KOSKIE MINSKY
JUSTICE MATTERS

Emerging Trends in Public Sector Pensions Legislative Reform

James Harnum

Overview of Presentation

- Emerging issues and themes in public sector pension legislative reform
  - Focus on four legislative reforms
    1. New Brunswick “Shared Risk” Model
    2. Federal Target Benefit Legislation (C-27)
    3. Broader Public Sector SEPP Conversions on Ontario
    4. Solvency Reform in Ontario
  - Examining these four topics will allow us to discuss many of the key issues facing public sector plans (and unions) across the country, including alternative funding models, contribution caps, plan consolidations, successor obligations, conditionality/contingency of benefits and the role of collective bargaining

Target Benefit Plans: Introduction

- Target benefits are not (yet) a common feature of single employer or public sector plans – this may be changing
  - New Brunswick ‘Shared Risk’ – first Public sector TB plans
  - Bill C-27 – next move
  - Key political moment in pensions
  - Core of political controversy – conversions from DB to TB plans

Target Benefit Plans: Introduction

- DB vs. Target
  - Benefit: Predictable and secure, vs. at risk benefit
  - Funding: statutory employer funding ‘covenant’, vs. contractual funding
- Conversion - Fundamental Breach?
  - Past service – earned benefit, statutory, contractual commitment
  - In NB, conversion altered past service commitment to employees/retirees – but not to others (creditors)

DB vs. TB

- Current DB vs. TB debate is at least a decade old and dates from the "Perfect Storm" of the early 2000s
- Continuing and increasing interest in such reforms after 2008
- Simple Dichotomy - DB vs. TB
  - DB promise is a "guaranteed promise" and requires "guaranteed" funding
  - TB promise is not a "guaranteed promise" and does not require "guaranteed" funding

DB vs. TB

- DB benefit is backstopped
  - Going concern funding while the Plan is ongoing and Solvency funding to address sponsor insolvency
  - Terminal funding obligations (including additional protections)
  - Imperfect because
    - Not all benefits funded, no wind-up expenses
    - Smoothing of assets and liabilities
    - Solvency deficiencies amortized over time
    - Risk of employer insolvency

DB vs. TB

- TB benefits are not guaranteed
  - Benefits can be reduced, subject to risk
  - No solvency funding required
    - Funding is contractual – either a Collective Agreement (MEPPs) or a Funding Policy (NB, C-27)

DB vs. TB

- Link between funding and benefits is focus for TB Regulators
  - ‘risk management’ (NB)
  - ‘pension benefit stability’ objectives (C-27)
- How to measure ‘risk’ or level of ‘stability’?
  - ‘stochastic modelling’
  - Issue of manipulation of assumptions and nature of actuarial “science”

Divide is Closing (because DB is eroding)

- DB “deal” is changing
  - Solvency funding is fading
    - Employer resistance due to cost, volatility
    - Resistance to solvency funding is often supported by trade unions (because employees really pay; bargaining table pressures)
  - Insolvency protections remains weak (and business community is advocating for further erosion)
  - Underlying economic dynamics
    - Interest rates historically low and market uncertainty

Divide is Closing
(because DB is eroding)

- The DB deal has changed in Quebec
  - Solvency funding eliminated, no longer even an option
  - Requirement for roughly a 15% stabilization reserve, determined on a going concern basis
  - Actual amount of stabilization reserve depends on the Plan’s discount rate and asset mix (i.e., level of risk)

Divide is Closing (because DB is eroding)

- DB funding has been eroding in Ontario
  - Multi-employer plans temporarily solvency exempt and jointly sponsored plans permanently exempt
  - No solvency funding for certain benefits, or for wind-up expenses
  - Smoothing of assets/liabilities permitted
  - Third round of “Temporary Solvency Funding Relief”
  - Deeper solvency relief in broader public sector
  - Now, ‘Solvency Review’

But Federal View is Different…

- At the federal level, the Divide remains intact
  - No change to solvency funding requirements for DB plans
  - C-27 - Introduction of TB plans with no solvency funding requirements
  - At the federal level, DB still equals solvency funding and the only ‘escape’ from solvency is a TB plan

New Brunswick "shared risk" model

- "Shared risk" model = target benefit plans
- Some have argued name is misleading
- base benefits under a shared risk plan are based on pension formula (usually a career average formula)
- Ancillary benefits (benefits such as COLA, bridge benefits and early retirement subsidies) will only be provided where there are sufficient funds in the plan

