How Bill C-228's protection of DB pension plans affects financial planning

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Canadians who are members of a defined-benefit (DB) pension plan now have extra protection thanks to the passage of Bill C-228, which received royal assent on April 27. The legislation extends "super-priority" to the unfunded pension liability of federally or provincially registered DB pensions, making it more likely pensioners will receive their full pensions if their employer becomes insolvent.

Members of DB pension plans will have a better chance of receiving about the full value of their plans in an insolvency because this legislation puts pension liabilities ahead of secured and unsecured creditors. However, some critics have warned it will make it more costly and thus less attractive for employers to maintain their current DB pension plans. That makes it more important for Canadians to have a well-diversified retirement income plan, some advisors say.

Alex Skoke, senior financial planning advisor with Assante Capital Management Ltd. in Stellarton, N.S., worked with two clients who saw their DB income stream reduced by 30 per cent after Sears Canada Inc. filed for court protection in June 2017. In January 2020, several more clients with DB plans faced similar uncertainty surrounding their "guaranteed" pension income when Northern Pulp Nova Scotia Corp. closed its mill in Pictou County, N.S.

"This legislation is a step in the right direction for the employee," Mr. Skoke says. "There's no question that this stream of income that was guaranteed when you went to work for this company, as part of your benefits package, must be firmed up."

If a DB pension plan is going to be offered, then it has to have more staying power and ability to pay out for the length of that person's life, he says. If not, it shouldn't be offered.

With the perspective that comes from 25 years in the business, Mr. Skoke believes risks associated with private-sector DB plans are growing. That makes it more important than ever to encourage clients with these plans to build up personal savings alongside employer pensions and government sources of retirement income.

Mr. Skoke also carefully considers whether it makes sense to take the commuted value of a DB pension – an approach that provides protection from the possibility of employer insolvency, but that also introduces market risk.

The specifics of his advice depend on each household's situation, but he always aims for diversified streams of income in retirement.

“When there is one income earner, one DB plan, no personal savings, that’s when all the risk is in one pool or stream of income that you’re counting on,” he says. “[I’m] very nervous about that as a [financial] planner.”

Keeping an eye on funding ratio

Joelle Hall, wealth advisor, portfolio manager and investment advisor with Hall O’Brien Wealth Counsel at Richardson Wealth Ltd. in Ottawa, works with many clients who have public-sector DB plans, which are more secure than private sector plans simply because governments can, in theory, raise taxes to fund liabilities.

With private-sector DB plans, she keeps a very close eye on the funding ratio, especially as clients approach the cut-off age (usually 55) for commuting a pension.

“There are several factors that go into that commuting decision, but we’d certainly start with how well-funded the plan is, and with anything less than 90 per cent funded, I get a little nervous,” she says.

Ms. Hall worked with clients who had DB plans through Nortel Networks Corp., which filed for bankruptcy protection in January 2009.

“There’s a pittance that they’ve received in cash payments, and we’ve had to look at their financial goals and what other sources of capital they have, and [work out if] any adjustments have to be made to their expectations of lifestyle going into retirement,” she says.

Watching the Nortel story play out is one reason Ms. Hall looks carefully at the proportion of retirement income each pension plan will provide. In her experience, few clients these days spend their entire careers with one private-sector employer. That means anyone DB pension plan doesn’t represent as big a risk within their retirement income plan.

Ms. Hall also runs modelling to stress test retirement income – for example – calculating the impact of 70 per cent income from a DB plan that only lasts 10 years. Then, she considers how the client might be able to make up the cash flow. With today’s higher interest rates, she might consider an annuity to provide additional guaranteed income.

She doesn’t see Bill C-228 changing her approach because even if pensions are closer to the front of the line to get paid following a company’s insolvency, “100 percent of zero is still zero.” She would like to see more stringent requirements around pension funding. For example, not allowing funding holidays just because markets have risen.

Diversify retirement savings

Nadine Aouad, vice-president of financial planning at RBC Dominion Securities Inc. in Montreal, points out that a different type of protection is already available for DB pensioners in Ontario. That province’s Pension Benefits Guarantee Fund tops up what the pension plan can provide to guarantee the first $1,500 in monthly benefits.

Despite this and the fact a DB plan is just one component of most clients' retirement income, she emphasizes that "it's important to consider the risk and potential impact of an employer's bankruptcy on the defined-benefit plan, [and] it's really important for advisors to encourage clients to diversify their retirement savings and look at other types of retirement accounts to supplement pension income."

When it comes to Bill C-228, Ms. Aouad says it won't alter the way her team approaches retirement plans. What's most important, she says, is to have a comprehensive financial plan and to revisit that plan regularly.

"Having a financial plan in place is key to ensure financial flexibility at retirement and really understand where the different sources of retirement income are coming from," she adds.