September 15, 2022

Alberta Ministry of Treasury Board and Finance
employment.pensions@goc.ab.ca

Subject: Consultation Paper – Private Sector Pensions Review

The Canadian Institute of Actuaries (CIA) is pleased to provide our comments on this consultation. We have commented on the sections of the paper relevant to the actuarial profession.

1) Private Sector Funding Rules (non-CBMEPs)

“Should solvency funding requirements be updated in Alberta?”

The CIA is generally supportive of the move towards a going-concern plus regime as set out in the consultation paper, as long as the implications are clearly understood by all stakeholders. A going-concern plus regime will significantly reduce contribution volatility, which has been a primary reason for the closure and freezing of defined benefit (DB) plans. We believe that DB plans are a very effective way to provide retirement security to Canadians, and therefore we are supportive of policy actions encouraging the maintenance of such plans.

There are various ways of reducing contribution volatility, including smoothing of asset values (and possibly liability values through averaging of interest rates), longer amortization periods, and replacing in full or in part the solvency requirements by a going-concern valuation with a provision for adverse deviation (PfAD). In theory, some or all of these approaches could be used to dampen contribution volatility. However, the CIA believes that harmonization of funding requirements, to the extent possible, across Canadian jurisdictions is important. Consequently, since most Canadian jurisdictions have now moved to a going-concern plus regime, we are supportive of Alberta moving in the same direction.

However, it is important for all stakeholders to recognize that the proposed change in funding regime is likely to result in lower benefit security for DB plan members. We advise that there be transparency in how this change is communicated.

The CIA also supports that solvency funding requirements should not be applicable to true public sector plans in situations where there is minimal risk of the sponsor going bankrupt or otherwise being unable to fulfil its funding obligations to the plan.

“Please share your thoughts on these funding requirements: Replace current solvency funding requirements with all of the following:

- ***Reduce the minimum required level of solvency funding from 100 per cent to 85 per cent of solvency liabilities, reducing solvency payments. Plans with less than 85 per cent solvency would be required to amortize the deficiency over no more than 5 years;"***

The CIA stresses that the solvency funding threshold level is effectively a policy decision. Any level below 100% is a public policy compromise, and not rooted in actuarial principles. A full elimination of solvency funding requirements could result in significant deterioration in benefit security under certain circumstances. In our opinion, a level of 85% could constitute a reasonable compromise between benefit security and affordability, and it is consistent with the threshold set in several other Canadian jurisdictions.

Furthermore, the CIA recommends continuation of the current formula for amortization payments that takes interest rates into account, rather than a simplistic division of the unfunded liability over a 5-year (60-month) period.

- ***"Enhance going concern funding requirements by shortening the required amortization period for unfunded liabilities from the current 15 years to 10 years;"***

The CIA recognizes that one of the key objectives of the current reform is to reduce the volatility of funding contributions to pension plans. This is largely achieved through the reduction in solvency funding requirements.

The CIA considers a 10-year period a reasonable compromise between affordability, stability, and security, while noting that the choice of a fixed amortization period is not based on any underlying actuarial principles. The CIA also encourages continuation of the current formula for amortization payments that takes interest rates into account, rather than a simplistic division of the unfunded liability over a 10-year (120-month) period.

- ***"Permit any going concern deficit to be considered on a fresh start basis at each valuation in order to consolidate deficits and simplify contributions; and/or allow solvency deficiencies to be considered on a fresh start basis at each valuation;"***

The CIA agrees with this approach and recognizes that it is consistent with previously announced solvency funding relief measures. We support this approach as it is being used in other jurisdictions. However, an implication of this measure is that funding of deficiencies is always being pushed forward with new 10-year amortization periods, and in the absence of experience gains, any targeted funding level is unlikely to be achieved within 10 years.

- ***"Require plans to fund to a level that is greater than the sum of a provision for adverse deviation (PfAD) plus the plan's liabilities calculated using best estimate assumptions before allowing any action that could weaken the plans funded position (e.g., reduce contributions, increase benefits, or withdraw excess). The PfAD must also be included in the normal cost unless the going-concern funded ratio, including the PfAD, exceeds 105% or some other threshold."***

We support the concept of requiring a minimum funding target equal to the sum of a PfAD plus the plan's liabilities calculated using best estimate assumptions if solvency funding requirements are reduced as proposed.