New Brunswick “shared risk” model

- However, all benefits (base benefits and ancillary benefits both past and future) under a shared risk plan may be reduced if there are insufficient funds
- Designed to be flexible and self-correcting
  - Where there are excess funds, more money can be spent on benefits and protections
  - Where the funding of the plan is less robust, less money will be spent on benefits and if necessary benefits will be reduced

New Brunswick “shared risk” model

- SRPs are required to have a funding policy
  - used by the administrator to determine whether actions must be taken under the plan
  - actions may include increasing or decreasing contributions by up to a specified amount, decreasing benefits for all members, granting indexation in the year for all members, or providing other base or ancillary benefit enhancements

New Brunswick “shared risk” model

- NB PBA now permits the conversion of all accrued benefits (including accrued benefits of both active and retired members) when a plan is converted to a shared risk plan.
- Upon conversion, a member’s accrued benefits (whether DB or DC) become base benefits under the SRP.
- All benefits under the plan become subject to conditional indexation and are also subject to benefit reduction should it be necessary in the future.

NB SRP – Example of Funding Policy

Public Service Shared Risk Plan

- The PSSRP Funding Policy sets the initial level of employee and employer contributions and then prescribes limits on the amounts by which those initial contributions may ever increase.
- In total, employee and employer contributions may each only increase by 1.5% of earnings over the life of the PSRRP.
- Once the matching 1.5% contribution rate increases have been made, then any further funding deficiencies automatically result in benefit reductions.

NB SRP – Example of Funding Policy

Public Service Shared Risk Plan

- The Funding Policy also prescribes the timing, nature and order of benefit reductions that the PSSRP Board of Trustees is required to make in the event of a funding deficiency.
- The Funding Policy also regulates the amounts of surplus that may be utilized, and controls when it may be utilized (For example, only 1/6 of the Plan's surplus may be used until the PSSRP is 140% funded).

NB SRP – Example of Funding Policy

Public Service Shared Risk Plan

- Funding Policy - surplus utilization priorities:
  - (i) to restore benefits previously reduced under the Funding Policy
  - (ii) to provide indexation benefits for all years since the Conversion that were not fully indexed under the Funding Policy
  - (iii) contribution rate reductions as required under the Funding Policy
  - (iv) the establishment of a reserve for 10 years' of potential future indexation.
- After these priorities, Board may consider benefit improvements

NB SRP – stress testing

- SRPs are required to undergo annual stress testing (asset liability modelling)
- Preliminary stress testing is done when the plan is established
- Contribution levels are to be set such that the plan can satisfy the risk management requirements under the legislation
- Specifically, at the time the plan is set up, the testing must illustrate that there is a 97.5% certainty that base benefits will not be reduced over a 20 year period and a 75% certainty that certain ancillary benefits will be paid over such period.

NB SRP – stress testing

- Risk management requirements have to be attained at certain other times, such as where a permanent benefit change is made.
- Annual stress testing also completed in regards to the annual funding policy actuarial valuation to determine whether actions under the funding policy must, or may, be taken in any given year.

NB SRP – no solvency funding

- SRPs are not subject to the solvency funding requirements and valuations required by DB plans
- SRPs are required to file annual funding policy valuations.
- “assets” in valuation include the present value of the next 15 years of excess contributions (the difference between the contributions and the normal cost of the base benefit)

NB SRP – administrator

- Requirement for third-party administrator
- Administrator of SRP must be a trustee, board of trustees or a not-for-profit corproation.
- No requirement for joint governance
- Appointee to Board cannot be removed by appointing party; can only be removed by Regulator

New Brunswick “shared risk” model

- NB SRP model has created significant controversy, and has both supporters and detractors
  - Accrued benefits altered
  - Constitutional challenges
    - Section 15 - Equality
    - Section 7 – Life, Liberty and Security of the Person
    - Section 2(d) – Freedom of Association
    - Property rights?

An aside on “expropriation”

“In short, the Legislature within its jurisdiction can do everything that is not naturally impossible, and is restrained by no rule human or divine ... The prohibition "Thou shalt not steal," has no legal force upon the sovereign body. And there would be no necessity for compensation to be given.”

