BFL CANADA

BFL MAKES A DIFFERENCE

The Cover Note

FALL 2013 - Volume 6 Issue 3

EDITORIAL

Barry F. Lorenzetti

The recent floods in Alberta and Toronto are a reminder that nature has many surprises in store for us.

Over the past 15 years, in my mind, we seem to have experienced "freak" natural events at a higher frequency than in the past. I will never forget the 1998 ice storm obviously, and remember the devastation in the Richelieu area in Quebec in 2011 or the flooding in the Okanagan Valley last spring. Just as was the case in Toronto, violent summer thunderstorms with flash flooding are causing damage in neighborhoods in many areas. And we are not the only ones, Europe, Australia and Asia have experienced flooding on a massive scale this year. I read recently that, globally, close to 50% of all losses were related to flooding.

Truth is, our environment is changing and we need to adapt to be able to rebound from natural disasters. The elephant in the room, climate change, is surely playing a big role in natural catastrophes, but since the Alberta situation, a conversation has been initiated in Canada that involves many other factors.

Infrastructure built to handle "normal" thunderstorms in 1950, is not adequate for today's severe occurrences, and the ever increasing presence of pavement resulting from land development has greatly diminished our environment's ability to absorb the huge quantities of water nature channels to our cities. Authorities giving license to development in flood prone areas and outdated flood maps are also cited as contributing factors. In addition, crisis/emergency management, disaster recovery planning and risk control are on the minds of many public officials.

I am not an expert in any of those fields, but what I know is overland flood insurance is not adequate in Canada and disasters such has Alberta as just gone through, and is still recovering from, result in crippling economic losses for both families and businesses. Although governmental programs bring some relief to the victims, they generally represent "a drop in the bucket" (we are talking about flooding after all!).

If you put yourself in the shoes of members of a family with financial goals, projects and dreams, who see all their objectives and plans literally washed away or, of an entrepreneur trying to build a company and having to let go his few employees and fold, you will know for sure that something needs to be done about overland flood insurance in this country. A discussion has begun and we should all take part in it. Your region could be next; as I mentioned above, nature has a way of surprising us all.

In this issue, our main article, written by Tom DeCoteau from our Vancouver office, discusses fiduciary insurance in cases of conversion from defined benefit to defined contribution pension plans (another hot topic in Canada) and David Vanasse, President of BFL CANADA Consulting Services Inc., brings us up to date with respect to the status of Pooled Registered Pension plans in the various Canadian jurisdictions. ♦

In this issue

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DEFINED BENEFIT (DB) PLANS vs DEFINED CONTRIBUTION (DC)

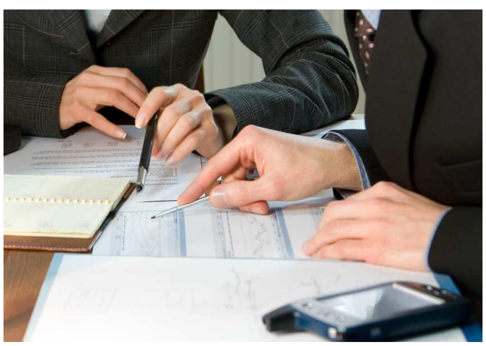
Tom DeCoteau, Vice President, BFL CANADA Insurance Services Inc., Vancouver

DB plans are based on the traditional "pension" plan model in which participants and their employers contribute and where the employee participants bear no risk whatsoever on the investment performance of the plan. This is a huge advantage for employees, however, traditional DB plans cannot be rolled into the plan of a new employer and often are not payable as a lump sum upon termination.

On the other hand, DC plan employee participants contribute to their retirement plan and the employer may also contribute to the plan, subject to match limitations. Typically, the participant is able to direct the investment of the contributions among various investment options offered by the plan, and the participant bears the entire risk of investment performance over time, i.e. there is no guarantee of any benefits at all when that individual leaves the employer, receiving only the assets that have accumulated in his or her account. Unlike DB plans, DC individual account assets are portable in that they can be "rolled" into another employer's plan.

Why are Companies converting from DB to DC?

Most employers with DB plans are looking to contain their pension costs, therefore, many companies are switching to DC plans. However, making such a switch can be complex and does not immediately eliminate the funding obligations associated with the DB pensions already accrued.



And while DC arrangements may yield more predictable funding costs, they nonetheless bring potential risk to plan sponsors. Unlike in the U.S. under its ERISA legislation, most Canadian jurisdictions have no "safe harbour" rules and plan sponsors are subject to fiduciary duties in relation to the administration of the plan, including the selection of investment options.

