February 21, 2018

Office of the Superintendent – Pension Commission
Room 1004 – 401 York Avenue
Winnipeg, MB R3C 0P8

Subject: Consultation Paper – The Pension Benefits Act Review

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Its members are dedicated to providing actuarial services and advice of the highest quality. The Institute holds the duty of the profession to the public above the needs of the profession and its members.

We are pleased to offer the following response to your consultation paper dated January 10, 2018, entitled The Pension Benefits Act Review (the "Consultation Paper"). The CIA has elected to respond to specific questions that have actuarial content.

The CIA supports greater consistency in pension regulation across Canada; hence, the content of this submission will be very similar to the responses we provided to a consultation issued by the province of Ontario in 2016 and the province of Nova Scotia in 2017.

Part 3 – New plan designs

We have responses for questions 1 and 2 only:

1. Should Manitoba develop a regulatory framework for a new target benefit or shared risk pension plan design?

   We support the concept of a new target benefit pension plan (TBP) or a shared risk pension plan (SRP) as a viable alternative design that should be made more readily available to the pension industry in Canada, and therefore support regulations that would allow for the enactment of target benefit legislation in Manitoba. Having the option of a target benefit model would be helpful and has many advantages over the defined contribution model, with which many defined benefit plans are being replaced.

2. If so, should a target benefit or a shared risk pension plan framework be developed?

   We support the development of a TBP/SRP framework. The Manitoba model for TBPs and SRPs should be reasonably simple and easy to administer and regulate. If the enhanced funding framework model were implemented, then it would be a relatively simple matter of linking the target benefit funding model to the enhanced going concern funding model. For example, a target benefit plan could be restricted from enhancing benefits from surplus below the prescribed provisions for adverse deviation

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(PfADs), and may require additional measures (enhanced contributions, benefit accrual reduction, or benefit reductions) in the case where the going concern ratio falls below 100 percent or some other prescribed ratio (e.g., 90 percent).

The CIA advocates for TBP/SRP regulations that allow for considerable flexibility in plan design and risk management practices. Specifically, we would like to see regulations focused on the following three areas:

a) Ensuring, through qualitative and quantitative controls, that the various policies of each plan support the specific objectives of the affected parties and the long-term sustainability of the plan as a whole;

b) Placing limits on intergenerational risk transfers that may otherwise endanger sustainability; and

c) Ensuring clear communication with plan members at inception and at regular intervals about the potential benefits and risks of the plan.

Alberta-style regulations, with the following modifications—inspired by the New Brunswick shared risk approach—to address their most serious shortcomings could be a workable model:

- Benefits/funding/investment (BFI) policy, with explicit policy ladder of triggers and benefit actions, should be a requirement for any plan to be considered a TBP. The risk-sharing deal needs to be explicit and transparent, and we see this policy as essential to this process.
- A TBP/SRP should be permitted to adopt and apply a customized BFI policy (i.e., affordability test, triggers, and consequences) that differs from the minimum PfADs prescribed in the regulations if the plan can provide evidence that it has performed stochastic modelling at the outset to validate the risk management framework adopted and demonstrate that the benefit risk does not exceed a minimum reasonable threshold. As an example, the threshold chosen by the plan might be expressed in terms of a probability that benefits at a minimum level will be delivered over a specified mid- to long-term time horizon, such as "75 percent probability that target benefits will be delivered over the next 20 years".

To facilitate the latter point, a technical standard for stochastic modelling of TBPs/SRPs, drawing on the technical guidance applicable to stochastic modelling of insurance liabilities should be established.

Part 4 – Solvency deficiency funding rules

General Comments

The CIA believes that defined benefit (DB)-type plan designs are the best vehicles to provide secure and predictable retirement income. In order to slow down the decline of DB coverage, or potentially increase it, the CIA would support a policy decision by the Manitoba government to change the funding regime by replacing the solvency funding framework with an enhanced going concern funding framework, provided that the going concern framework would appropriately include regulated PfADs. The CIA supports the general frameworks outlined in option 1, and the use of the four approaches. The CIA could support option 2, especially if it is integrated with option 1. Details of our position are provided below. The CIA would not support option 3 (eliminating solvency funding without implementing PfADs for going concern funding).

Pros and Cons of Removing Solvency Funding

We note that there are several pros and cons associated with removing solvency funding. Arguments in favour of this include the following:

- While solvency funding has served to increase the pool of assets dedicated to fund DB pension plans, the need for repeated relief measures over the last 10 years indicates that the regime requires fundamental change.
- It has resulted in unsustainable volatility in contributions, as it is based on market interest rates, notwithstanding the smoothing mechanisms available.
- It is procyclical, and asks plan sponsors to increase contributions once poor performance has already impacted the plan, and at a time when they likely cannot afford the contributions, rather than building a buffer before the impact of poor performance is realized.
- For some sponsors, solvency funding requirements and the resulting level and volatility of contributions are difficult for them to budget and manage and are used to justify plan terminations and/or conversion to defined contribution (DC) plans.
- It is based on the assumption that the plan will be terminated. Despite the rarity of plan terminations, we submit that the goal should be to reduce underfunded plan terminations. Solvency funding has failed to achieve that. In our opinion, sponsors and members would be better served by a new model.