The CIA also supports that the PfAD be applied on an internally consistent basis to both the normal cost and the actuarial liability (as well as the measurement of the going-concern funded ratio), which is also consistent with the approach taken by most of the other jurisdictions requiring PfADs.

As to the ratio of the plan's assets to the actuarial liability that must be exceeded before allowing any action that could weaken the plan's funded position or excluding the PfAD from the normal cost, we support the application of a threshold above 100% (105% or higher). We believe that contribution holidays and surplus withdrawals should not be permitted if they would result in the solvency ratio falling below 100% plus a threshold (e.g., 105%).

- ***"If you support an enhanced going concern funding proposal, what approach do you recommend to calculate the magnitude of the PfAD?"***

The CIA believes that the PfAD should reflect the inherent risk being taken by the plan, ideally by being linked to the degree of asset-liability mismatch (as in Québec). This can be accomplished using a two-dimensional grid based on the level of non-liability matching assets and the portion of interest rate risk being hedged. If this is deemed too complex, then it should be based on the level of investment risk (as in Ontario). Notwithstanding this, rules will be necessary for the categorization of alternative investments; the CIA is not expressing an opinion on such categorization.

A PfAD that is linked to the level of risk being taken in the pension plan would have a positive impact on benefit security (vs. a PfAD which is not linked to the level of risk) because it would require plans that are exposed to more risk to build bigger buffers before contribution holidays are taken.

The CIA prefers the Québec or Ontario approach over the British Columbia approach to the level of PfAD. We make the following observations on the British Columbia approach, which is primarily based on interest rates:

- If interest rates rise significantly, the PfADs could become inappropriately high, which could unduly restrict plans sponsors' ability to use surplus to fund contribution holidays and/or to grant benefit improvements.
- The PfAD will not help contribution stability if long-term bond rates fall significantly below 1%. Economic experience in early 2020 at the onset of the pandemic exhibited this very real possibility.
- We believe that a funding regime should be robust enough to function effectively under a broad range of plausible economic scenarios. In our view, the British Columbia PfAD structure could work effectively under some economic scenarios but could be counter-productive under other economic scenarios.
- The PfAD under the British Columbia regime does not take into account the level of risk the plan sponsor has elected to undertake.

Other considerations

In addition to the four key points set out in the consultation paper, we support maintaining the following aspects of the existing funding rules:

- Continue to permit the alternative settlement methodology for indexed plans.
- Continue to permit solvency reserve accounts (SRAs) to be established and used. If Alberta does change the funding rules, the rules regarding which contributions would be deemed to be made to the SRA will need to be revisited. The name of the account may also need to be revisited to the extent that contributions other than solvency special payments are permitted to be made to the account.
- Continue to allow letters of credit to be used instead of cash contributions to bring the solvency ratio up to the proposed 85% threshold.

2) CBMEP Funding Rules

The current formula for the calculation of the PfAD seems appropriate to the CIA provided that the equity risk premium in the calculation of the benchmark discount rate (BDR) is at a similar level as that included under the Ontario funding legislation.

The purpose of PfADs in a collectively bargained multi-employer plan (CBMEP) 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 a CBMEP. 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.

In a pension plan context, the primary sources of risk come from volatile investment returns and interest rates. While the proposed approach of minimum PfAD set out in the consultation paper (i.e., a fixed, required minimum PfAD of 7.5%, and an additional principles-based PfAD to be determined by the plan administrator based on plan characteristics) has the merit of being simple, it does not fully protect against either of these sources of risk. The CIA is of the view that the minimum PfAD should be developed with consideration for at least interest rate risk, and the framework adopted by the Québec government is one example. Doing so may encourage plan administrators to manage both the return risk from volatile investments and the interest rate risk in their plans. The CIA would be willing to help the regulator articulate these principles.

With the above in mind, we would support the concept that regulations prescribe a minimum level of PfAD in the funding of a target benefit plan as is currently proposed. It would also seem reasonable that any additional PfADs that are included in the contributions or the balance sheet of each particular CBMEP 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, we agree that it should be up to the plan sponsor or plan negotiators of each CBMEP to determine the appropriate PfAD to be included in the actual contributions and balance sheet of each plan. In a target benefit 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 the 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 a holistic consideration of the contributions, benefits, investments, and PfAD of each plan.