Despite these complexities and risks, Canadian companies continue to dismantle DB plans even as the economy improves, due to the impact of low interest rates, rendering many plans insolvent. As such, the financial crisis appears to have led to a permanent shift in the attitudes of companies regardless of whether economic conditions improve, or a more sponsor-friendly legislative environment appears.

Risks with Conversion

There are several risks and hidden costs associated with converting from a DB to a DC plan, including, but not limited to, the following:

- Even if a company converts today, it still will be managing that DB plan for another 70 years or so, which means managing two plans;
- Without the employee retention benefits of a DB plan, employees might be more willing to move to a competitor;
- Education costs rise because employees retain the risk of poor investment strategy;
- The onus is on the employer to provide multiple investment options, to explain them and to choose the investment firm – all of these actions are likely to increase litigation;
- Investment management fees may increase, even if the majority of the management fee is being transferred to the employees.

Types of Claims Conversion Might Trigger

The risk of claims under a fiduciary liability policy increases during periods of economic downturn, merger, acquisition or divestiture of companies and winding down of plans (including how deficits are funded or surpluses disbursed).

DB plans carry with them fiduciary conduct exposure, but claims in the context of a DC plan have very different implications. Why? Misconduct by fiduciaries in a DC plan has a direct impact on the very value of a participant's benefits. For instance, if a fiduciary fails to monitor an investment fund in which a participant invests assets, the participant may lose those assets. This is not the case in a DB plan since mismanagement of investments has no immediate impact on a participant's entitlement to a defined benefit. In essence, when a company converts from a DB to a DC plan the organization's entire risk profile as a fiduciary changes with it. The types of claims that often arise when converting from a DB to DC plan include the following:

1. Failure to advise members of plan amendments with reasonable warning;
2. Inaccurate or misleading statements, and even if the error was honest, the allegation will be failure to take appropriate corrective action;

BFL CANADA Risk and Insurance Inc.
45 Westwind Drive
Hammonds Plains, NS B3Z 1K6
Tel: 902-864-4982
Fax: 902-864-0200

2590 Laurier Blvd, Suite TBC 600
Quebec City, QC G1V 4M6
Tel: 418-658-6337
Fax: 418-654-2045

2001 McGill College, Suite 2200
Montreal, QC H3A 1G1
Tel: 514-843-3632
Fax: 514-843-3842

BFL CANADA Risk and Insurance Services Inc.
2685 Queensview Drive, Suite 101
Ottawa, ON K2B 8K2
Tel: 613-722-7798
Fax: 613-722-7829

181 University Avenue, Suite 1605
Toronto, ON M5H 3M7
Tel: 416-599-5530
Fax: 416-599-5458

BFL CANADA Insurance Services Inc.
175 Carlton Street, Suite 205
Winnipeg, MB R3C 3H9
Tel: 204-594-0260
Fax: 204-594-0259

877 Henderson Highway
Winnipeg, MB R2K 2L8
Tel: 204-661-2446
Fax: 204-663-0344

1167 Kensington Crescent NW, Suite 200
Calgary, AB T2N 1X7
Tel: 403-451-4132
Fax: 403-313-3365

5185 South Ridge Drive
Kelowna, BC V1W 4Z4
Tel: 250-575-2327
Fax: 778-477-0011

1177 West Hastings Street, Suite 200
Vancouver, BC V6E 2K3
Tel: 604-669-9600
Fax: 604-683-9316

1-866-688-9888

3. Conflict of interest in investments or investment management choices;
4. Failure to adequately disclose fees and other related costs.

Certainly a breach of fiduciary duty claim with respect to a DB plan will also allege mismanagement and fiduciary miscues. But such lawsuits, if successful, do not directly benefit the plaintiff participant because, irrespective of the mismanagement, the participant remains entitled to receive his or her defined benefit under the plan.

Coverage Considerations When Converting From a DB to DC Plan

Most policy wordings respond to cover those individual persons who are deemed "fiduciaries" for their defense costs, but also the plan sponsor for loss incurred indemnifying the individual persons, as well as the plan itself for asset loss based on the fiduciary's negligence. However, some fiduciary liability policies only cover the personal loss of individual persons, and do not respond to the loss of the sponsor or the plan.

