Pension Update

Target Benefit Plans and Annuities for Federally Regulated Enterprises

Last month the federal government introduced Bill C-27, which proposes to amend the Pension Benefits Standard Act, 1985 (PBSA). If passed, the Bill would give federally regulated employers two new rights. First, it would allow the establishment of single-employer and multi-employer target benefit plans. Second, it would allow employers to purchase annuities as a full discharge of the plan's liabilities. Bill C-27 applies to roughly 12,000 federally regulated enterprises comprising 820,000 employees in federally regulated industries — transportation, banking, broadcasting and telecommunications. The Bill does not apply to the federal civil service; the armed forces, nor provincially registered plans.

Target Benefit Plan Proposal

Target benefit plans allow for fixed or capped contributions to a targeted "defined benefit type" pension formula. The key difference from a normal defined benefit pension plan is, in the event of a funding deficit, benefits can be reduced both prospectively and for accrued benefits. Target benefit plans are not a new concept. They have existed for many years in the form of negotiated contribution Multi-Employer Pension Plans (MEPPs). MEPPs are very popular in certain industries, often where a union or association is present. A union or industry association ties the employees of various employers together, allowing for one organization or group of trustees to act as administrator for a pension plan, where the individual employers may be unable or unwilling to setup a pension plan by themselves. While the actual situation is complex, suffice it to say, unlike a single employer defined benefit pension plan, a MEPP cannot rely on an employer to backstop a funding deficit, therefore reducing benefits is often the only option if the deficit is severe.

Bill C-27 is important mainly because it gives single employers the option to setup a target benefit plan where they will not face the downside funding risks of a defined benefit plan. For a variety of reasons, defined benefit plans have faced major sustainability issues. They have faced a significant decline in the private sector, most notably due to the escalation of liabilities due to declining interest rates. Target benefit plans may give employers a viable alternative to defined contribution pension plans. Bill C-27 does not allow for plan sponsors to unilaterally convert existing defined benefit plans to target benefit plans. Only new target benefit plans can be created if the Bill is passed.

Annuity Buy Outs to Provide Full Discharge of Plan Sponsor Obligations

A plan sponsor can pay an insurance company to take over some or all of its defined benefit pension obligations owed to plan beneficiaries by purchasing annuities. This is called an annuity buy-out. This transfers many risks to the insurance company, including investment and longevity risk. However, plan administrators retain ultimate responsibility in the event the insurer becomes insolvent unless the annuities are purchased during a plan wind up. This makes buy-out annuities less attractive to plan sponsors who are looking for unconditional release from liability. Bill C-27 proposes to remove this responsibility from plan sponsors who opt for an annuity buy-out if certain conditions are met.

Annuity buy-outs could provide greater protection for plan beneficiaries. Capital requirements are stricter for insurance companies than pension plans. Also, annuity insurance, through Assuris, provides specified levels of protection against loss of benefits due to the bankruptcy of a member Canadian insurance company.

Various details are still to be determined, however highlights of the current details can be found here.

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