ven as regulators move to expand decumulation options for Canadians in defined contribution pension plans, the degree to which employers will actually adopt the solutions available, including variable benefits, remains an open question.

Various factors fuel the conundrum, but exposure to liability and litigation risk loom as perhaps the most daunting obstacles. Proponents of safe harbour provisions tout them as a way to ameliorate the risks and get more employers to buy into internal decumulation options. But just what employers would like to see in such provisions isn’t clear.

What is clear is that maintaining a post-employment relationship with retirees is counterintuitive for many employers.

“Employers see themselves as businesses, not pension providers,” says Jordan Fremont, who practises pension law in the Toronto office of Hicks Morley Hamilton Stewart Storie LLP. “Once the employees are no longer with the company, they’re no longer supporting the business.”

While it’s true that employers maintain a relationship with former employees in the defined benefit context, there are signs that they do so reluctantly.

“Private employers in Canada are not exactly willing to continue with DB, in part because of past service obligations related to retirees,” says Roman Kosarenko, the Toronto-based director of pension investments for George Weston Ltd.

“They are closing and freezing DB plans. Those who still have DB can’t extricate themselves because of scale, labour relations or the inability to focus on a long-term strategy.”

And proponents of decumulation solutions like variable benefits say pensioners could benefit from having funds paid directly from their employers’ defined contribution plan. Pensioners would have broader investment choices, investment fees would likely be lower than those payable if they transferred their balance to a personal savings vehicle and they would likely benefit from the investment expertise associated with an existing plan.

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Skeptics, however, point out that internal decumulation options prolong pension management, keep fiduciary duties alive and raise the possibility of liability to pensioners after they leave employment.

For example, a plan administrator that errs in calculating the minimum and maximum amounts of variable benefits that a pensioner can withdraw could incur liability that exists only because the option for variable benefits is available.

“In the case of DCs, unlike DBs, the relationship between the employer and the employee generally ends at the point of retirement, so from employers’ point of view, extending the relationship with a retiring employee for another 20 years is definitely a risk,” says Kosarenko.

“Not only would the balance of responsibilities be with the employer, the technological and operational resources relevant to that relationship are mostly with the employer as well. So when the relationship goes sour for some reason, litigation becomes a real risk.”

Arguably, then, a key step in having employers embrace variable benefits and other decumulation options is to reduce their exposure.

“The question becomes: How can assurances be provided to employers who are concerned about decumulation risk?” says Fremont.

Breaking down safe harbour

Safe harbour provisions, Fremont suggests, could help alleviate employers’ concerns and break down the barriers to adopting internal decumulation options. Other observers go so far as to say safe harbour provisions could be game-changers in promoting such arrangements.

At their core, safe harbour provisions, which arise most frequently in the investment context, prevent pensioners from complaining about plan sponsors’ investment decisions so long as they follow the rules. But not everyone agrees on how to articulate the rules.

“Safe harbour is a regulatory concept most applicable to the U.S., where ERISA [the Employee Retirement Income Security Act] legislates many aspects of the open-ended fiduciary duty relevant to common law countries, such as Canada,” says Kosarenko.

“To the best of my knowledge, there is no safe harbour protection in Canada in that narrow sense, whether for DB, DC or any other retirement saving structure.”

In Canada, the closest thing to safe harbour arises in s. 8 of the federal Pension Benefits Standards Act. The legislation deems an administrator to have complied with its standard of care, with respect to pension investments, where it offers investment options of varying degrees of risk and expected returns that would allow a reasonable and prudent person to create a portfolio of investments adapted to their retirement needs.

While the [federal act] doesn’t use the term safe harbour, the legislation is, in fact, about managing risks and returns in plans that offer investment choices,” says Fremont. “The problem is that the legislation doesn’t address other aspects of an administrator’s responsibilities, including giving advice, disclosure, education and other issues.”

