisingly, employers under federal jurisdiction struggle to avoid TBPs in this uncertain legal environment.

The purpose of this E-Brief is to provide context for this problem, examine it in more detail, and suggest a concrete solution, including specific language for minor legislative changes required to fix it. In summary, this problem can be addressed by: (i) clarifying that employer contribution obligations under TBPs will be respected, no matter what; (ii) requiring the regulator to exercise the same even-handed approach to regulation as the administrators it supervises; or (iii) some combination thereof. If this situation is not addressed, federal TBPs will continue to be rare.

1 See International Association of Machinists and Aerospace Workers, (2014 para. 4).

2 See Shilton (2011). This comprehensive work provides a brief history of pension plans at pages 32 to 60 and a more detailed history of multi-employer pension plan (MEPPs) at pages 295 to 309. See also, Ontario, Expert Commission on Pensions. 2008. *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules*. Queen's Printer for Ontario, which indicates that target benefit plans "clearly dominate Ontario's DB system" with 69 percent of plan members in Ontario belonging to multi-employer or jointly sponsored pension plans (at pages 64-65).

Background

There appears to be little debate that DB plans deliver retirement income more efficiently than DC plans.[3] In addition, DB plans are more versatile tools for human resource planning– for example, in attracting and retaining workers, or planning for workforce adjustments.[4] Despite their advantages, many employers have clearly decided they cannot bear the financial risks associated with traditional DB plans. These risks include volatility in contribution requirements dictated by market-oriented solvency funding rules and market-oriented financial reporting requirements.[5]

The abandonment of DB plans is evident in the shrinking proportion of the Canadian labour force covered by them. In 1986, over 39 percent of the Canadian labour force had DB plans; in 2012, it was less than 25 percent (Bauslaugh, Edelist and Steele 2014). Over the same period, DB plan coverage among private-sector employees alone has been cut by over half to less than 12 percent.[6] This includes conversion of DB plans to DC arrangements[7] even though "there is little reliable evidence that investment efficiency and long-term stock performance improves" as a result of making such conversions (Phan and Hedge 2013).[8]

As a consequence of these developments, increasing attention has been given to developing a sustainable DB model, one that incorporates the fixed-contribution attributes of DC arrangements with the many efficiencies and workforce management attributes of DB plans. The most promising solution is the more flexible model known generally as a TBP. The principal characteristics of a TBP are fixed employer and employee contributions with a target or aspirational benefit that can be reduced if estimated liabilities exceed available assets. Cost savings are achieved by pooling investment, interest rate and longevity risks (Steele, Mazerolle and Bartlett 2014). In essence, a TBP is a hybrid DB and DC arrangement.

3 Depending on scale and other factors, DB plans are approximately 40 percent more cost effective than DC plans (Pierlot and Laurin 2012). See also Brown and McInnes (2014), Pierlot (2008), Steele, Mazerolle and Bartlett (2008) and Bauslaugh, Edelist and Steele (2014).

4 For example, because employees under DB plans receive the greatest benefit accruals for longer service and/or at higher ages, they can be used to lock employees into jobs they might otherwise leave. Other personnel planning advantages include early retirement incentives and early retirement windows that can be implemented to ease workforce reductions.

5 There are many reasons for volatility: for example (i) taking investment risk that does not or cannot perfectly match assets to liabilities; (ii) human mortality, including improvements in human lifespans; and (iii) how regulations interact with accounting rules in a low interest environment. See, for example, http://www.bpmmagazine.com/benefits_news.php?source=email

6 Data on pension plan coverage in 2011 available here http://www.osfi-bsif.gc.ca/Eng/oca-bac/fs-fr/Pages/FS_RPP_2013.aspx. Most recent Statistics Canada's *Pension Plan in Canada*'s data suggest private-sector DB membership may have dropped further, possibly to something around 10 percent.

7 The share of registered pension plan members covered by a DB plan during this period fell from 92 percent to 75 percent, while the proportion in a DC plan more than doubled from 7 percent to 16 percent (Brown and Meredith 2008). See also, Shilton, pp. 313-314.

