Intelligence MEMOS

From: Jason Vary

To: Pension Policy Watchers

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Re: **Bill C-228: The Four-Year Countdown Starts Now**

Well, despite all the doomsaying about unintended consequences, Bill C-228 the *Pension Protection Act* is now law. It received royal assent on April 27 and a four -year transition clock is now ticking.

**Quick Refresher**

The new act amends the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* to ensure that claims in respect of unfunded liabilities or pension plan solvency deficiencies are given priority in bankruptcy proceedings.

You can find more background on super-priority for pension deficits in cases of employer insolvency here and here. Today I focus on the way forward.

**It's Not Four Years for Everyone**

While it's generally reported that this new *Pension Protection Act* won't take effect for four years, that's not quite true. The four-year transition period only applies to defined benefit (DB) plans that existed before April 27. The new law is fully effective for any new DB pension plans established after April 26, which is possible, but unlikely these days. The best example is when a company spins off a division and the new entity sets up a new plan that mirrors existing pension benefits. This is now a new factor for firms to consider when negotiating their next merger and acquisition transaction.

In addition, loan agreements typically have long-term durations. Banks and other lenders will respond promptly by adjusting their underwriting processes and introducing new covenants for borrowers regarding their DB plans. Borrowing costs may increase, say industry experts, and borrowers may be required to maintain full DB plan funding at all times.

**Can We Finally Kill the PBGF?**

At Actuarial Solutions, we've written about the Ontario Pension Benefits Guarantee Fund (PBGF) many times before and generally we consider it a bad idea.

The new law will increase security for DB beneficiaries, reducing the need for PBGF protections. So perhaps there is at least one silver lining? One hopes the Ontario government will revisit the cost-effectiveness of maintaining the PBGF.

**More Than You Bargained For?**

One peculiarity in the new law its granting of super-priority to the greater of the going-concern unfunded liability or the solvency deficiency. This makes no sense given its stated goal of protecting plan member benefits in cases of bankruptcy and plan termination. The only requirement should be to fully fund any solvency deficiency. In bankruptcy, the employer and the pension plan are no longer a going concern, so funding the plan on a going-concern basis could provide an unfair windfall to plan members that is inconsistent with the purposes of this new law.

**What About Quasi-DB Pension Plans?**

Some legal experts have raised concerns regarding the applicability of the new law to various pension plan types. It makes no sense to impose these new regulations on quasi-DB pension plans, where the employer obligation is limited to a negotiated or prescribed contribution. Examples of such plans include Multi-Employer Pension Plans (MEPPs), Target Benefit Plans (TBPs), and Jointly-Sponsored Pension Plans (JSPPs). It would be a real shock if employers in these plans were held responsible for funding shortfalls in case of insolvency.

Legislators have said that this is not the intention and that the law will only apply to employers legally responsible to backstop their pension plan. Nowhere, however, is this said in the law as written. Unless the regulations – presumably forthcoming – clearly address this issue, the courts may have to provide the final answer as is so often the case in pension plan matters.

**What Now?**

As previously noted, several unresolved issues linger. Many will be answered, one hopes, in the regulations. In particular, they should explicitly exempt MEPPs, TBPs, JSPPs, and similar plans from these rules, and clarify the "greater of" issue.

Fortunately, most DB plans remain adequately funded. But many employers will be considering de-risking them in face of the new act, to reassure lenders that significant shortfalls are unlikely. Regrettably, the ultimate in de-risking is plan wind-up. This is already a trend, and I would not be surprised to see it accelerate.

Companies that rely on loans to operate will feel the impact of the new rules on borrowing costs. It is easy for foresee a further decline in DB pensions and a rise in the DC pensions that transfer investment and mortality risks to employees. But it's not necessary to choose between DB or DC plans. There are alternatives that offer the best of both worlds. MEPPs, TBPs, and JSPPs are gaining popularity among employers and employees as they provide a reasonable compromise between benefit security and risk-sharing.

**Whiplash**

Employers offering DB pension benefits may feel whiplash from the constant pendulum swings between good news and bad. Just when we thought provincial funding reform was going to slow the decline of private-sector DB plans in Canada, Ottawa throws a wrench into the mix with C-228.

Well, hang on tight – the next four years should be really interesting this all shakes out.

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