It’s also worth noting that the Pension Benefits Standards Act doesn’t use the words “safe harbor,” and the extent to which the current provision actually protects plan administrators and sponsors hasn’t yet been tested.

What legal protections would DC plan sponsors like to see to support decumulation offerings?
Prescriptive versus descriptive

However that may be, what’s certain is that the Canadian legislation’s approach to safe harbour differs markedly from the one taken by U.S. legislation and in other jurisdictions where the [Canadian legislation] is much more principle-based and descriptive,” says Steele.

“ERISA has a very comprehensive and prescriptive approach, while the [Canadian legislation] is much more principle-based and descriptive,” says Steele.

“But the results are the same, in the sense that administrators who meet the statutory tests are deemed to have complied with the prudent-person standard.”

Still, the prescriptive approach can have its advantages. “It’s a case of ticking off the boxes in ERISA, which facilitates compliance and adds certainty,” says Steele, who argues that a principle-based approach smack of redundancy in Canada, where the prudent-person test prevails in the absence of legislation.

“If you’re already complying with the standards that exist with regard to investment and governance, do you really need a safe harbour?” she asks.

On the other hand, critics of the prescriptive approach question whether the U.S. law has resulted in less liability or litigation over defined contribution plans compared to the Canadian experience. They also argue that fiduciary innovation, fail to provide absolute and clear immunity from liability and can be confusing and costly to implement.

Kosarenko believes safe harbour regulations wouldn’t be effective in Canada.

“People who ask for safe harbour don’t understand the meaning of trust and fiduciary obligations,” he says. “Where safe harbour might apply, it would apply to specific risks and would never cover the totality of the risks faced by an employer who considers setting up a decumulation scheme.”

Indeed, a recent survey conducted by Alight Solutions found a significant number of U.S. plan sponsors cited fiduciary concerns as a barrier to developing in-plan retirement income solutions, such as annuities, despite the existence of a safe harbour rule related to the selection of an annuity provider. According to the survey, 82 per cent of those not intending to add in-plan annuities or other listed fiduciary concerns as a reason for not doing so.

At the same time, only 20 per cent of plan sponsors surveyed offered in-plan annuity or insurance products as part of the fund lineup.

The need to harmonize

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“To be sure, harmonization — if it’s at all achievable — seems a long way off. After all, decumulation options, such as variable benefits, are still not available in some jurisdictions.

For example, although the Income Tax Act has allowed defined contribution plans to pay variable benefits directly from a defined contribution plan, Ontario has yet to finalize the amendments.

Because variable benefit provisions aren’t universally in place, multifiduciary employers may be reluctant to adopt something that’s available only to some of their employees. And even among provinces that allow variable benefits, the rules differ, which creates complexities that challenge administrators and make them all the more reluctant to offer the option.

With those jurisdictional concerns in mind, Fremont believes a principle-based approach to governance, similar to the one taken by the Canadian Association of Pension Supervisory Authorities, is generally the better way to deal with decumulation than carving out rules for specific activities.

Other solutions

As it turns out, safe harbour isn’t the only way of mitigating risk concerns.

In its 2017 study on decumulation, the Association of Canadian Pension Plans and the Canadian Retirement Income Federation surveyed plan sponsors about diligence that has succeeded in the past,” the report stated.

In Canada, the Saskatchewan Pension Plan has, since 1986, offered retirement savings options to the general public and small employers. The plan features limited choice, low costs, external decumulation options and independent governance.

It’s unlikely that anyone would refer to such alternatives as safe harbour provisions in the strict sense. But in truth, many of the jurisdictions that feature so-called safe harbour provisions in their defined contribution regimes in fact offer what substantively amounts to prescribed alternatives that allow employers to avoid or diminish fiduciary obligations.

For his part, Kosarenko advocates the creation of a template or a precedent.

“The best possible protection would be an industry-sponsored or even government-sponsored decumulation structure that operates as an open book and can be copied by private employers,” he says.

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