Arguments in favour of keeping solvency funding requirements include the following:

- Plan participants will be better protected on plan wind-up if contributions are made on this basis compared with only using the present going concern basis. Furthermore, participants need to be informed of the wind-up position of the plan in order to be aware of the risk.
- Sponsors’ concerns can be partially addressed through the following:
  - Additional temporary relief during unfavourable economic circumstances;
  - Increasing the amortization period, resulting in lower levels and volatility of contributions; and
  - Implementing a solvency reserve account where excess solvency contributions can be refunded.

Response to Questions 7–10

7. Are any of the above options reasonable and practical in a Manitoba context?
8. If so, which option or combination of options described above would be most effective in balancing the different interests of plan sponsors, unions, members and retirees?
9. If a regulatory framework based on option 1 is developed, which approach or combination of approaches described under option 1 should be considered?
10. If the 100% solvency threshold is reduced to require partial funding, is a threshold of 85% appropriate? If not, what should the threshold be?

<u>Summary Comments</u>

With respect to questions 7–9, the CIA supports the general principles outlined in the Consultation Paper regarding an enhanced going concern funding model if solvency funding requirements are removed (i.e., option 1) and the use of the four approaches. The CIA also strongly supports permitting the use of solvency reserve accounts (option 2), especially if they are integrated into option 1.

With respect to question 10, the CIA stresses that the level of the trigger is effectively a policy decision. Any level below 100 percent is a public policy compromise and not rooted in actuarial principles. In our opinion, a level of 85 percent could constitute a reasonable compromise between security and affordability.

<u>Specific Comments</u>

Approach A of option 1 – Shorten the amortization period

In prior submissions to other provinces, we discussed the considerations surrounding the amortization period, and the impact of reducing that period. Though 15 years or another fixed amortization period have no underlying actuarial principles, the CIA considers 15 years a reasonable compromise among affordability, stability, and security. Should solvency funding be removed, we believe that a shorter amortization applied with a PfAD could be a reasonable compromise. Other provinces have moved to 10 years, which could be considered a minimum.

Approach B of option 1 – Require a provision for adverse deviation (PfAD)

In prior submissions to other provinces, we discussed a number of options. One of them included the requirement to have a funding cushion, otherwise known as a PfAD. Including a new PfAD in future going concern valuations is a good way to address the risks involved. The PfAD should reflect the risks by being linked to the degree of asset-liability mismatch and potentially other factors.

Québec’s new rules prescribe a relatively simple two-dimensional grid. We believe that such a grid is a step in the right direction and hope to see a slightly more refined approach in the near future. Others have suggested determining a PfAD by reference to the valuation interest rate assumption, but that is not the best approach, as it poorly reflects the asset-liability mismatch. Suggestions to reflect certain plan provisions or the financial strength of the plan sponsor may be relevant to assess certain risks, but we consider them too difficult to implement in a practical manner. Other factors such as plan maturity and demographics are taken into account by Québec's new approach.

The suggestion to take into account the level of funded PfAD before the plan may take action, such as benefit improvements or using surplus, is appropriate. We believe the level of security targeted with a PfAD is a policy decision, and should be prescribed through legislation or regulatory policy. The CIA would be willing to offer assistance in developing appropriate guidelines, as we have done with other jurisdictions.

The CIA is not in favour of removing solvency funding without implementing a PfAD (i.e., the CIA is not in favour of option 3).

We would also suggest that the current approach of reflecting the actuary's best estimate expectations be maintained, without any regulatory requirement or expectation that an implicit margin in or offset from the discount rate be reflected. The more direct and appropriate way to accomplish the objective is through regulated PfADs. CIA members are guided by our actuarial Standards of Practice, so it would be desirable for any regulations to be coordinated with these standards.

Approach B was silent on the recognition of letters of credit (LOCs) to fund a new PfAD. Existing solvency LOCs as well as new LOCs should be available for use to fund the new PfAD. In terms of security, note that LOCs are comparable to bank deposits.

Approach C of option 1 — Solvency trigger for enhanced funding

The Consultation Paper suggests that solvency could continue to play a role by referring to a plan's solvency position as a trigger to determine whether additional funding is needed or if the plan would be allowed to take an action that would weaken its funded position (as examples: requiring additional funding or restricting benefit improvements if a plan falls below a certain solvency level). Implicit in this approach is that, regardless of the funding method, a specific level of benefit security on a solvency basis is required.

