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**Subject: Pensions – Consultation: Revised Proposed Regime for Negotiated Cost Pension Plans**

The Canadian Institute of Actuaries (CIA) is the national organization and voice of the actuarial profession. The Institute is dedicated to serving the public through the provision, by the profession's 4,900+ members, of actuarial services and advice of the highest quality. In fact, the Institute holds the duty of the profession to the public above the needs of the profession and its members.

We are pleased to provide the following comments on the consultation paper entitled [Revised Proposed Regime for Negotiated Cost Pension Plans](#) (NCPPs). Negotiated cost pension plans have a structure where the contributions to the pension plan are defined and fixed, usually through a negotiation process between the plan settlors or plan sponsors. Contribution rates can be changed through the established governance process. Benefits are then designed with the fixed contributions and the investment policy in mind. This results in plan experience being spread out over the group of plan members and over a number of years. Since contributions are essentially fixed, the plan operates under a structure where fluctuations in plan benefits are a reality.

We would like to offer comments on the following sections:

**Part 2: Funding**

**2.1 Proposed Funding Regime**

The CIA is generally in support of the minimum funding requirements set out in the proposed regime, and we observe the following:

- Not requiring the provision for adverse deviation (PfAD) on the current service cost (CSC) to be funded in the first actuarial valuation report following the adoption of the proposed regime is a reasonable compromise to give time to existing plans to adjust contribution or benefit levels;
- Making a distinction between a benefit improvement to pensions in pay (BIP) and any other benefit improvement (OBI) with respect to minimum funding is one way of acknowledging funding risks posed to the current and future contributors under each type of benefit improvement; and

- Stress testing can be a useful risk management tool and should focus on factors that can materially impact the funded status/benefit levels of the plan and such factors may vary by plan. Stress testing should be encouraged as a best practice.

## 2.2 Solvency Valuations and Funding

The CIA supports the requirements for solvency valuations and funding set out in the proposed regime. Further, we agree that the disclosure of solvency valuations in actuarial valuation reports may provide valuable information to pension plan stakeholders.

## 2.3 Going Concern Valuations and Funding

The CIA supports the requirements for going concern valuations and funding set out in the proposed regime. However, with respect to increases in special payments, we observe that in the absence of a deferral mechanism (e.g., one year or option to phase in contributions over a period where special payments are still required to be made over 15 years from the valuation date), administrative difficulties may arise; in particular, where employee or employer contributions can vary based on the results of a new funding valuation.

## 2.4 Provisions for Adverse Deviation

The purpose of PfADs in an NCPP is to provide a buffer against varying plan experience and as such, PfADs may provide a measure of stability to the benefits that are paid from an NCPP. As the level of PfAD is increased, the plan has a larger capacity to absorb adverse plan experience, but this may come at the cost of lower plan benefits. If the PfADs are lowered, larger benefits or lower contributions may be possible, at the cost of larger fluctuations in those benefits or contributions.

The provisions for adverse deviation set out in the proposed regime are based on the level of equity allocation in the plan's asset mix. While this approach has the merit of being simple, it does not reflect another significant risk to which a plan is subject: the duration mismatch between the fixed-income portion of the assets and the plan liabilities (also known as the interest risk). The interest risk can exist even for a fully funded plan with 100 percent assets invested in fixed income when the duration of the fixed-income portfolio differs from the duration of the liabilities. The interest risk is amplified when a portion of the assets are allocated to equities or when the plan is not fully funded. In those circumstances, the interest risk can be fully hedged by using overlay (derivatives) strategies.

The Québec government recently adopted new funding rules for single employer defined benefit (DB) plans under which solvency funding was replaced by an enhanced going concern funding approach with a required PfAD. The calculation of the PfAD under the Québec rules is based on both the target allocation in variable yield investments (i.e., not fixed-income investments) and the extent of asset/liability duration matching. (Under the Québec approach, up to 50 percent of real estate and infrastructure investments can be considered as fixed-income.)