We note that under the proposed legislation, sponsors will need to contribute the PfAD on the current service cost until the going-concern funded ratio (including PfAD) is 105%. An effective way to enhance contribution stability would be to raise this threshold. For example, the legislation could establish a higher going-concern funded ratio (e.g., 120%), below which PfAD on the current service contributions would be required to be made. In order to recognize the fact that funded status volatility depends on the investment strategy, the size of the range would ideally be based on the size of the asset-liability mismatch. However, simpler alternatives where the range is based on the level of investment risk or even a fixed range would be more effective than the proposed PfAD design in maintaining contribution stability under a broad range of scenarios.

A variation of this approach is to have a corridor or buffer zone beyond the PfAD which does not require funding but which restricts use of excess assets. We could refer to this as a “wait-and-see” zone that gives some leeway to markets to adjust a bit without affecting contributions. The proposed approach includes such a buffer of 5.0% above the target PfAD, which helps in this sense, whereas Québec chose to apply a buffer of plus and minus 5%, i.e., on each side of the target PfAD, which can be more effective in reducing volatility.

Regarding the other proposals, we have the following comments:

- The original purpose of the BDR component was to require an additional PfAD for target benefit plans using going-concern discount rates that could be viewed as aggressively high. By replacing the current additive approach (i.e., asset allocation component + BDR component) with a minimum PfAD equal to either (i) the greater of the two components or (ii) the average of the two components, the original purpose of the BDR is greatly diminished. In either proposal, additional PfAD would only hold if the discount rate greatly exceeds the BDR.
- We would support elimination of the BDR component of the PfAD if the asset allocation component was expanded to include a component taking into account interest rate risk, such as the asset/liability duration matching component in Québec. We believe this more sophisticated approach in the calculation of the PfAD should be used for target benefit plans as it would encourage plan administrators to manage both the return risk from volatile investments and the interest rate risk in their plans. In our opinion, that approach would make the calculation of the BDR unnecessary.
- A reduction in the BDR component of the PfAD would have the effect of reducing the overall PfAD but would decrease the mitigation of potentially aggressive discount rates. For example, under the current regime of 0.15% for each basis point that the discount rate exceeds the BDR, a plan that has a duration of 15.0 or more on the current service cost or liabilities would still see a net positive benefit of increasing discount rates above the BDR. By lowering the BDR component of the PfAD, this net-positive benefit of exceeding the BDR grows, which could encourage the use of even more aggressive going-concern discount rates.
- We would not support placing a maximum on the amount of PfAD in isolation as this would only benefit pension plans who are taking on the most risk (either through asset

mix policy or the going-concern discount rate used), which are typically the plans that should be holding the highest PfAD.

3) Funding Status Quo Risks

Many plan sponsors believe that the current DB funding requirements do not represent an appropriate balance between member benefit security and the sustainability of DB plans. The volatility in contribution requirements caused by funding rules has been a contributing factor in the closure and freezing of DB plans in Alberta and across Canada.

History has shown us that temporary funding relief measures have not been a solution to longer-term systemic problems, particularly given the level of maturity of DB plans in Alberta.

As described in our response to item 1:

- A going-concern plus regime will significantly reduce contribution volatility, which has been a primary reason for the closure and freezing of DB plans. We believe that DB plans are a very effective way to provide retirement security to Canadians, and therefore we are supportive of policy actions encouraging the maintenance of such plans.
- All stakeholders need to recognize that the proposed change in funding regime is likely to result in lower benefit security for DB plan members. Transparent communication of the implications of the change in the funding regime is critical.

4) Annuity Purchase and Liability Discharge

The CIA supports legislation that provides for a discharge of liabilities upon the purchase of a buy-out annuity, as is the case in the British Columbia legislation. It is our understanding that this is consistent with the long-standing position of the Alberta Superintendent of Pensions, but this position has never been included in the legislation.

Regarding the points discussed in the consultation paper, we offer the following comments:

- It is reasonable that the legislation require that the annuity would have to provide benefits in materially the same form and manner as the ongoing plan in order to satisfy the conditions for liability discharge. The issue at hand becomes what is “materially” the same form.
- We support legislation that would allow for the provision of a reasonable level of fixed indexation rather than inflation-linked indexation for an annuity purchase. The costs of inflation-linked indexation present a significant challenge to plan sponsors who wish to purchase annuities. The CIA supports legislation that would allow plan sponsors to amend their plans to provide a fixed level of indexing in conjunction with an annuity purchase, for both ongoing and terminating plans. It is natural that the Alberta Superintendent review and approve the level of indexation being provided by the plan amendment prior to the annuity purchase. Upon receiving approval from the Alberta Superintendent, transparent member disclosure should be required. A policy decision will need to be made as to whether member consent should be required. If the decision is made to require consent, decisions will need to be made as to whether it should be individual or group consent, the required thresholds for group consent, etc.

