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Subject: COMMENTS ON BILL 68 SUBMITTED BY THE CANADIAN INSTITUTE OF ACTUARIES (CIA) TO THE QUEBEC COMMITTEE ON PUBLIC FINANCE

Mr. Champagne,

The CIA is honoured to participate in the consultations on Bill 68. Our representatives have prepared the attached comments on behalf of the Institute.

Please submit any questions you may have to Michel Simard, Executive Director of the CIA, at 613-236-8196, ext. 108, or michel.simard@cia-ica.ca.

Sincerely,

[signature]

Michel St-Germain, FCIA

President of the Canadian Institute of Actuaries

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Our 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.

COMMENTS ON BILL 68 SUBMITTED BY THE CANADIAN INSTITUTE OF ACTUARIES (CIA) TO THE QUEBEC COMMITTEE ON PUBLIC FINANCE, *An Act mainly to allow the establishment of target benefit pension plans*

My name is Bernard Morency, and I chair the CIA's Public Affairs Council. I have also sat on the Expert Committee on the future of the Quebec retirement system (the D'Amours Committee). With me today is Krystel Lessard, who has worked for more than 10 years as an actuarial consultant and has volunteered to help us draft this memorandum. We are pleased to be with you to discuss Bill 68.

Bill 68 is concerned with the establishment of target benefit pension plans (TBPPs) and improvements to the Supplemental Pension Plans Act. We will discuss these two subjects separately, beginning with target benefit pension plans.

Target benefit pension plans (TBPPs)

Background

Supplemental pension plans (SPPs) play a very important role in Quebec retirees' financial security. For a long time, these plans were either "pure" defined benefit plans (DB plans) or "pure" defined contribution plans (DC plans). In the case of DB plans, the benefit level and the member contributions are fixed. As for employer contributions, they vary according to actuarial calculations and the plan's experience. In the case of DC plans, member and employer contributions are fixed, while the benefits vary according to the return on contributions, changes in interest rates and members' retirement date, and longevity.

Over time there has been a significant decline in the number of DB plans, such that today, fewer than 10% of Canadian private sector workers participate in these plans. Several reasons explain this decline, including increased costs due to declining interest rates and increased life expectancy. However, we cannot underestimate the impact of cost volatility, changes in accounting standards, and plan sponsors' considerable reticence to assume 100% of the risks associated with DB plans.

Target benefit pension plans (TBPPs) are based on the same principles as those underpinning DB plans: these plans establish a benefits level, and then they use actuarial calculations to establish member and employer contribution levels. These calculations consider multiple assumptions, chief among them are future return levels, as well as members' life expectancy and retirement age.

The main difference between DB plans and TBPPs lies in the consequences when losses result from a less favourable experience than forecast by the assumptions used. In a DB plan, the plan can either increase future contributions or reduce future benefits, or a combination of the two. In a TBPP, the plan can do both these things, i.e., increase future contributions or reduce future target benefits, but it can also reduce past accumulated benefits.

This has two major consequences. The first has to do with the level of risk sharing between the members and employer. The second has to do with the various member cohorts. In a DB plan, retired members and older active members are mostly unaffected if the pension fund's return is lower than expected or if interest rates decline. Younger members further away from retirement are most affected. In a TBPP, all members may be equally affected.

The CIA supports the government's decision to allow an employer to establish such plans without having to join a group of employers or some other group. We also welcome the fact that such plans can be offered to both unionized and non-unionized employees. We believe that TBPPs respond to a need by offering both a predetermined benefit level and risk sharing among the members, as well as certainty when it comes to the level of employer contributions. They constitute an additional tool for employers and unions to enhance Quebecers' financial security.

Bill 68 recognizes the importance of monitoring these plans to properly define the rules and avoid the arbitrariness of bad surprises for members and employers alike. We agree with most of the proposed rules but would like to make the following comments on some of them.

Governance and risk management

The Bill contains no specific provisions concerning risk management or the composition of pension committees. Therefore, the provisions applying to the other supplemental pension plans would apply here as well. **Given the features of the TBPPs cited earlier, it might be worthwhile to consider certain specific provisions**, such as a number of member representatives at least equal to the number of employer representatives or the presence of two independent third parties, at least one of them having expertise in investment or risk management on the pension committee. You could also require better documentation of the risk management process.

Mandatory and prohibited provisions

The Bill does not allow a pension based on the average of an employee's most recent or best paid years but does allow a pension based on an indexed career salary. We agree with this provision. However, we note that no post-retirement indexation is allowed. **We understand the importance of keeping inflation-related risks to a minimum, but why not allow a certain indexation of pensions post-retirement** at a predetermined rate, equal to or lower than the one used pre-retirement? Such a provision could be very useful if recovery measures proved necessary and pension benefits had to be reduced.

Funding rules

We agree that the pensions should be financed on a funding basis with standards identical to those that apply to DB plans, including a stabilization provision, but without an obligation to fund the stabilization provision. This provides for the plan to be financed over the long term, making it possible to reduce contribution volatility as well as the likelihood of having to use recovery measures.

Provision is made for employer contributions to be able to vary within a range. **We support this measure as an option available to the stakeholders, but not as a requirement.** The accounting treatment of this type of contributions is vague at this time, and it would be counterproductive for such a requirement to change the accounting treatment and undermine the establishment of a TBPP.