8 The study examined the impact of freezing DB plans and replacing them with DC plans on liquidity, financial leverage, investment and market value of a sample of firms over 2001-2008. While concluding "there is little reliable evidence that investment efficiency and long-term stock performance improves", the research otherwise confirmed that such freezes tend to reduce the drain on corporate liquidity and relieve the pressure on borrowing to pay for mandatory pension contributions.

Despite the fact that TBPs have been around for decades (IAMAW 2014 and Shilton 2011), TBPs have been hailed as an "innovation" worth expanding (Steele, Mazerolle and Bartlett 2014) because they seem to capture the best aspects of DC and DB plans. Like DC plans, employer contributions are certain, since they can be fixed or capped. Like DB plans, TBPs provide lifetime pensions, not just savings, and they do this through DB-like mechanisms, such as pooling of investment and longevity risk based on a "target" benefit. The benefit might increase in the event of surpluses or decrease if available funding cannot support it.

The recent federal consultation paper on TBPs[9] (the "Consultation Paper") suggests TBPs would be an innovation for federal employers. But the reality is that a structure for them has existed for many years under the federal *Pension Benefits Standards Act* (PBSA)[10] as multi-employer pension plans (MEPPs) and as MEPPs that are negotiated cost plans (NCPs).[11] Unfortunately, these vehicles are rarely used in the federal private sector. The reason is that existing federal legislation creates uncertainties for employers. The most relevant uncertainty is an entrenched regulatory bias that favours the interests of plan participants over employer rights and interests. This fundamental problem is not addressed in the Consultation Paper.

The Problem

Clearly, there is an intent under the existing PBSA to recognize TBPs; i.e., plans that offer contingent defined benefits and fixed contributions.

The PBSA defines multi-employer pension plans, including those that are negotiated cost plans, as arrangements under which employer contributions are determined either by collective agreement, by agreement among the participating employers or by legislation.[12] The act also requires that participating employers in a multi-employer pension plan must pay all the contributions required by agreement among the employers or by collective agreement.[13] This suggests employer contributions can be limited by those agreements.[14] It is only a suggestion, since it does not specifically say employer contributions can be limited to the amounts set out in the agreements.

TBPs are generally treated as DB plans under federal legislation.[15] At the risk of oversimplification, DB pension plans must be provisionally funded on a going-concern basis, which uses long-term demographic and economic assumptions, subject to solvency funding requirements. Broadly speaking, solvency funding determines the ability of the plan to provide for all accrued DB benefits in the event of immediate plan wind up. Solvency funding is, therefore, subject to current market valuation rather than long-term assumptions associated with a going-concern valuation that tends to smooth out economic peaks and valleys. Also, while going-concern

9 According to the government paper, it "presents proposals to incorporate into the PBSA provisions for Target Benefit Pension Plans (TBPs) that would be available to federally-regulated pension plans." This implies that multi-employer plans may not be TBPs, although the consultation paper specifically asks, "To what extent could the proposed elements of the federal TBP framework apply in a multi-employer context?"

10 *Pension Benefits Standards Act*, R.S.C., 1985, c. 32 (2nd Supp), herein referred to as the PBSA. They also exist under pension standards legislation in many provinces.

11 At subsection 2(1), the PBSA defines "multi-employer pension plan" and "negotiated contribution plan."

12 *Ibid*.

13 PBSA, subsection 9(1.2).

14 Contributions may be fixed or may be variable with a maximum contribution stipulated.

15 It is beyond the scope of this E-Brief to argue whether they ought to be treated more like DC arrangements.

deficits can normally be amortized over a period of up to 15 years, solvency deficits must be amortized over a maximum of five years.

Some would argue that because benefits are not guaranteed in a TBP, it should not be subject to solvency funding. This is because, in many ways, a TBP operates more like a DC arrangement under which benefits are determined or adjusted by reference to agreed-upon funding.

