Restructuring Employee Benefits: Options and Restrictions

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A. INTRODUCTION

Financial pressures often prompt an employer to review the benefits provided to employees and former employees in order to determine whether changes can be made that would decrease the cost of those benefits. Other times an employer will make changes to the benefits it offers in order to attract new employees or to better respond to the demographics of its workforce. This paper explores some of the more common changes employers make in respect of the benefits they offer to active and retired employees and highlights the more significant restrictions on an employer's ability to implement those changes.

There is a long list of benefits an employer can provide to its employees and former employees (as well as their dependents). For the purposes of this paper I will limit my comments to the more significant benefits that flow from the employment relationship:

- benefits provided through a registered pension plan (as opposed to a group RRSP);
- health benefits, meaning MSP, extended health and dental benefits that are provided to *active* employees and their dependents; and
- health benefits, meaning MSP, extended health and dental benefits that are provided to *retired* employees and their dependents.

An employer's ability to make changes to the benefits described above will depend on the answers to the following questions:

- What is the benefit that is being changed?
- Has provision of the benefit been negotiated in a collective agreement?
- Are there statutory rules and restrictions that apply to the provision of the benefit?
- Does the individual have a vested or an accrued right to the benefit?

If you are a family law practitioner, I am hopeful that these materials will give you some helpful information about how pension plans and health benefit plans are created and restructured. If your client or your client's spouse participates in a pension or health benefit plan that undergoes restructuring, this paper is designed to help you identify how that restructuring can affect your client's rights or obligations.

B. RESTRUCTURING PENSION PLAN BENEFITS

1. PRELIMINARY COMMENTS

Before discussing the specific types of changes employers typically seek to make in respect of the pension plans they sponsor, it is important to provide some basic information about how pension plans are structured. There are two types of registered pension plans:

- A **defined benefit pension plan** is one where the *benefit* that will be paid from the plan when a member commences a pension is defined in the text of the plan, and the sponsor has an obligation during the lifetime of the plan to fund the benefits that have been promised. The benefit to be paid upon the member commencing his or her pension is usually expressed in a formula that uses an individual's earnings (either in the last few years of employment, his or her highest earnings or an average over the individuals' career) and the years of service with the employer.

- A **defined contribution pension plan** is one where it is the *contributions* to the plan that are defined or pre-determined, not the benefit payable from the plan. Defined contribution plans resemble group RRSPs because the employer agrees to contribute a certain amount for each employee who participates in the plan, and when the employee commences a pension he or she simply receives the value of the account attributable to him or her in the plan plus investment returns on the amounts contributed.

As the above descriptions illustrate, a defined benefit pension plan sponsored by an employer imposes on the employer an obligation to fund the plan as is necessary in order to pay out the benefits promised. Often this means that an employer has to make special payments designed to address the funding gap that can arise between a plan's assets and its liabilities. These obligations can be extremely onerous and one only needs to review the history of Air Canada and its struggles with its pension obligations to see why an employer may seek to restructure or change the nature of the pension benefit that it has historically provided to its employees.

2. WIND-UP

The most drastic option available to a sponsor of a pension plan is to wind-up the plan and cease providing pension benefits to its employees. If an employer has made a commitment in a collective agreement to maintain and contribute to a pension plan, wind-up will not be an option until the next round of bargaining. Further, a wind-up is prospective. It does not eliminate the promises made up to the effective date of the wind-up (subject to there being a need to cut benefits due to the funded status of the plan and the financial position of the employer). However, if the provision of the pension plan has not been collectively bargained, an employer that sponsors the plan has the authority to decide whether to continue sponsoring that plan.

If a pension plan is wound up at a time that its liabilities (meaning value of the benefits that have accrued to date) exceeds its assets, the employer may be required to contribute additional amounts to "fund up" the plan. If the gap between liabilities and assets is addressed by additional payments from the employer, each member's entitlements will be determined and paid out from the assets in the plan. Members' entitlements will be transferred to another locked-in vehicle, either another registered pension plan or a locked-in RRSP. If the employer is insolvent and unable to "fund-up" the plan, a wind-up of the plan will mean that accrued benefit entitlements will be reduced across the board.