-*Florence Mining Co. v. Cobalt Lake Mining Co.,* (1909), 18 O.L.R. 275, [1909] O.J. No. 196 (C.A.), at p. 279 O.L.R., per Riddell J.

NB SRP's and Collective Bargaining

Public Service Labour Relations Act

63(2)No collective agreement shall provide, directly or indirectly, for the alteration or elimination of any existing term or condition of employment or the establishment of any new term or condition of employment,

(a) the alteration or elimination of which or the establishment of which, as the case may be, would require or have the effect of requiring the enactment or amendment of any legislation by the Legislature, except for the purpose of appropriating money required for its implementation,

(a.1) that has been or may be established by the pension plan converted to a shared risk plan in accordance with An Act Respecting Public Service Pensions,

Federal TB Plans: Bill C-27

- Bill C-27 – new TB rules
  - Federal legislation follows Alberta, British Columbia (Ontario process still underway)
  - Introduced October 19, 2016
  - Reflects federal view
    - DB (private sector) requires solvency funding because benefits “guaranteed”
    - TB that do not guarantee benefits need not provide guaranteed funding

Federal TB Plans: Bill C-27

- Bill C-27 – new TB rules
  - PBSA amendments only
  - No draft PBSA Regulations
  - No *Income Tax Act* (Canada) amendments
  - Clearly patterned on New Brunswick (Shared Risk Plan) approach – some differences

Federal TB Plans: Bill C-27

- Key TB Question
  - How to reconcile funding with level of benefits
  - In principle, for the same level of funding, a plan can provide either
    - Higher benefits, with less security (i.e. greater chance of future reduction), or
    - Lower benefits, with higher security (i.e. lower chance of future reduction)

Federal TB Plans: Bill C-27

- Traditional TB answers to key issues:
  - Traditionally, TB MEPPS have answered these questions as follows:
    - The trade-off is made by the plan administrator (joint administration), within going concern funding parameters
    - In the event of a funding shortfall, the collective bargaining parties may increase plan funding
    - Failing an increase in funding through the collective bargaining process, the plan administrator may reduce benefits (future or accrued) to resolve a shortfall

Federal TB Plans: Bill C-27

- Bill C-27 – new TB rules
  - Different approach from traditional TB – close to NB 'shared risk'
    - Joint administration not required
    - Qualifications of trustees may be prescribed
    - Level of benefit security to be expressed, in advance, in a Funding Policy (stochastic modelling)
    - Contribution levels set out in Funding Policy
    - Benefit reduction triggers specified, in advance, in a Funding Policy

Federal TB Plans: Bill C-27

- Bill C-27 – new TB rules
  - Actual TB funding requirements not specified in C-27
  - Benefit security objectives to be specified in Funding Policy, perhaps controlled by Regulation
  - Compare New Brunswick – where “primary” and “secondary” risk management objectives are specified in Regulation

Federal TB Plans: Bill C-27

- Bill C-27 – new TB rules
  - C-27 proposes to regulate TB plans largely by regulating the content of two mandatory policies
    - Funding Policy
    - Governance Policy
  - Mandatory elements of both policies to be prescribed by Regulation

Federal TB Plans: Bill C-27

- Bill C-27 – new TB rules
  - Funding Policy
  - Initial and current benefit formulae
  - Contributions
  - Benefit security objectives
    - Must be assessed through initial and periodic actuarial modelling
    - Cannot be amended
  - Deficit recovery and surplus utilization

Federal TB Plans: Bill C-27

- Bill C-27 – new TB rules
  - Governance Policy
  - Joint governance not required
    - At least one person chosen by active members
    - At least one person chosen by survivors under the TB plan and at least one person chosen by survivors of transferees “where numbers warrant”
  - Regulations may contain additional prescriptions re composition, qualifications, etc.

Federal TB Plans: Bill C-27

- Bill C-27 – conversion rules
  - Conversion from DB to TB
    - Historically, no conversion from DB to TB
    - Permitted in NB without consent, expropriation of earned entitlements
    - C-27 permits conversion, with consent
      - Requires consent from each active, former member and other beneficiaries
      - Trade union may give consent for active members, if authorized
      - Disclosure requirements, focused on new TB plan
    - Why would any member/retiree consent?
      - Insolvency, lockout, buyout, misleading threats/promises?