- Allowing retroactive discharge of liabilities would be beneficial for plan sponsors who have already purchased annuities. This also avoids any potential differential treatment from plan sponsors who purchase annuities after the legislation is amended.
- The CIA supports legislation that would allow for annuity purchase and associated liability discharge for all types of members. Different types of members – whether member pensioners, surviving spouses, deferred pensioners, or active members – can be commingled within a single group annuity purchase. The Canadian annuity market has become more sophisticated in recent years, allowing for annuity purchases of this nature.
- We believe it is reasonable for the legislation to require disclosure to the affected members following a buy-out annuity transaction, but to not require member consent to proceed with an annuity transaction. There should not be any disclosure or consent requirements in the case of a buy-in annuity transaction since that is effectively a plan investment.
- In cases where the buy-out annuity will provide benefits in the same form and manner as provided by the ongoing plan, there is little reason for member consent to be required. Member consent would be difficult, if not impossible, to obtain in practice. This would result in a significant increase to the costs and timeframes required to effect the annuity purchase.
- It is reasonable to require that an annuity purchase not impair the solvency funded position, in ratio terms, for the remaining members of the plan. This approach is consistent with the current legislation and provides an acceptable level of benefit security for the remaining plan members. It follows that it is reasonable to require plan sponsors to remit a “top-up” contribution to the plan if necessary to maintain the funded ratio at the lesser of the solvency ratio prior to the transaction and 85% (the solvency funding threshold), or for this additional deficit to be funded over five years. From a practical perspective, it would be most effective for this information to be provided to the Superintendent after the annuities are purchased. Review and advance approval by the Superintendent of the additional funding requirements would not be practical since annuity prices and funded position of the plan could vary significantly between the calculation date and the actual transaction date. Consequently, it should not be required in order for the plan sponsor to proceed with the annuity purchase. Specific funding requirements should align with the changes made to the overall funding framework.
- It is reasonable that the Superintendent be notified of the annuity purchase, and to receive certification from the actuary that the annuity purchase is in compliance with the legislation. In the event that additional funding is required, it would also be reasonable that an updated actuarial valuation or cost certificate be filed in conjunction with the annuity purchase. Specific filing requirements should depend on the size and materiality of the annuity transaction. However, we do not believe that review and approval by the Superintendent of the annuity purchase should be a mandatory requirement in order for the plan sponsor to proceed, as this would present challenges to plan sponsors from a practical perspective.

5) Target Benefit Conversion for CBMEPs

We agree that the restriction on retroactive conversion of plans from DB to target benefit plan be removed from the Employment Pension Plans Act for CBMEPs.

As discussed in the consultation paper, CBMEPs, which are negotiated cost plans, already operate under a target-benefit–like regime, as they have the ability to reduce benefits if the contributions or plan assets are unable to support the benefit levels under the plan and have the ability to elect to fund under a target benefit regime under s.10.1 of the Act. We understand that the vast majority of Alberta CBMEPs have elected to fund under a target benefit regime under s.10.1 of the Act. As such, allowing retroactive conversion for CBMEPs would not materially change the funding and operation of these plans.

With this in mind, we would suggest, at a minimum, board of trustee consent be obtained prior to conversion, as well as a required notice and disclosure process under all situations. This would be under the assumption that the plans have union members as well as pensioner members on the board. Should this not be the case, then we suggest that union consent would be required.

6) Variable Payment Life Annuities (VPLAs) and Advanced Life Deferred Annuities (ALDAs)

We strongly encourage Alberta to amend the legislation to authorize VPLAs and ALDAs, and further to make them as accessible as possible to defined contribution (DC) plan members.

VPLAs in particular have the potential to become a very important part of the retirement system, since they could allow the growing number of Albertans in DC plans to decumulate their assets in an orderly fashion, protect themselves against longevity risk, and receive an adequate retirement income.

ALDAs also have the potential to be an important tool for DC plan members to manage longevity risk. However, the interest of insurers in offering such a product is not as clear.

We do not yet have a view as to exactly how the legislation should be amended, but we would be willing to work with regulators on this. However, while it is important to safeguard member interests, the legislation regarding VPLAs and ALDAs should be flexible and not be overly onerous, so as to be attractive to plan sponsors and members. Further, sponsorship of the VPLA should not be restricted to certain industries, so as to allow greater competition and foster innovation.