Given the heightened exposure and change of risk profile associated with converting from a DB to a DC plan, selecting adequate limits of liability for an insured is a key consideration. Specifically, insureds should consider the following:

A. The limit of liability is an aggregate limit for each and every claim and each and every insured (including all insured persons, sponsors, plans, and past, present and future fiduciary);
B. Defense and investigation costs can be very expensive due to high costs of actuaries, accountants and lawyers specialized in this unique field – except for Quebec where defense costs are outside the limit;
C. The long duration of investigation, defense and settlement, where the aggregate limit of the policy may be stretched over many years and not "replenished" at the expiry of the policy – (In Quebec defense costs are outside the limit);
D. The heightened likelihood of class action proceedings;
E. The "long-tail" nature of risk based on potential for years between an alleged "wrongful act" and the resulting claim.

All fiduciaries, whether the plan is DB or DC, need to pay attention to a series of risk management issues, and these include:

- Insurance maintained by third party service providers including fund managers;
- Crime/fidelity insurance for the plans;
- Crisis management plans for the sponsor(s) and the plans;
- Access to independent legal, financial, and actuarial advice for the plan managers.

Whatever your company decides, DB or DC, make sure the risks are thoroughly identified! ♦

UPDATE ON THE POOLED REGISTERED PENSION PLAN (PRPP) AND VOLUNTARY RETIREMENT SAVINGS PLAN (VRSP)

David Vanasse, President, BFL CANADA Consulting Services Inc., Montreal

This article is a follow-up to those published in 2012 in which I discussed the pending arrival of a new retirement plan in Canada:

- Voluntary Retirement Savings Plan (VRSP) in Quebec;
- Pooled Registered Pension Plan (PRPP) at the federal level and in the other provinces.

Presented below is the status of the new plan, both on a federal level and for each of the Canadian provinces, as of September 2013:

	Federal	Bill C-25 on pooled registered pension plans (PRPP) has already been adopted.
	British Columbia	The provincial election delayed the adoption of the bill; a new draft bill was tabled on June 6, 2013.
	Alberta	Bill 18 on the Alberta PRPP was tabled in the Legislative Assembly on April 19, 2013, and will come into force upon proclamation (TBA). The target date is January 1, 2015.
	Saskatchewan	Bill 93 regarding the Saskatchewan PRPP was tabled in the Legislative Assembly on April 8, 2013, and will come into force upon proclamation (TBA).
	Ontario	Upon the tabling of the Ontario budget on May 2, 2013, the Minister of Finance announced that the Ontario government would look into introducing a PRPP, officially responding to the Federal Government's call to action. More details to follow.
	Quebec	A new bill was tabled on May 8, 2013, which retained many of the aspects of the initial VRSP. It is expected to take effect on January 1, 2014. The Quebec bill differs from those of the other provinces.
	Nova Scotia	A bill based on the general CPP legislation was tabled by an MLA. However, the Nova Scotia government has not yet indicated whether it will move forward with the introduction of a PRPP.
Other provinces (Manitoba, Newfoundland, New Brunswick and Prince Edward Island)		There has been no news since the 2010 agreement in principle by Finance Ministers to adopt PRPPs in these provinces.

The PRPP/VRSP offers employers and employees essentially the same tax benefits as a traditional retirement savings plan. Generally speaking, its key features are as follows:

- Optional implementation of a PRPP for employers;
- No obligation to implement a PRPP if an employer already offers an accumulation plan;
- No obligation for the employer to contribute;
- Inexpensive plan;
- Automatic enrollment, but withdrawal from the plan is possible.

The VRSP in Quebec includes the following differences:

- ◊ All employers with five employees or more are obliged to offer a VRSP;
- ◊ Default contribution rate for employees.

In short, the PRPP/VRSP could become a powerful investment vehicle if the contributions made reach a high enough level for insurers to offer a reasonably-priced product, but what will actually happen? As an employer, you would do well to analyze all of your options by asking an independent advisor to guide you. We will update you on any PRPP developments in the other provinces as they occur. ♦

BFL CANADA

BFL CANADA Consulting Services Inc.

2590 Laurier Blvd, Suite TBC 600
Quebec City, QC G1V 4M6
Tel: 418-658-6337
Fax: 418-654-2045

3448 Stanley Street
Montreal, QC H3A 1R8
Tel: 514-843-3632
Fax: 514-843-3842

181 University Avenue, Suite 1605
Toronto, ON M5H 3M7
Tel: 416-599-5530
Fax: 416-599-5458

1177 West Hastings Street, Suite 200
Vancouver, BC V6E 2K3
Tel: 604-669-9600
Fax: 604-683-9316

1-866-688-9888

Send comments or suggestions to publications@bflcanada.ca