The CIA is of the view that the PfAD should be developed with consideration for the interest risk described above, and the framework adopted by the Québec government is one example. Doing so may encourage plan administrators to manage both the return risk from variable yield investments and the interest risk in their plans.

We would support the concept that regulations prescribe a minimum level of PfAD in the funding of an NCPP (i.e., as is currently proposed for the current service cost of the plan). It

would also seem reasonable that any additional PfADs that are included in the contributions or the balance sheet of each particular NCPP be part of the ongoing negotiations and operations of each plan. As such, PfADs should form an integral part of each plan's funding policy.

Subject to the above requirement, it should be up to the plan sponsor or plan negotiators of each NCPP to determine the appropriate PfAD to be included in the actual contributions and balance sheet of each plan. In a negotiated cost pension plan, the actuary would take the role of an advisor who assists the plan sponsors in understanding the risks inherent in the plan and then assists the plan sponsors to determine the appropriate level of PfAD that each plan should have. The actuary would then be able to opine on the ability of the contributions and investment income to support the benefits of the plan and on the longer term sustainability of the plan. These opinions would be based on the combination of the contributions, benefits, investments, and PfAD of each plan.

We note that there is currently research being conducted by the CIA on the appropriate determination of PfADs, and we encourage you to consult the findings once they are completed.

#### 2.5 Actuarial Gains

The CIA supports the permitted use of actuarial gains set out in the proposed regime.

#### 2.6 Funding/Benefit Policy

The CIA does not object to the contemplated approach for funding/benefit policies set out in the proposed regime.

### **Part 4: Benefit Types**

As acknowledged in section 8.2 of the consultation paper, the Actuarial Standards Board (ASB) is currently conducting a review of the practice-specific standards governing the calculation of pension commuted values. Regardless, we support the ability for an NCPP to continue to provide benefits that are calculated using the current CIA commuted value (CV) methodology or for an NCPP to be amended to provide for the calculation of commuted values based on the going concern CV methodology.

Because these are negotiated plans, the going concern commuted value and the plan's funded ratio for the purpose of determining the proportion of the commuted value to be paid to terminating plan members should both be allowed to be determined using the best estimate going concern assumptions of each plan (i.e., the going concern commuted value and funded ratio should not include any PfAD that may be included in the funding valuation of each plan). However, parties should be free to negotiate termination benefits that would reflect the PfAD if so desired.

We support the going concern (GC) CV methodology being implemented retrospectively, as well as going forward. In addition, if an NCPP is amended to use a GC CV methodology and the GC funded ratio is

- Less than one, then we do not object to the GC CV being reduced to the GC-funded ratio of the NCPP; or
- At least one, then we do not object to the NCPP design addressing whether and how the GC funding excess would be included in the GC CV.

We do not oppose the conditions outlined in the proposed regime in the event an NCPP is amended to provide for the calculation of commuted values based on the going concern CV methodology.

#### **Part 5: Communications**

On the topic of member communications, we support the simplified disclosure requirements as proposed.

#### **Part 9: Consultation Questions & Process**

Response to question 1: The funding of an NCPP is usually viewed through the lens of long-term investing and risk sharing. The CIA CV methodology (current standard) reflects a guarantee in its pricing and thus a former member who receives their CV is then without risk. Further, since the former member is removed from the contributing and future beneficiary pool, there is a transfer of risk to the remaining and future contributors and current and future beneficiaries. Given the possible misalignment of CV pricing and the GC pricing, shortfalls can be significant.

Response to question 2: We expect that the stakeholders who may oppose retrospective application would be members who have the intention of transferring their entitlement out of the plan.

Response to question 3: There is one concern we wish to raise with regards to implementation; namely, if a plan is amended to adopt the going concern CV methodology retrospectively, consideration should be given as to how outstanding solvency deficiency payments would be affected.

#### **Conclusion**

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

Yours truly,



David R. Dickson, FCIA  
CIA President