Canadian Institute of Actuaries
Institut canadien des actuaires

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Framework for Target Benefit MEPPs
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The Canadian Institute of Actuaries (CIA) is the national organization of the actuarial profession in Canada. The CIA establishes the Rules of Professional Conduct, guiding principles and monitoring and discipline processes for qualified actuaries. All members are expected to adhere to the profession's standards of practice and support Guiding Principle One, which holds the duty of the profession to the public above the needs of the profession and its members. The CIA also establishes guidance to support standards developed by the independent Actuarial Standards Board, which are applicable to actuaries working in Canada.

The CIA would like to offer the following comments on the July 2015 paper entitled *Regulatory Reform for Target Benefit Multi-Employer Pension Plans (MEPPs).* We note that there are several questions that address administrative and regulatory issues. However, in order to narrow the scope of our comment, we have chosen to respond only to selected questions that address actuarial issues.

The requirements and mechanics of these types of plans are very different from single-employer pension plans (SEPPs), and this new legislation, which should address those differences, is very important. Therefore, it is critical that the final framework encourages the development and maintenance of these plans. To achieve this, the framework implemented should be strong in theory, but still practical to implement. These plans are not "one size fits all", so the rules should not be overly prescriptive, and should provide sufficient flexibility to the board of trustees. A simple regulatory scheme will not meet those goals.

The CIA recently issued a task force report on target benefit plans (http://www.cia-ica.ca/docs/default-source/2015/215043e.pdf), and this report suggested that regulations should consider a wider (not narrower) variety of target benefit designs, including ones that make more frequent adjustments in benefits, up or down, and should also start from a defined contribution (DC) model rather than a defined benefit (DB) model. This would imply less focus on benefit security and more on governance, disclosure/communication, ensuring that stakeholders understand plan risks, risk management efforts that are consistent with the risk

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tolerances expressed by stakeholders, and that plans can reasonably live up to the benefits communicated to members, both in the short and long term, subject to the risks specified.

The consultation paper assumes that the focus of regulation should be on benefit security, which tends to lead to lower benefits, especially in a system with fixed contributions. It is our opinion that this focus has contributed to a decline in single employer plans, and we do not believe that this should be extended to MEPPs. We would also like to note that it will be difficult to apply simple rules, since there is a significant diversity in the types of MEPPs registered in this province.

1.1. How should a plan's PfAD be calculated? What aspects of the plan (e.g., plan maturity and demographics) should determine the PfAD, and how much weight should be given to each factor?

The provision for adverse deviations (PfAD) concept should apply to contribution adequacy only. However, we note that there are a number of variables that affect PfADs, such as industry, plan maturity, plan size, degree of unionization, economic conditions, asset mix, asset-liability mismatch, and several others. These are too numerous to fit into a single formula. PfADs should reflect the risks that are specific to the plan.

That being said, if the goal of the PfAD is to minimize funding shortfall over a relatively short horizon (e.g., one to three years), then the asset structure of the plan is a key risk parameter to consider, as it will create the largest funded ratio volatility. This should be the key aspect if the rules are intended to be simple. Over longer horizons, plan maturity and demographic risks become equally important.

The CIA report suggested having a simple formula like the one in Alberta, with plans having the option to determine their own PfADs through stochastic modelling.

1.2. How frequently should target benefit MEPPs file valuation reports? Do triennial valuations for a well-funded target benefit MEPP provide sufficient disclosure to plan participants?

Ideally, annual filings should be required as a good governance policy, but action to reduce benefits in the event that the test for sufficiency of contributions is not satisfied should not be required immediately. The requirement to prepare annual valuations will allow the funded position of the plan to be monitored, and action should be required if the deficiency persists.

This will encourage trustees to take a proactive approach, rather than a reactive approach to addressing the plan's funding concerns. Under the current rules, there are many cases where plans prepare valuations only every three years, and then in the event of a contribution deficiency, they are forced to make reactive decisions to address the problem. With more time, better solutions could be achieved for both the plan and the membership. If the goal is to protect the members, then implementing a change that is ultimately reversed a couple of years later is not in their best interests. The CIA report supports annual valuations, with the option to take partial or delayed action. We also note that annual valuations are required in Quebec.

One possible downside is that annual valuations will be expensive for all plans, and more so for smaller plans. Plan sponsors will need to work with their actuaries to control the costs of annual valuations.

1.3. What limits should there be on uses of excess assets? Should there be a required order of priority for using excess assets (e.g., previously-reduced benefits must be restored before additional benefit improvements can be made or a contribution holiday is taken)?

There are too many different circumstances that would need to be taken into account here. Therefore, these should not be set out in the regulations, and should be determined on a plan-by-plan basis. A prescriptive approach would not be recommended here.

1.4. Should a plan be required to maintain a funding reserve larger than the PfAD after making a benefit improvement?

As per our earlier comments, PfADs in general should not be prescribed. Benefit improvements will already be difficult to achieve, and requiring that reserves in excess of the PfAD still remain after the improvement will make them even less likely. This leads to intergenerational inequity.

1.5. If employees are making contributions, should there be a requirement that members share contribution holidays with employers?