If a client or a client's spouse is a member of a pension plan that is being or has been wound-up, it will be important to know whether the employer that sponsors the plan will fund up any shortfall so that you have a complete understanding of the member's entitlement in the plan. Further, if you are acting for the member's spouse and the member's plan is wound up, you will need to be informed about what will happen to the member's entitlement so that you can claim an entitlement to that family asset the same way you would have claimed an entitlement to a portion of the pension that accrued in the plan had the wind-up not occurred.

3. Conversion

A popular topic among employers that sponsor defined benefit pension plans is the option of converting the plan to a defined contribution pension plan. As noted above, a defined contribution pension plan shifts the risk of poor investment returns to the members themselves, and provides more certainty to the sponsoring employer in respect of its funding obligations. Many employers view a defined contribution pension to be less costly and less risky for an employer because its funding obligation is limited.

Conversion of a pension plan from defined benefit to defined contribution can occur in one of the following ways:

- The employer can wind-up the defined benefit plan, and create a new, defined contribution pension plan to which it will make all contributions as of the conversion date.

- The employer can apply to transfer the assets and liabilities of the defined benefit pension plan to the new, defined contribution pension plan, with post-transfer accruals relating to defined contribution benefits alone.

- The employer can amend the existing defined benefit pension plan to add a defined contribution portion, and then freeze benefit accruals in the defined benefit stream of the plan. That is, after effective date of the conversion, all contributions made to the plan would relate to defined contribution accruals. Some employers may only apply the conversion to employees who join the plan after the conversion date and allow existing employees to continue to accrue on a defined benefit basis despite the conversion.

Some employers may require that all employees participate on a defined contribution basis as of the conversion date.

4. Amendment

Less drastic than a full plan wind-up or a plan conversion is an amendment to the pension plan designed to change the benefit provided through the plan. If the employer sponsors a defined contribution pension plan, the amendment options are limited. The only real amendment option for the sponsor of a defined contribution pension plan is to change the contribution rate, either increasing or decreasing the amount payable by the employer. There are other amendments that can be made such as allowing employees to contribute on their own behalf, but from an employer's perspective, a change to the employer's contribution rate is the only amendment worth noting here.

If the employer sponsors a defined benefit pension plan there is a wider range of available amendments that would have the effect of decreasing the cost of providing the pension benefit. For example:

- The employer could amend the plan to eliminate a bridge benefit;
- The employer could amend the plan to eliminate the provision allowing for an early, unreduced pension;
- The employer could raise the normal pensionable age or the age at which an individual can commence an early, unreduced pension;
- The employer could change the benefit formula, for example, lowering the percentage that will be applied to an individual's earnings and years of service.

5. Restrictions on Pension Plan Restructuring

(a) Restrictions Arising from the Employment Relationship

As noted above, one of the options an employer has if it wants to restructure the pension benefits provided to its employees is to change the actual benefit that is provided through the plan. If the plan is a defined contribution plan, all the employer has to do is change the contribution that it is required to make to the plan per employee.

Whether or not the employer has the option of reducing its contribution rate depends on whether the contribution rate has been collectively bargained, and whether the contribution rate would be considered a term and condition of employment that cannot be amended unilaterally by the employer. In terms of a collectively bargained contribution rate, if the employer has agreed with the union representing the plan members that it will contribute a certain amount per hour worked by each employee, the employer will not be permitted to alter that contribution rate until that rate is renegotiated in the next round of bargaining.

If the members of a defined contribution plan are not unionized, the employer must still consider whether it is permitted to unilaterally change its contribution rate to the pension plan. If an employee is hired on the understanding that his or her employer will contribute a certain amount to the defined contribution plan on behalf of the employee, an employer's decision to reduce that contribution amount might constitute a unilateral change to the terms and conditions of the individual's employment amounting to constructive dismissal.