Federal TB Plans: Bill C-27

- Bill C-27
  - Conversion from DB to TB
    - Mechanism is transfer of consenting member from DB plan to TB plan
    - Asset transfer from DB to TB plan, prescribed amount
    - Some successorship rules
      - Prior employment in DB counted toward TB plan
      - Five year DB guarantee if wind-up of TB plan

Solvency Review (Ontario)

- Ontario discussion paper released July 2016
  - Background
    - Solvency funding provides partial protection – not all benefits covered, no wind-up expenses, 5 year amortization
    - Three rounds of temporary solvency relief
    - Special relief for the broader public sector (“BPS”)
    - MEPPs and JSPPs have temporary and permanent solvency relief
- Ontario seeks a more unified approach

Solvency Review (Ontario)

- Underlying forces
  - Continued low interest rates
    - Beyond a “temporary timeframe”
    - Lower for longer expectation: opportunistic or realistic?
  - Competitive pressures
    - Especially vis-à-vis Quebec, US border states

Solvency Review (Ontario)

- Political dynamics
  - Many DB plans in the private sector have been closed to new entrants, or converted to DC plans
  - Many remaining DB plans are in the public or broader public sectors (different rules)
  - This implies that solvency funding, which is concerned with past service liabilities, may be a predominantly retiree issue
  - Retirees can be a powerful political force, especially a pre-election year

Solvency Review (Ontario)

- Ontario proposes two broad avenues for change
  - Approach A - Modified Solvency Funding
  - Approach B - Eliminate solvency funding, enhance going concern funding rules
- The Discussion Paper raises a number of techniques under both approaches

Solvency Review (Ontario)

- Labour (OFL) position
  - Common position, supported by all OFL affiliates
  - Three key points
    - One size does not fit all – different rules necessary for private, public and jointly sponsored plans
    - No solvency relief without union or member consent
    - Any decrease in benefit security resulting from solvency funding changes should be offset by an improvement in Pension Benefits Guarantee Fund coverage

Solvency Review (Ontario)

- Other stakeholder positions
  - Generally, employers support a Quebec style going concern funding enhancement and the elimination of solvency funding
  - Ontario's JSPPs do not want any changes to their status quo funding arrangements, i.e. no solvency funding and status quo going concern funding rules
    - Apprehensive that any changes to going concern funding rules could affect them
  - BPS employers seeking their own track under Regulation 178/11, i.e. solvency funding to reduced targets

Solvency Review (Ontario)

- Approach A – Modified Solvency Funding
- Examples
  - Use average solvency ratios rather than current ratios
  - Lengthen amortization periods
  - Consolidation of solvency deficiencies (i.e. rolling or “fresh start” funding)
  - Fund a percentage of the solvency liability
  - Solvency funding for certain benefits only
  - Solvency reserve accounts
  - Letters of credit (above 15% of solvency liabilities)

Solvency Review (Ontario)

- Approach B – No Solvency Funding, Strengthen Going Concern Funding
  - Examples
    - Require a provision for adverse deviation (PfAD)
    - Shorten amortization period
    - Restrict interest rate assumption
    - Use solvency ratio as a trigger for enhanced going concern funding
    - Enhance the PBGF

Solvency Review (Ontario)

- Other considerations
  - Annual valuation reports
  - Mandatory governance and funding policies
  - Modified commuted value payments
  - Restrictions on contribution holidays and benefit improvements
  - Administrative discharge for annuity buyouts
  - PBGF enhancement

Conversions, Mergers and Transfers: Case Study – Ontario BPS

- Sections 80.4 and 81.0.1 of PBA
- Amendments to the PBA permit a broader public sector employer-sponsored single employer pension plan (SEPP) to either transfer or merge into a new or an existing jointly sponsored pension plan (JSPP) (section 80.4), or convert to a JSPP (section 81.0.1), if specified conditions are met.

Conversions, Mergers and Transfers: Case Study – Ontario BPS

- Section 80.4 of the PBA governs a conversion that is implemented through a transfer of assets and liabilities from the SEPP to another pension plan that is a JSPP.
- Section 81.0.1 of the PBA governs a conversion that is implemented through an amendment to the SEPP itself, converting it into a JSPP and will be referred to as a conversion.