Contribution holidays should not apply to MEPPs. In a target benefit MEPP, the employer bears zero downside risk, so it is unclear why it should reap any rewards on the upside.

1.6. Are there any other funding rules which should be considered to encourage plans to develop a substantial reserve to reduce the risk of benefit reductions?

As mentioned in our introduction, the focus on benefit security has generally lowered benefits, and has contributed to the reduction in DB plans in Canada. We advise against taking the same approach with MEPPs for that reason. Substantial reserves will discourage these types of plans. Developing a PfAD that appropriately reflects the plan-specific risks would be more beneficial in addressing benefit security, rather than multiple layers of simplistic funding rules that don't address those risks.

1.11. Should lump sum values paid from target benefit MEPPs be calculated using the CIA commuted value standards or using the plan's going concern assumptions? Should lump sum values be reduced to reflect the funded ratio of the plan, and if so, how?

We support the use of going concern assumptions, and believe that transfer values should reflect the funding level of the plan. The CIA report discusses and supports both of these concepts.

1.12. Given plan participants of a target benefit MEPP could only be entitled to receive a commuted value that reflects the funded status of the plan on termination of membership, should target benefit MEPPs be required to file periodic updates on their funded position (e.g., every three months) to ensure that commuted value transfers better reflect the funded position of the plan at the time of transfer?

Annual updates would suffice, since going concern actuarial assumptions and funded ratios will be much less volatile than solvency funding assumptions and funded ratios. However, plans should be allowed to update assumptions more frequently than annually if they choose to. This will be relevant for plans with a heavily-weighted fixed income asset mix.

1.14. How should the value of entitlements of plan participants be determined when a target benefit MEPP winds up?

This is generally not an actuarial issue. However, the CIA report mentions that different valuation bases will allocate benefits slightly differently, so the valuation basis to be used to determine wind up entitlements should be set out in advance in general terms to avoid surprises or conflicts at the time of wind-up.

1.17. What regulations, if any, are needed regarding actuarial assumptions?

These should not be addressed in the legislation. Compliance with existing actuarial standards should be sufficient. If the government feels that there are other aspects not addressed in existing guidance, then it should work with the CIA and/or the Actuarial Standards Board to develop appropriate guidance.

1.18. If target benefit MEPPs reduced their best estimate interest rate assumption by a margin for adverse deviations, should that affect the calculation of the plan's PfAD?

PfADs and margins need to be applied together, so that any conservatism is applied on an aggregate basis. The CIA report explicitly mentions the linkage of the discount rate and the size of the PfAD in the Alberta regulations as a positive feature.

1.19. Under what circumstances should the regulator be able to order the board of trustees of a target benefit MEPP to prepare a new valuation report because of inappropriate assumptions?

We believe that the authority that FSCO currently has is sufficient.

2.7. Should stress testing of target benefit MEPPs be required? For what factors (e.g., investment returns) should the regulations require stress testing?

We support the encouragement of stress testing, as it assists with the understanding of the plan and the risks it faces. Investment returns are obviously the biggest impact, but plan maturity and the demographics of the plan can be valuable for planning purposes.

2.8. If required, how frequently should target benefit MEPPs be required to perform stress testing?

We believe that the proper frequency is at most every three to five years. The exception to this would be if circumstances have changed significantly in the interim (such as major investment policy changes). If the frequency of valuation reports is ultimately set at every three years, then testing should be done with every valuation, so that the board of trustees has the analysis in hand to help monitor the plan's funded position between valuations.

2.9. If required, should the regulations specify whether the plans should perform deterministic or stochastic tests?

These tests should not be prescribed, as there is too much variability from plan to plan. The method should be decided by the board of trustees in consultation with their actuary. There will be significant costs associated with stochastic modelling and it may not be feasible for smaller plans. Deterministic testing may be sufficient to assess the risk levels of these plans, due to their size.

2.10. How should target benefit MEPPs be required to use the information provided by stress tests? For example, should the regulation specify what a plan should do to address problems identified in a stress test?

The CIA does not believe that this should be mandated in the legislation. We would like to note that the CIA report (appendix B) references the Danish experience, and mentions the "traffic-light system" put in place in Denmark in the early 2000s. It was a series of stress tests required to be performed by all plans, with the regulator assigning green/yellow/red lights to plans. It was an early warning system that helped the regulator use its resources effectively by identifying high-risk plans. Instead of prescribing specific solutions, the regulator engaged yellow and red light plans in a dialogue to draw up a plan of action. Doing so maintained flexibility for plans while fostering a culture of risk self-assessment and management. A similar model could work in Ontario.

2.21. Should the regulations specify a priority sequence for benefit reductions in target benefit MEPPs to manage concerns such as intergenerational equity?

These should not be specified in the regulations. There are potentially too many different scenarios to be accommodated within a simple priority scheme. The prioritization should be left up to the board of trustees.

Conclusion

Target benefit plans provide new approaches for managing risks in MEPPs and other defined benefit plans. We hope that the regulatory environment for these plans will encourage sponsors to consider target benefit plans as an effective plan design with features that blend the strengths of traditional defined benefit and defined contribution plans.

The Canadian Institute of Actuaries hopes that its comments provided herein will be of value to you. Please feel free to contact me if you have any questions, or require any clarifications.

Regards,

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