An employer that sponsors a defined benefit pension plan has a greater number of plan amendment options open to it if it seeks to decrease the go-forward cost of providing the benefit. Again, an employer could amend the benefit formula to provide a less lucrative benefit upon pension commencement, could raise the age at which an individual can commence an unreduced pension or could remove the right to have the pension payments indexed for inflation. However, an employer will still have to consider whether provision of a particular type or level of pension benefit coverage is a term or condition of employment. As noted above, if the particular pension plan being provided can be viewed as being a term or condition of employment, an employer may not be able to unilaterally change that plan without risking a claim that it has constructively dismissed its employees.

(b) Legislative Restrictions on Pension Plan Restructuring

In addition to any employment law issues that might arise, an employer has to contend with the legislative provisions that will apply to a pension plan restructuring. The *Pension Benefits Standards Act*, R.S.B.C. 1996, c. 352 (the "PBSA"), applies to all pension plans registered in British Columbia. How an employer restructures the pension plan will determine which of the PBSA provisions apply. For example, if the employer converts its defined benefit pension plan to a defined contribution pension plan by transferring the assets and liabilities of the former plan to the new defined contribution plan, the various transfer provisions of the PBSA will be engaged.

In terms of amending a pension plan, the most significant restriction in the PBSA is paragraph 59(1)(a) which states:

> An amendment to a pension plan or the adoption of another plan in place of a pension plan must not
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> (a) reduce a person's benefits in respect of employment on or after the initial qualification date and before the effective date of the amendment or the adoption of the other plan, …[1]

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[1] The most significant exception to the rule set out in paragraph 59(1)(a) of the PBSA (that an amendment cannot interfere with vested or accrued rights) is that the administrator of a negotiated cost plan (being a plan where the employer's financial contribution is limited to what the employer is contractually obliged to contribute, such as a pension plan where the employer's contribution rate has been collectively bargained), may reduce benefits with the consent of the regulator.

Paragraph 59(1)(a) prohibits an amendment that interferes with a right to a benefit from the plan if that right has vested in a plan member before the effective date of the amendment. Though easy to state, the effect of paragraph 59(1)(a) is more difficult to apply because it requires an understanding of what is a vested right. Some assistance is provided in subsections 26(1) and (3) of the PBSA:

> (1) If a member completes 2 years of continuous plan membership … and terminates his or her membership while employed in British Columbia, there immediately vests in the member, on that termination, an entitlement to receive a pension in respect of his or her membership in the plan. …
>
> (3) For the purposes of this Act, a benefit vests when the person acquires an unconditional entitlement under the pension plan to receive the benefit, whether at the present time or in the future.

The interaction of paragraph 59(1)(a) and section 26 of the PBSA means that no amendment to a pension plan can interfere with any portion of an individual's pension that has been earned before the effective date of the amendment.

Some amendments clearly violate paragraph 59(1)(a): an employer could not adopt an amendment to the plan that reduces the benefit formula in respect of service already provided by an employee.

Some amendments clearly comply with subsection 59(1)(a): an employer can adopt a plan amendment that reduces the benefit formula in respect of service that will be provided after the effective date of the amendment.

Some amendments are more questionable. For example, can an employer eliminate an early retirement provision for all plan members that have not yet reached the age at which the early retirement was available? What if a plan member is one day away from qualifying for an early, unreduced pension? Does the fact that he or she has not satisfied every condition to retire early with an unreduced pension mean that he or she does not have a vested right to that provision? Many pension commentators say the answer is yes, that a plan member only has an accrued or vested right to an early retirement provision, as of the effective date of the amendment, if the member has reached the age at which he or she can take advantage of that provision. The concern with this rationale is that it relies on a fairly simplistic notion of vesting, that unless a member has satisfied every single condition for a benefit entitlement at the time of the amendment changing that benefit entitlement, it is not a vested right.

This reasoning is problematic because it ignores the fact that the PBSA expressly contemplates that an individual can have a vested right even if he or she cannot exercise that right until some time in the future (see subsection 26(3) of the PBSA). As noted above, section 26 of the PBSA gives a member the right to a pension after 2 years of continuous plan membership. A member could be 25 years old when his or her right to a pension vests even though he or she cannot commence a pension until satisfying other conditions, namely reaching the age at which a pension can commence. However, it is clear that the 25 year old has a vested right to the pension and no amendment could interfere with that right.