There are hints in the federal legislation that MEPPs may not be subject to solvency funding, a usual source of contribution volatility in DB plans. Subsection 9(1.1) of the PBSA states that "in respect of a plan that is not a [MEPP], the employer shall pay … all amounts … required to meet solvency standards."[16] The implication is that MEPPs are not subject to solvency funding, because solvency funding applies only to other plan types. This is only an implication because there is no express statement that multi-employer pension plans are exempt from solvency funding.

On wind-up, employers must pay all amounts required to satisfy plan obligations, unless it is a negotiated cost plan.[17] Again, there is an implication that funding obligations can be limited to fixed amounts if it is an NCP, but there is nothing that states this in a positive way. The exception is not elaborated and, in any event, it only applies to multi-employer plans that are also NCPs and not to other multi-employer plans.

Although all of this suggests that these MEPP and NCP employers are responsible only for agreed-upon contributions, and that negotiated cost plans are exempt from solvency funding, it is not clear that employers would never have to pay more than the contributions established: (i) by collective agreements; (ii) by agreements among employers; or (iii) as fixed by the plan terms. This is because all multi-employer pension plans including NCPs, are otherwise treated as traditional DB plans. Employers with traditional DB plans are generally subject to solvency funding and top-up funding requirements. There are no explicit statements that MEPPs are exempt. So there is uncertainty.

This uncertainty around employers' funding obligations in MEPPs might not matter if it were clear that accrued benefits could be reduced to conform to the agreed-upon funding rate or to the available assets. But there is no such clarity.

Under the *Pension Benefits Standards Act*, it is possible to reduce a plan's accrued benefits but only if the amendments are authorized by the Superintendent of Financial Institutions.[18] The act goes on to specifically provide that MEPPs that are negotiated cost plans may reduce accrued benefits,[19] but theoretically any plan, including other multi-employer or DB plans could reduce benefits, if authorized by the superintendent. What is perfectly clear is that any amendment to any plan that reduces accrued benefits is void unless authorized by the superintendent.[20]

From the employer's perspective, there are many unanswered questions. Is it reasonable to expect that the superintendent would ignore an employer's fixed-funding obligation that may be stipulated in negotiated cost plan documentation that creates and supports the arrangement? Shouldn't the specific language applicable to

16 PBSA, subsection 9(1.1).

17 PBSA, subsection 29(6.1).

18 PBSA, subsection 10.1(2)(a).

19 PBSA, subsection 10.11.

20 PBSA, subsection 10.1(2).

multi-employer plans that are negotiated cost plans override any general language? Is it realistic to assume that the superintendent will not respect the fiduciary decision of the negotiated cost plan administrator?

These questions highlight the ambiguity that makes TBPs too risky for federal employers under the current legal framework. The superintendent could very well override the administrator's fiduciary decision to reduce benefits because the superintendent is not bound by the same even-handed approach imposed on the plan administrator. While the administrator must act as a trustee for the employer and for the plan participants, the superintendent, as explained further below, is required to vigorously protect plan-participant interests without any regard whatsoever to competing employer rights or interests.

By way of background, MEPPs must be administered by a board of trustees or a pension committee constituted in accordance with the terms of the plan.[21] Where the plan is established pursuant to a collective agreement, the board or committee will invariably have significant representation from plan members. Where the plan is not established by a collective agreement, the PBSA provides for plan member and retiree representation.[22] The implication is that because of collective bargaining or the presence of employee or retiree representatives, the administrator will inherently represent member interests. The reality is, the act clearly establishes an even-handed responsibility when it says, "The administrator shall administer the pension plan … as a trustee for the employer, the members of the pension plan, former members, and any other persons entitled to pension benefits under the plan."[23] In other words, the administrator is a fiduciary with a rock-solid legal obligation to act in a fair and even-handed manner among all plan stakeholders. As explained below, it could be argued that the superintendent is not even permitted to be even-handed.

Unlike TBP legislation in other jurisdictions,[24] any amendment made by a federally empowered administrator to reduce accrued benefits and rights will be void unless it is authorized by the superintendent.[25] In other words, the federal *Pension Benefits Standards Act* grants the superintendent a discretion to veto any decision made by the plan administrator to reduce benefits, even where the administrator's decision is dictated by its trust-based fiduciary duty, which necessarily requires it to consider the terms of any relevant collective agreement, employers' agreement and plan terms that may limit contributions.