The CIA stresses that the level of the trigger is effectively a policy decision. Any level below 100 percent is a public policy compromise, and not rooted in actuarial principles. In our opinion, a level of 85 percent could constitute a reasonable compromise between security and affordability. However, as mentioned in a prior submission to another province, requiring a lump sum contribution would create a potentially onerous pension funding cliff for plan sponsors in particularly challenging economic climates. Therefore, both the level of the trigger and the resulting funding requirements when triggered would need to consider this issue. We observe that this approach would therefore be most effective when combined with some, or all, of the following solvency modifiers:

Longer Funding Period

A longer amortization period for solvency deficiencies would represent a certain compromise between security and affordability, as contributions would be significantly reduced, but does not remove the basic problem of solvency variability.

Consolidate Solvency Deficiencies

The consolidation of all past deficits at each valuation date is effectively the approach adopted under the federal solvency regime and would also serve to lengthen the amortization period for solvency deficiencies. The CIA would support this approach if solvency funding was maintained, though the period should be chosen so as to target the desired funding level within a reasonable time frame.

Solvency Reserve Accounts (Option 2)

The CIA strongly supports the concept of a solvency reserve account, which we would more broadly refer to as a flexible funding account (FFA). FFAs should be enabled whether or not the policy decision is made to uphold or remove solvency funding requirements; in fact, we believe that the concept should be extended to the going concern funding requirement as well (although this would be under a different name).

The CIA has long been an advocate of FFAs, either achieved through a separate account or within the plan; for example, through a “banker’s clause” as in Québec. The acceptance and willingness of employers for increased funding could be enhanced through the adoption of FFAs.

Plan sponsors are very concerned that they are required to make large solvency payments, especially in the current low-interest-rate environment. A significant increase in interest rates may by itself eliminate current solvency deficits. Under that scenario, those solvency payments would only contribute to a surplus. Often, the utilization of a surplus is a contentious issue; furthermore, on plan wind-up, it is often subject to litigation.

The CIA has suggested that these payments be accumulated in a special account and that the account could be refunded to the entity that has made those payments if all accrued benefits are fully secured. In particular, on plan wind-up, if all accumulated benefits have been settled, the part of the remaining surplus attributable to those payments could be refunded.

Letters of Credit

The CIA supports allowing the use of LOCs without limit on their use as currently permitted in Manitoba (with limited exception), given the high quality of these instruments. The market will find a natural limit for letters of credit, since banks will not offer them and sponsors will not buy them to any greater extent than justified (because they are expensive and reduce the sponsor's ability to obtain lines of credit for other business purposes). We also note that Alberta and BC have no limits.

Approach D of option 1 – Consolidation of deficiencies

The CIA supports the consolidation of all past going concern unfunded liability deficits at each valuation date. However, the implications of this measure entail that the funding of such deficiencies is always being pushed forward to the maximum going concern unfunded amortization period, which is currently 15 years in Manitoba. Further, in the absence of experience gains, funding deficiencies, or any targeted funding level, the funding of such deficiencies is unlikely to be achieved within that period.

Response to Question 11

11. Are there any other reforms to the funding framework that should be considered?

<u>Transfer Values</u>

An issue not raised in the Consultation Paper is transfer values. If the enhanced going concern model is adopted, then it may be appropriate to revisit the calculation of transfer values. As pension plans would no longer be expected to be fully funded on a solvency basis in a five-year time horizon, it may not be logical to provide a commuted value assuming a 100 percent solvency ratio.

A potential solution would be to pay the commuted value times the most recently determined solvency ratio (and not to provide the unfunded portion of the commuted value in five years). Terminated members always have the option of selecting the deferred pension, and potentially could be offered the commuted value option periodically, say every five years, as the solvency ratio might improve in future years.

<u>Frequency of Valuations</u>

The frequency of valuations could take into account the level of funded PfAD.

Part 5 - Locking-in provisions and access to locked-in pension funds

Part 6 – Compulsory pension plan membership

We have no comments on these two parts.

Part 7 – Division of pensions on relationship breakdown

Introduction

Questions 17 and 18 of the Consultation Paper relate more to public policy issues than specific actuarial issues, although there may be some repercussions if the new plan designs being considered and discussed in the Consultation Paper are implemented.

Current Situation

The current legislation ensures that upon relationship breakdown the pension is dealt with at the time of separation and thus serves to manage the future financial obligation and administration requirements of the specific pension plan. This is a good policy, as it attempts to ensure that the rights and entitlements of non-member spouses or common-law partners are addressed.