While a full discussion of vested and accrued rights is beyond the scope of this paper, the discussion set out above is included to demonstrate that the question of what is a vested right is not an easy one to resolve. Given that vested rights create considerable obstacles to an employer's ability to restructure a pension plan, it is useful to bear this discussion in mind when considering changes to a pension plan made by an employer.

C. Restructuring Health Benefit Plans

1. Preliminary Comments

Many employers sponsor a program of benefits for their employees beyond pension benefits, often made up of some or all of the following: MSP, extended health, dental benefits, life insurance, accidental death and dismemberment and long term disability insurance. For the purposes of this discussion, I will use the term "health benefit plan" to mean a program of health related benefits provided to employees and former employees, comprised of one or more of MSP, extended health and dental benefits.

Health benefit plans are often extended to cover an employee's dependents (spouse and children) and some employers even continue to provide a health benefit plan to its retired employees and their dependents. Health benefit plans are often provided through an insurance policy purchased by the employer, though it is not unusual for an employer to self-insure these benefits, simply bearing the actual cost for those benefits as the costs are incurred. There may or may not be a formal plan text, but there will usually be communication materials provided to employees such as brochures, explaining the benefits that will be provided through the health benefit plan.

2. Options for Restructuring a Health Benefit Plan

In recent years the cost of providing health benefits has risen dramatically, due to increases in drug costs and cutbacks in government funded healthcare programs[2]. It is now common for employers to review the health benefits being provided to employees to determine whether costs can be saved by restructuring those benefits. Though not as common as health benefit plans for active employees there remain some employers that provide similar health benefit plans to retired employees (and their dependents). Increases in the cost of providing those benefits is

[2] The Canadian Institute for Health Information advises that, after controlling for inflation, from 1991 to 1996 health spending increased by .9% each year. Again, controlling for inflation, from 1996 to 2009 health spending grew by 4.7% per year, and since 1998, total health care spending has grown faster than the GDP of Canada. Taken from "National Health Expenditure Trends: 1975 to 2009", The Canadian Institute for Health Information, 2009 Ottawa Ontario, xiii.

even more pronounced with health benefit plans provided for retirees because health care costs increase as we age.[3]

An employer seeking to restructure the health benefit plan provided to its active employees or its retired employees has two options:

- wind-up or terminate the health benefit plan; or
- amend the plan either in terms of how the health benefit plan is funded or the benefits that are provided through that plan.

The wind-up option requires little explanation. The employer simply needs to advise the covered employees of the termination of the health benefit plan and then terminate the policy through which the health benefit plan is provided.

There is a wider range of options available to an employer that is content to simply amend the health benefit plan rather than terminating it entirely. Some common changes employers make to a health benefit plan to decrease its cost are as follows:

- An employer can introduce a co-pay or premium sharing obligation for the individuals that participate in the plan to defray some of the cost;
- An employer can review the health benefit plan and the cost of providing the various benefits through that plan and eliminate or scale back the more costly benefits such as dental care;
- An employer can restrict the categories of individuals who can participate in the health benefit plan, such as precluding part-time employees from participating in the plan or excluding dependant coverage;
- An employer can impose lifetime maximum limits in respect of extended health coverage;

[3] The Canadian Institute for Health Information reports that:

- the average health care costs for people aged 1 to 64 is $3,809;
- the average health care costs for people aged 65 to 69 is $5,589;
- the average health care costs for people aged 70 to 74 is $7,732;
- the average health care costs for people aged 75 to 79 is $10,470; and
- the average health care costs for people aged 80 and higher is $17,469.

- An employer can restrict the benefits that are available through the plan, such as restricting employees to generic drugs or restricting the number of treatments that will be covered by the plan.

3. Restrictions on Health Benefit Plan Restructuring

Unlike pension benefits, health benefit plans are not registered and are not governed by a statute like the PBSA. There are statutes that will apply to the administration of a health benefit plan depending on how it is structured, but an employer that seeks to restructure its health benefit plans does not need to be concerned with legislative restrictions on its ability to do so.