The basic problem with the superintendent's veto power is that, in contrast to the plan administrator who must by law be an even-handed fiduciary, the superintendent must make decisions that "strive" to protect plan members. It is hard to imagine any situation in which benefit reductions would benefit plan members, except possibly where it was clear that an employer could not make the top-up contributions without jeopardizing its own existence or that of the plan. How can it be the case that legislation subjects an even-handed administrator to the supervision of a one-sided – some might say, legally biased – regulator? The answer lies in the *Office of the Superintendent of Financial Institutions Act*.[26] This is the legislation which empowers the Superintendent.

21 PBSA, subsections 7(1) (a) and (b).

22 PBSA, section 7.1. A pension committee must include a representative of the active members, and in plans with 50 or more retired members, the committee must also include a retiree representative, if requested by a majority of the members or retirees, as applicable.

23 PBSA, subsection 8(3).

24 Ontario legislation, for example, does not require additional regulatory approval.

25 PBSA, subsection 10.1(2).

26 RSC 1985, c 18 (3rd Supp), Part I.

The act provides that the Office of the Superintendent of Financial Institutions (OSFI) "shall strive … in respect of pension plans, to protect the rights and interests of members of pension plans, former members and any other persons who are entitled to pension benefits or refunds under pension plans.[27] The Oxford Dictionary defines "strive" as to "make great efforts to achieve or obtain something" or "struggle or fight vigorously for."

The OSFI Act makes no reference to, and imposes no obligation to protect, the rights or interests of employers. This means the superintendent must judge the plan administrator's actions based on a standard different than the even-handed fiduciary standard applicable to the administrator itself.

The act goes on to state that "regulation and supervision must be carried out having regard to the fact that administrators of pension plans are responsible for the management of the pension plans and that pension plans can experience financial and funding difficulties that can result in the reduction of those benefits."[28] That might suggest that some weight could be given to the trust-based fiduciary perspective of the plan administrator, but there is no express reference that allows the superintendent to give any weight to employer rights or interests or to water down the admonition to "strive to protect" member rights. In addition, all amendments to reduce accrued benefits are to be presumed void unless authorized by the superintendent.[29]

Some might argue that the superintendent must have some derivative ability to look out for employers because he/she must enforce legislation under which administrators must protect employer as well as plan-member interests.[30] But that is a shaky and untested argument for employers to rely on.

The bottom line is that the superintendent's veto power over fiduciary decision-making makes employers nervous. When that is coupled with a legislated directive to "strive" to protect plan members, the predictable result is that employers will, and would be well advised to, resist TBPs. Even without the other uncertainties around funding noted above, the biased perspective required by the superintendent when reviewing a decision to reduce benefits is the most significant impediment to the use of TBPs in the federal sector. A prudent employer is not likely to be prepared to assume the risk that it would have to contribute more to the plan than it intended in any situation short of proving to the regulator, and thereby announcing to the world, that it is in financial distress. Accordingly, this remains a significant impediment to the development or establishment of TBPs among employers with employees in federal undertakings. Unless this impediment is removed, any further expansion of TBPs flowing from the recent federal Consultation Paper is unlikely to result in any increase in TBPs for employees in the federal sector.

This issue of the legal sanctity of an employer's fixed-contribution commitment and the biased veto power of the superintendent was clearly of concern to Air Canada when it made a conditional offer to its unions in 2011 to establish participation in a TBP "should there be a change in the regulatory environment affecting the availability of a target benefit plan in these circumstances."[31]

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27 OSFI Act, subsection 4(3).

28 *OSFI Act*, subsection 4(5).

29 PBSA, subsection 10.1(2)(a).

30 This is because, as noted above, the administrator, who is supervised by OSFI, must act "as a trustee for the employer, the members of the plan, former members, and any other persons entitled to pension benefits under the plan." See also *PBSA*, subsection 8(3).