Conversions, Mergers and Transfers: Case Study – Ontario BPS

- Ontario JSPP characteristics:
  - provides defined benefits;
  - jointly funded (members max cont. of 50%);
  - is jointly governed;
  - permits reductions on wind up;
  - may opt out of grow-in provisions;
  - not covered under the PBGF

Conversions, Mergers and Transfers: Case Study – Ontario BPS

- Administrator of the SEPP must provide notice to members, former members, retired members and other persons entitled to benefits under the SEPP, to any trade union that represents members of the SEPP and, to the Superintendent.
- The notice content requirements are set out in the PBA and Regulation 311/15 and include information about the benefits provided under the SEPP, information about the benefits to be provided under the JSPP and the nature of a JSPP.

Conversions, Mergers and Transfers: Case Study – Ontario BPS

- PBA requires that at least two-thirds of the members of the SEPP give their consent and, no more than one-third of the retired members, former members and other plan beneficiaries under the SEPP, as a group, object.
- Any consent given by a trade union that represents a member or members is counted as that member's or those members' consents.
- Superintendent must provide consent prior to merger, transfer or conversion – reqs for consent come in PBA and Regs

Conversions, Mergers and Transfers: Case Study – Ontario BPS

- PBA requires that at least two-thirds of the members of the SEPP give their consent and, no more than one-third of the retired members, former members and other plan beneficiaries under the SEPP, as a group, object.
- Any consent given by a trade union that represents a member or members is counted as that member's or those members' consents.
- Superintendent must provide consent prior to merger, transfer or conversion – reqs for consent come in PBA and Regs

Conversions, Mergers and Transfers: Case Study – Ontario BPS

Statutory criteria for Superintendent's consent

(13) The Superintendent shall consent to the transfer of assets in accordance with the application if all of the following criteria, and such other criteria as may be prescribed, are satisfied:

1. Notice of the application for the Superintendent's consent has been given in accordance with this section to the members, former members, retired members and other persons entitled to benefits under the single employer pension plan and to any trade union that represents members of the plan.

2. The employer of the single employer pension plan and the sponsors of the jointly sponsored pension plan have entered into an agreement with respect to the proposed transfer of assets.

3. Notice of the proposed conversion of the pension plan and transfer of assets has been given in accordance with this section to the members, former members, retired members and other persons entitled to benefits under the plan, to any trade union that represents members of the plan and to the Superintendent.

4. Consent to the proposed conversion and transfer of assets has been given or is deemed to have been given, in accordance with this section, by the members, former members, retired members and other persons entitled to benefits under the plan.

Conversions, Mergers and Transfers: Case Study – Ontario BPS

Statutory Criteria for Superintendent's Consent

5. As of the effective date of the transfer, the employer is a participating employer under the jointly sponsored pension plan.

6. As of the effective date of the transfer, the transferred members and other transferees cease to be entitled to benefits under the single employer pension plan and they are entitled to benefits under the jointly sponsored pension plan.

7. As of the effective date of the transfer, the commuted value of the pension benefits provided under the jointly sponsored pension plan for the transferred members is not less than the commuted value of their pension benefits under the single employer pension plan.

8. As of the effective date of the transfer, the pension benefits provided under the jointly sponsored pension plan for the other transferees are, at a minimum, the same as the pension benefits provided for them under the single employer pension plan.

9. As of the effective date of the transfer, every transferred member is entitled to credit in the jointly sponsored pension plan for the period of his or her membership in the single employer pension plan for the purpose of determining eligibility for membership in, or entitlement to benefits under, the jointly sponsored pension plan. 2014, c. 7, Sched. 26, s. 12.

Conversions, Mergers and Transfers: Case Study – Ontario BPS

Continuing obligation of employer for pre-conversion benefits on wind up

- If the JSPP is subsequently wound up, benefits may be reduced
- In such a circumstance, the legislation requires the employer of the SEPP, who had transferred assets under section 80.4 of the PBA to the JSPP, to pay the amount of the shortfall related to the benefits that were credited under the
- Similarly, the employer who had converted the SEPP into the JSPP pursuant to section 81.0.1 of the PBA, is required to pay the amount of the shortfall related to those pre-conversion benefits into the pension fund (subsection 75.1(1.2) of the PBA) for the benefit of the members, retired members, former members and other persons entitled to benefits under the SEPP before the conversion. The amount of shortfall is prescribed under section 29.2 of Regulation 909.