The CIA has standards of practice for the calculation of capitalized values of pension benefits upon marriage breakdown, which are designed to develop fair values to both parties from an actuarial perspective, for use in family property accounting for the purpose of compensation payment. These standards are rarely being applied to calculate the values of Manitoba pensions for family property purposes. This is due to the mandated approach to division prescribed in the Pension Benefits Act (PBA).

In practice, the current legislation has led to some shortcomings both in the values presented to the parties and in the understanding of how the legislation is intended to operate by actuarial practitioners and the legal community.

Shortcomings of PBA-Calculated Value for Family Property Act (FPA) Purposes

The current PBA prescribes the calculation of an administrative value at the date of separation equal to the commuted value of the pension accrued during cohabitation, assuming the member terminated employment on the date of separation. This procedure does not consider contingent or imminent additional values that may be realized by the plan member in the future but nevertheless relate to the service accrued during cohabitation. For example, future salary increases in a best-average-earnings plan or early retirement benefits to which the member may soon be entitled.

The presumption of member termination on the date of separation can also serve to overstate the calculated value. For example, a member who is eligible for immediate retirement on the date of separation but has no intention or ability to retire for a number of years will have a value calculated that is greater than the eventual value the member will realize for the benefit accrued during cohabitation.

Interpretation by Plan Members and Legal Community

Our experience has been that most members of the legal community in Manitoba treat the prescribed value calculated by plan administrators as the correct and only value to be used for family property purposes. It is our view that this can serve to misrepresent the value of the pension to the parties as discussed above. We would prefer to see situations where Manitoba lawyers seek independent actuarial advice to confirm whether the prescribed values properly represent the pension entitlements accrued during cohabitation. Also, it is unclear whether a Manitoba court will accept a different value of the pension for family property accounting purposes.

Response to questions 17 and 18

17. Should the current framework requiring a mandatory 50/50 division of the pension earned during the period of the relationship be maintained?

18. Should the current framework be amended to permit parties to determine the portion of the pension to be divided, subject to the spouse or common-law partner receiving no more than 50% of the pension earned during the period of the relationship?

Questions 17 and 18 more or less ask the same question, i.e., should flexibility in the shareable portion of the pension be introduced?

From a CIA perspective, this is a public policy question; however, we see no reason why a different allocation should not be allowed, and it may provide needed flexibility to the parties in certain family property situations.

We should note that the sentence in the Consultation Paper just before discussion questions 17 and 18 on page 9 contains an error. Under the federal Pension Benefits Standards Act (PBSA), 100 percent of the entire pension may be assigned to the non-member spouse. The sentence states that all other jurisdictions restrict the spouse to receiving at most *50 percent* of the pension accrued *during the relationship*. Our experience is that the PBSA flexibility has served parties well and has not disadvantaged plan members in family property situations.

New plan designs and impact on family property values

In light of potential new plan designs and shared-risk funding arrangements being introduced in the pension community and contemplated in the Consultation Paper, there may be a need to review the amounts that could be or should be available from pension plans upon relationship breakdown.

One design change that is associated with shared-risk pension arrangements is that upon member termination from the plan, the option to the member might be either to take a deferred pension or receive a refund of only his or her own contributions. This could significantly change the values that should be available upon relationship breakdown, depending on whether the relationship breakdown value available or communicated to the member is prescribed by legislation.

Conclusion

In summary, depending on whether Manitoba wishes to continue the requirement that pensions are either divided (or opted out of) upon relationship breakdown, we recommend consideration be given to the following:

a) Removal of the fixed 50/50 sharing requirement.

b) Clarification that any values prescribed for transfer under the PBA (if that approach continues) are not necessarily the correct values for FPA purposes, and that independent actuarial advice is advised. This may be accomplished through some sort of public education or special communication to the pension industry.

c) Introduction of a maximum available amount for sharing from a given plan depending on the plan design and funding arrangement, again with proper communication to the relevant stakeholders.

Part 8 – Clarification/legislative gaps

We have a response to question 19 only.

19. For plans not already designated as a multi-unit pension plan (MUPP), is it reasonable in a Manitoba context to replace MUPPs with multi-employer pension plans and specified multi-employer pension plans, consistent with the provisions in other jurisdictions and the Income Tax Act (Canada)?

For plans not already designated as a multi-unit pension plan (MUPP), we support the decision for Manitoba to replace MUPPs with multi-employer pension plans and specified multi-employer pension plans. We recommend that the provisions implemented be consistent with the existing provisions in other jurisdictions and the Income Tax Act (Canada).

Conclusion

Thank you for taking the time to consider our comments. Please do not hesitate to contact Chris Fievoli, CIA staff actuary, communications and public affairs, at 613-656-1927 or chris.fievoli@cia-ica.ca if you require clarification of any element of the submission.

Yours truly,

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