31 Brown, Robert L., *Air Canada Pioneers Pension Advance, Financial Post*, November 3, 2011; *Air Canada v. CAW*, Burkett Arbitration, Addendum, pp. 3-4.

It is unclear why the federal legal framework is such an outlier on this issue. The reality is many of Canada's best plans are provincially regulated TBPs that are successfully managed by joint boards of trustees, where the regulator does not have a veto power, including many of Canada's public-sector plans.

The Solution: Satisfy the Desire to Implement TBPs

Obviously, there are different approaches that could be taken to address uncertainty surrounding TBPs in the federally regulated sphere. One approach might be to address each and every one of the various uncertainties identified above. But there are simpler solutions that would likely have immediate beneficial effect.

After years of neglecting or ignoring TBPs, except to acknowledge the existence of the TBP concept inherent in most multi-employer plans, Canadian pension standards legislation increasingly deals with TBPs in a splintered and tentative fashion. A pension landscape virtually devoid of fresh approaches a decade ago is now crowded with a stunning array of acronyms and labels, including: MEPs, SMEPs, MEPPs, SOMEPPs, MUPS, MUPPs[32], negotiated contribution plans, defined ambition plans, collective defined contribution plans, aspirational plans, pooled target benefit plans, flexible defined benefit plans, and the most recent darling, shared risk plans. I oppose more splintering to respond to particular uncertainties – this simply works to make the TBP field too confusing, inexplicable and unapproachable for employers.

The main TBP concept is very simple: allow for a more flexible form of DB plan that has two main characteristics that already seem to be legally recognized in the PBSA. These are: (i) employer and employee contributions that can be defined in collective bargaining or by agreement among two or more unrelated employers; and (ii) an administrator that must be an even-handed fiduciary empowered with a statutory right to reduce both future accruals and benefits already accrued if necessary to respect the plan terms, including any contribution agreement. Additional consideration should be given to expressly relaxing solvency standards for multi-employer plans to avoid volatility that could lead to short-term benefit reductions or contribution increases that may result in inter-generational inequities.[33]

Obviously, good governance is the key component in the success of TBPs. The governance structure must be flexible. It must be adaptable to changing economic and demographic circumstances as well as to an evolving legal environment. The party responsible for governance, the administrator, must be capable and empowered to manage risk within existing circumstances.

32 These refer to "multi-employer plans (MEPs); "specified multi-employer plans" (SMEPs); "multi-employer pension plans" (MEPPs); "specified Ontario multi-employer pension plans" (SOMEPPs); "multi-unit plans" (MUPs); and multi-unit pension plans" (MUPPs).

33 The difficulty with solvency standards under a flexible defined-benefit plan is that they ignore the long-term nature of the pension commitment because the standards use current market assumptions without smoothing. This results in volatility that can lead to intergenerational inequities. Solvency concerns could be better addressed in a multi-employer environment by imposing solvency funding only on a withdrawing employer, which it could address by funding its share of any shortfall. Or the trustees could address the shortfall by exercising a fiduciary discretion to reduce benefits associated with that withdrawing employer. I would also support "solvency testing" with flexibility to allow the administrator, as a trust-based fiduciary, to adopt measures to address ongoing solvency issues that fit the demographic and contractual circumstances of the particular plan.

Much of this flexibility for federal plans is already achieved by requiring an administrator to act as a trustee.[34] Several observations about trust law are relevant since pension governance derives from 500 years of trust law development.[35] (i) The law applicable to trusts is the most flexible legal instrument known to the law.[36] (ii) Fiduciary duty arising out of trust-based law is the "highest duty known to the law."[37] (iii) The core of fiduciary duty is the obligation of loyalty, which involves taking no advantage of the fiduciary position. Accordingly while competence and prudence are required, mere competence or prudence is not enough.[38] It is not merely a duty to "do no harm."

To avoid the problems inherent in prescriptive approaches, such as the "factor of nine" for valuing pension accruals for tax purposes, lawmakers should avoid the prescribed risk-management approach inherent in the New Brunswick shared-risk pension legislation.[39] Such a prescriptive approach may be appropriate today, but may not be tomorrow, especially if it locks administrators into inappropriate future responses to evolving demographic, economic or other circumstances.