Payment of benefits to members

Bill 68 provides that the assumptions to be used in calculating the value of the benefits to be paid to members exercising their right of transfer be set by regulation. In the past, there has always been excellent cooperation between Retraite Québec and the CIA. **So, we propose that the Institute take part in a joint task force with Retraite Québec to develop these regulatory provisions.**

We note that the Bill indicates that calculations will take account of the degree of solvency, while the approach and the assumptions have yet to be determined. Recently the CIA published new standards to take effect on December 1. These new standards propose that the value of member benefits be established in line with the same approach as that used to fund the plan. The objective is to give members exercising their right of transfer their fair share of plan assets and to maintain equity among all members: those exercising their right of transfer and the vast majority who do not. **We feel that adjustments to the Bill are needed to ensure that everything is properly in synch and to leave all options on the table for Retraite Québec.** To that end, the reference to degree of solvency could be replaced with a reference to degree of payment.

Recovery measures and procedures for restoration of benefits

The Bill requires that recovery measures, necessary in the event of a deficit, and the procedures for the restoration of benefits, necessary in the event of a surplus, be clearly defined in the plan text. It stipulates certain options and principles to be followed. But the Bill leaves it to the stakeholders – members, unions, and employer – to decide which options to choose while requiring those chosen to be stipulated in the plan rules. **We agree with this approach and are pleased that the principle of equity among the cohorts, namely active members, non-active members, and retirees, has been specifically promoted.**

We have no other comments on recovery measures, but we would like to offer two comments on restoration of benefits:

- First, it is stated that benefits reduced due to previous recovery measures can be restored when surplus assets exceed the stabilization provision, without other stipulation. **In cases where the pensions of current retirees have been reduced in the past, it seems to us that the Act or Regulations should allow stakeholders to consider retroactive restoration of these pensions being paid** when drafting the plan rules.
- Second, the Bill requires that the full stabilization provision be funded before restoration can be carried out. This could represent 15% of the liabilities, if not more. **We believe that the Bill could provide for restoration procedures without the stabilization provision having been fully funded.** This would allow for faster restoration, something everyone would appreciate, especially retired members. The threshold could be set at 50% of the stabilization provision or be pre-determined, for instance a funding rate of 105% or 110%.

Conversion into a TBPPs

The Bill makes it possible to convert a DC plan (but not a DB plan) into a TBPP. It would be possible for a DB plan to suspend accumulation of future benefits to set up a TBPP, without, however, changing the accumulated benefits.

We understand the issues associated with converting a DB plan into a TBPP and respect the government's decision not to allow such conversions. However, we would like to make two comments on this:

- First, **it is important to reassure the DB plan sponsor that the plan whose future accumulated benefits are suspended will not have to be terminated** when a TBPP is set up, nor in the future, following a decision by Retraite Québec.
- Second, please note that the CIA's position has always been that such a conversion **could be in the members' interest and, consequently, could be permitted with the stakeholders' consent**.

Miscellaneous

We understand that it is impossible for Bill 68 to cover every eventuality, and that certain measures must be set out in the ensuing regulations. Accordingly, we would like to draw your attention to the following issues:

- The Bill states that a TBPP may adopt an annuity purchasing policy allowing the pension committee to purchase annuities for certain members from an insurer and thereby free the plan of any obligation toward these members. While such an annuity purchase could be used as a risk management measure for a traditional DB plan, its use in connection with a TBPP raises certain equity issues. The amount of the annuities purchased from an insurer would be fixed and would no longer vary according to the plan's financial situation. Thus, members affected by an annuity purchase and whose annuity had been previously reduced could not benefit from a potential surplus asset. Conversely, members whose annuity was not purchased could see their benefits subsequently reduced on the heels of recovery measures. **If lawmakers want to offer TBPPs the possibility of proceeding with such annuity purchases, we believe that this should be subject to a member consent process and a clear set of rules as to the amount of money to be used to purchase such an annuity.**
- Once the Bill has been passed, **it will be important to properly harmonize the Quebec and federal income tax laws to consider issues specific to TBPPs.** For example, calculation of pension adjustments, past service pension adjustments and pension adjustment reversals is not adapted to the reality of benefits that could be reduced or increased from time to time.
- Lastly, the Bill indicates that the applicable conditions for TBPPs that will cover members subject to a jurisdiction other than Quebec will be determined by regulation. **We would point out the considerable challenges posed by differences between jurisdictions, and we hope that the regulations keep these differences for TBPPs to a strict minimum.**

Other changes to the Supplemental Pension Plans Act

The following comments concern the other changes to the Supplemental Pension Plans Act.

Just like for the portion of Bill 68 involving the establishment of TBPPs, we support most of the proposed changes to the current Act. This includes the measure providing for a more frequent updating of the degree of solvency, considered when a DB plan member's benefits are paid, and the increased flexibility when it comes to the filing of actuarial valuations.

We are especially pleased that the Bill will allow DC plans to offer variable payment life annuities (VPLA). This is a concrete way to help members of DC plans by allowing them to share investment/longevity risks. This is very encouraging for many Quebecers approaching retirement, and it is truly relevant in light of the multitude of DC plan members coming up on retirement. In this instance, as in the case with TBPPs, it will be important to harmonize the Quebec and federal income tax laws.

This new measure is so important and welcome that **the government could consider expanding it by allowing larger plans, as well as financial institutions, to receive sums from members of smaller plans** lacking sufficient critical mass to offer it to their members.

In closing, we would like to thank you for inviting us to testify before your committee. We would be pleased to answer your questions.