The underlying purpose of VPLAs is to pool longevity risk. Therefore, it will be important to avoid creating significant anti-selection risks. Consequently, we recommend against allowing for commutation in the case of reduced life expectancy, particularly once the member has begun receiving retirement income. Commutation could be permissible for small amounts and/or non-residency.

7) Unlocking for Reduced Life Expectancy

The Act should limit unlocking for reduced life expectancy to those individuals who are within two years of dying (or some other quantifiable threshold). The Act’s current requirement of “likely shorten the member’s life considerably” is subject to interpretation by the medical practitioner. Since benefits can be unlocked simply for reduced life expectancy, there is

potential for abuse (i.e., pension benefits are unlocked for an individual who could then live for many more years).

Introducing a specific timeframe should make it clearer to the medical practitioner as to what they are certifying. The desired result would be medical practitioners only making certifications for individuals who truly have a short life expectancy.

Unlocking for shortened life expectancy was first introduced into pension legislation in the late 1990s as a compassionate provision to address evolving new illnesses, such as HIV/AIDS and Hepatitis C, that, at the time, had very high rates of mortality. Introducing a specific timeframe will move the provision to be more consistent with the intent of the original provision (i.e., apply to situations where a person has a very short life expectancy).

We also observe that Nova Scotia, Ontario, and Manitoba have a two-year requirement in their legislation. Ontario legislation allows pensions in pay to be unlocked due to shortened life expectancy. Due to the anti-selection risk for the plan, we strongly encourage Alberta to avoid adopting a similar practice and to maintain its prohibition on commuting pensions in pay.

Alberta should also ensure it is clear what evidence a plan administrator can accept before unlocking a member's benefit. For example, a medical practitioner could be required to certify their opinion on the member's health and life expectancy on a statutory form.

8) Relationship Breakdown

We agree that s.87 of the Act should be amended to clarify that an administrator's entitlement to charge a fee for the services provided under that relationship breakdown division extend to the preparation of pension statements upon relationship breakdown, even if that pension is ultimately not divided.

Potential suggested changes to s.36(6) of the regulation are to include the member's designated beneficiaries in the disclosure statements (which we understand are relating to relationship breakdowns). Members don't always identify their pension partner as their designated beneficiary. If a member identifies someone else as their designated beneficiary (for example, family or children), care must be taken to ensure privacy relating to these relationship breakdowns. We would not recommend that s.36(6) of the regulation be amended to have the member's designated beneficiaries (who are not the pension partner) included in the disclosure statements being sent to the member's former pension partner.

We agree that s.82(14) of the regulation should be amended to remove the requirement to recalculate commuted value payouts for relationship split calculations after 180 days. However, s.82(14) should not be removed and instead clarify how interest on the final payout is to be applied to the relationship split commuted value determined at the date of division under s.82(13) of the regulation.

10) Deemed Trust

We agree that the Act should be amended to clarify that any contributions due and owing to the plan should be held in a deemed trust.

13) Other

The CIA believes that any changes to the funding rules applicable to private sector plans should also apply to public sector plans which are subject to solvency funding.

20) Defined Contribution Plans – Automatic Features

We agree that automatic enrolment and auto-escalation of contributions are desirable features in DC pension plans. We believe it would be helpful to explicitly permit these features in both pension and employment standards legislation, which would remove doubt amongst plan sponsors regarding their permissibility.

It would be helpful to reduce administrative burden by not requiring notice of automatic enrolment and auto-escalation beyond the clear description of these features in the plan booklet and/or other educational materials.

The CIA appreciates the opportunity to provide feedback on these issues, and we would welcome further discussion with you throughout this process.

If you have any questions, please contact Chris Fievoli, FCIA, Actuary, Communications and Public Affairs, at 613-236-8196 ext. 119 or chris.fievoli@cia-ica.ca.

Sincerely,

Hélène Pouliot, FCIA
President, Canadian Institute of Actuaries

The Canadian Institute of Actuaries (CIA) is the qualifying and governing body of the actuarial profession in Canada. We develop and uphold rigorous standards, share our risk management expertise, and advance actuarial science to improve lives in Canada and around the world. Our more than 6,000 members apply their knowledge of math, statistics, data analytics, and business in providing services and advice of the highest quality to help Canadian people and organizations face the future with confidence.