That is not to say that the New Brunswick prescriptions should be ignored, or that the New Brunswick prescriptions are not forward-looking in some respects. Indeed, their very existence will no doubt provide a benchmark by which to assess fiduciary behaviour and the manner in which TBP reductions are prioritized, even in those Canadian jurisdictions where risk management is not so prescriptive.

A better approach to TBP risk management is one that is more holistic, one that is responsive to particular circumstances and that relies on a combination of statutory minimums with a heavy overlay of trust-based fiduciary duty. As noted in a recent report by the UK Law Commission, "In many ways fiduciary duties can be thought of as 'legal polyfilla,' moulding themselves around other structures to plug the gaps" (*Fiduciary Duties of Investment Intermediaries* 2014). Trust-based fiduciary duty avoids point-in-time or stipulated approaches in favour of a more holistic stewardship that enables flexibility and creativity while requiring administrators to understand, explain and develop risk-management strategies that are appropriate to their legal, social and commercial environments.

34 PBSA, subsection 8(3).

35 "The principal method for governing occupational pension schemes is trust law as amended by statute; trust law itself has been in continuous development for over 500 years." Pension Scheme Governance – fit for the 21st Century? NAPF Discussion Paper No 1, July 2005.

36 Donovan Waters et al. (2005, p.3)

37 *Ben-Israel v. Valcare Medical* 8 CPR (3d) 94, 1997, per Justice B Beaulieu: "a fiduciary duty imposes the highest duty in law on the party holding the duty – the fiduciary – to act altruistically for the sole benefit of the beneficiary, to the fiduciary's own detriment if necessary."

38 See for example, Lord Justice Millet's remarks in *Bristol and West Building Society v. Mothew* [1998] Ch 1 at 19: "The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary."

39 Bauslaugh, Edelist and Steele (2014) provides a summary of the legislation's risk management provisions, which include prescriptions for stress testing through stochastic and deterministic modelling to demonstrate a high probability that base benefits and ancillary benefits will be provided as well as prescriptive terms for deficit recovery and surplus use.

Based on this author's experience in the field, I believe employers and other stakeholders are not likely to be opposed to certain embellishments to the existing trust-based structure that address the so-called "two-hat" conflict issue baked into our existing system – i.e., the ability of employers and employees to be the administrators of their own plans.[40] One easy solution would be to enhance public confidence or perception by imposing a requirement for a minimum number of independent governance committee members or trustees,[41] as is the case in legislation tabled recently in the Northwest Territories and Nunavut.[42] Independent trustees would serve a similar purpose to independent directors of a public company. Legislators might also consider a requirement that independent trustees possess some degree of pension literacy or expertise, either as actuaries, lawyers, professional administrators, professional trustees or investment managers. Independence and, possibly, expertise could be used to address governance concerns associated with TBPs for single-employer and non-union plans.

However, as indicated previously, the existing governance framework is, in fact, sufficient. Accordingly, only very modest language changes need be considered to provide a very significant and immediate fix to the problems in the current federal legislation applicable to multi-employer and negotiated cost plans.

First, replace the implied ability to honour contribution agreements by adding a more express statement that clearly respects agreed-upon fixed contribution requirements set out in a collective agreement or employer's agreement applicable to negotiated cost plans. Accordingly, the existing subsection 10.11 of the *Pension Benefits Standards Act*, could be revised to read (new wording underlined):

> <u>The superintendent shall authorize</u> an amendment to any document referred to in paragraph 10(1)(a) or (b) that has the effect of reducing pension benefits or pension benefit credits, <u>if the administrator certifies the amendment is necessary to avoid any increase in contributions determined in accordance with an agreement entered into by the participating employers, a collective agreement, a statute or a regulation, or to respond to financial and funding difficulties.</u>

Second, change the OSFI Act to recognize that pension plans are put in place to respond to the needs and aspirations of a broad spectrum of stakeholders, including employers. Subsections under 4(3) should be changed to reflect the more even-handed intent expressed in the *Pension Benefits Standards Act*:

> 4(3) In pursuing its objects, the Office shall strive
>
> …

40 See *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6. In this case, the Supreme Court of Canada acknowledged that pension standards laws generally allow corporations to wear two hats as employer and as administrator of a pension plan. However, the corporation must be prepared to manage these baked-in conflicts as they arise. In this case, the inability of the corporation to manage the conflict resulted in a unanimous determination that it was in breach of trust.