(a) Restrictions Arising from the Employment Relationship

An employer may be limited in its ability to restructure a health benefit plan if it has promised to provide that benefit plan in a collective agreement. It is not uncommon for a collective agreement to require an employer to maintain a health benefit plan for the individuals covered by that collective agreement. If an employer has committed to sponsor such a plan, it is important for the employer to still determine whether it can make changes to that health benefit plan without contravening its obligations as set out in the collective agreement. For example, the collective agreement may require the employer to maintain a "basic program of health benefits". If the employer has in fact provided a health benefit plan that is quite generous, it may be possible for the employer to change the benefits being provided without contravening its collective agreement obligations. Of course, there is always a risk that making any changes to a health benefit plan during the currency of a collective agreement will invite resistance and the safest route is to wait until the expiry of the collective agreement and notify the union that the health benefit plan will be subject of negotiation.

If the employer provides a health benefit plan to a non-unionized work force, it is still important for the employer to determine whether it may unilaterally change the benefit plan without changing a term and condition of employment. Unlike a pension plan, however, it is my view that it will be more difficult for a non-unionized employee to argue that provision of a particular level of benefit coverage was a term and condition of his or her employment such that a change in that benefit coverage amounts to constructive dismissal. Again, the nature of health benefit plans is such that there may be ways to change the benefits being provided in order to decrease the cost of the benefit while still providing a basic level of benefits.

(b) If the Health Benefit Plan is for Retired Employees, Have the Benefits Vested?

One of the most active areas in benefit litigation concerns an employer's ability to change a health benefit plan maintained for the employer's retired employees. As noted above, employers have seen dramatic increases in the cost of providing a retiree health benefit plan. Many employers find themselves sponsoring a health benefit plan for retirees, the cost of which is double or triple its cost at implementation (controlling for inflation).

If an employer wants to stop providing a health benefit plan to its retirees the option that creates the least risk is to eliminate it for new retirees only. This option avoids any suggestion that the change interferes with an individual's vested right to retiree health benefits because to the extent that retiree health benefits vest, they vest at retirement.[4]

If an employer wants to make changes to the benefits provided to existing retirees, it should verify that it is not restricted in its ability to do so by the terms of the collective agreement. It is unusual for a retiree health benefit plan to be referred to in a collective agreement. Generally, collective agreements speak about the benefits to be provided to "employees", meaning active employees.

If an employer wants to make changes to the benefits provided to existing retirees the most significant issue will be whether the retirees have a vested right to those benefits. Again, there is no statute that explains when an individual will have a vested right to a benefit from a health benefit plan. However, there has been a significant number of benefit litigation cases in recent years that address that question. A review of those court decisions helps explain when an employer can and cannot reduce or eliminate benefits provided to retired employees[5]:

- A retired employee can have a vested right to receive benefits from a health benefit plan, but if the right to those benefits vests it does so at the time the individual retires;

- To determine whether a retired employee has a vested right to benefits from a health benefit plan, the court must determine the intention of the parties;

- Intention of the parties is determined by a review of the communication material and any other material that explained the health benefit plan to the retired employee at the time he or she retired. That is plan brochures, retirement letters and any other communication materials that advised the retired employee of his or her entitlements upon retirement will be relevant in determining intention;

- While intention of the parties is relevant, it is also appropriate for the court to consider the concept of "inter-generational equity", that it may not be appropriate to require one generation to when interpreting , the

- It will be difficult for a retired employee to argue that participation in the retiree health benefit plan was a term and condition of employment because it will be difficult for him

[4] *Dayco (Canada) Ltd. v. CAW-Canada,* [1993] 2 S.C.R. 230, at 305.

[5] *B.C. Nurses Union v. Municipal Pension Board of Trustees*, 2006 BCSC 132; and *Bennett v. British Columbia*, 2009 BCSC 1358.

or her to demonstrate consideration for that benefit promise at the point of hire. That is, if the health benefit plan for retirees was communicated to the individual after he or she was hired, it will be difficult for that individual to establish consideration;

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