41 Independent in this context means unrelated to any employer participating in the plan and unrelated to any person entitled to receive pension or survivor benefits under the plan.

42 In bills relating to the *Northern Employee Benefits Services Pension Plan Act*, the Governments of the Northwest Territories and Nunavut have continued a target benefit plan applicable to municipalities formerly subject to the PBSA and have introduced a requirement for two independent trustees to be appointed to the governance committee. (See *Northern Employee Benefits Services Pension Plan Act*, section 12 at http://www.assembly.gov.nt.ca/sites/default/files/14-02-27_bill_12.pdf and http://www.assembly.nu.ca/sites/default/files/Bill%201%20North.%20Emp.%20Ben.%20Services%20Pension%20Plan%20Act%20EF%20Final.pdf.)

(b) in respect of pension plans, to protect the rights and interests of employers, members of pension plans, former members and any other persons who are entitled to pension benefits or refunds under pension plans.

It would also be appropriate to modify subsection 4(5) of the OSFI Act along the following lines:

> Notwithstanding that the regulation and supervision of pension plans by the Office and the Superintendent can reduce the risk that pension plans will fail to pay the expected benefits, regulation and supervision must be carried out having regard to the fact that administrators of pension plans are responsible for the management of the pension plans and that administrators may be obligated by the nature of the pension plan to reduce those benefits where required by the terms of the pension plans, or in the event of financial and funding difficulties.

Conclusion

The essential goals of a pension system, namely, to provide adequate retirement income security; to ensure fiscal sustainability; and to maintain or improve workforce productivity, can be achieved by taking steps to better accommodate TBPs. Such plans promise improved pension outcomes with improved sustainability. They combine many of the advantages of the DB plans currently favored in the public sector with those of DC plans prevalent in the private sector.

While I favour building on the existing trust-based approach to governance and risk management to simplify regulation, improve understanding and broaden access to a broad range of TBP design offerings, the immediate goal is to at least reduce the current uncertainty associated with multi-employer and negotiated cost plans. We need to ensure that current impediments do not persist in any new legislation intended to accommodate a broader range of TBPs.

More specifically, in the context of TBPs, the federal government should:

(i) allow the superintendent to rely on the decision-making of a trust-based fiduciary;

(ii) provide the superintendent the same even-handed perspective as the administrators he/she supervises; and

(iii) consider modifying solvency rules to prescribe mandatory testing, but leave the manner of addressing solvency concerns to the discretion of trust-based fiduciaries.

Like the mythical character Tantalus, chained in a pool of water beneath a fruit tree with the fruit ever eluding his grasp, and the water always receding before he can take a drink, the *Pension Benefits Standards Act* holds out the prospect of TBPs with no clear assurance to employers that the financial risks associated with DBs can be addressed. More specifically, the act provides no guarantee that agreed-upon fixed costs will be respected or that accrued benefits can be reduced if liabilities outpace funding.

Tantalus's punishment was to forever be tempted to eat and drink without the prospect of being satisfied. Until the fundamental changes referred to in this paper are made, that will continue to be the fate of federal TBPs, regardless of any adjustments resulting from the Consultation Paper. As long as the superintendent has the potential ability to second guess trust-based fiduciaries and ignore contractual or trust-based limits on funding, the sad reality is that TBPs will continue to be avoided by federally regulated employers. The repairs required to make what is already a tantalizing landscape a reality are easy to make – and certainly within reach.

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Randy Bauslaugh is National Practice Leader, Pensions and Benefits, at McCarthy Tétrault LLP in Toronto.

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