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The Association of Canadian Pension Management

L'Association canadienne des administrateurs de régimes de retraite

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Response to the Saskatchewan Negotiated Cost Pension Plan Consultation Paper



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FOREWORD

ACPM (THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT)

ACPM (The Association of Canadian Pension Management) is a national, non-profit organization acting as the informed voice of plan sponsors, administrators and their service providers in advocating for improvement to the Canadian retirement income system. Our membership represents over 400 companies and retirement income plans that cover more than 3 million plan members.

ACPM believes in the following principles as the basis for its policy development in support of an effective and sustainable Canadian retirement income system:

Diversification through Voluntary / Mandatory and Public / Private Options

Canada's retirement income system should be comprised of an appropriate mix of voluntary Third Pillar and mandatory First and Second Pillar components.

Third Pillar Coverage

Third Pillar retirement income plan coverage should be encouraged and play a meaningful ongoing role in Canada's retirement income system.

Adequacy and Security

The components of Canada's retirement income system should collectively enable Canadians to receive adequate and secure retirement incomes.

Affordability

The components of Canada's retirement income system should be affordable for both employers and employees.

Innovation in Plan Design

Canada's retirement income system should encourage and permit innovation in Third Pillar plan design.

Adaptability

Canada's retirement income system should be able to adapt to changing circumstances without the need for comprehensive legislative change.

Harmonization

Canada's pension legislation should be harmonized.

Questions and Responses per Section 9.0 of the Consultation Paper

1. With respect to each Part, are there any additional concerns or considerations that you wish to identify?

None.

2. Do you agree with the Principles?

Yes. The principles documented in 1.3 of the Draft are:

- Pension Sustainability
- Benefit Security
- Equity and Transparency
- Flexibility

3. Do you agree with the proposed funding requirements, including the method of calculating the PfAD?

There are numerous ways or methods but, in general, we agree with the concept of the margin (Provision for Adverse Deviation is the dollar amount of margin) varying with the asset mix. In particular, the margin increases as the risk of the portfolio increases. We would advise against making the margin calculation overly complex. ACPM would recommend that the PfAD be determined by reference to plan assets only and not the second component in the discount rate. This is consistent with the feedback that ACPM has supplied to Québec and it reduces the complexity and helps improve the understanding of the PfAD.

In terms of the potential for abuse of using an inappropriate going concern discount rate (i.e. too high), we note that the plan actuary is required to set the going concern discount rate in accordance with the CIA's Standards of Practice and the Regulator has the authority to request the actuary to provide additional information to support the use of a given discount rate.

We like the principles stated in section 2.4 of the Draft and in particular that "The PfAD should be built up during times of favourable plan experience and drawn upon during times of adverse plan experience."

We believe the plan actuary and the Board of Trustees are in the best position to determine the most appropriate level of PfAD for the particular plan taking into account the specific characteristics of the plan.

There is a lack of clarity in the Consultation Paper on the PfAD in the Current Service Cost. In the calculation of the PfAD, we refer to “equity allocation” and “non-equity allocation”. The document should elaborate on what is considered “equity”. As per Québec Bill 57, some asset classes offer some equity characteristics and some fixed income characteristics and we may need to apportion a specific asset class like Real Estate or Infrastructure between “equity” and “non-equity”.

We would ask the Superintendent to reconsider adding an additional PfAD for a discount rate that differs from a certain benchmark. The discount rate is usually derived from the fund’s asset mix and the discount rate PfAD could be integrated in the initial PfAD established for the equity allocation. Markets are very dynamic and each plan has a unique way to manage risk, so a PfAD on the discount rate versus a discount rate benchmark could cause the funding policy to be very unflexible at the plan level.

4. Should the rules be more prescriptive regarding the funding policy for an NCPP (e.g. require that such plans have a funding policy; set-out the minimum contents of a funding policy)?

We would prefer less prescriptive. More principles based. This would facilitate the characteristics of each plan to determine the best approach to meet the principles.

Require a governance policy be developed for each NCPP. The Trustees to determine the governance policy that is most appropriate for the plan. The Trustees can seek professionals to assist them in developing the governance policy.

5. Is the stress testing an appropriate way to understand the risk of an NCPP?

We like stress testing to be applied to plans. The plan actuary and the Board of Trustees are in the best position to develop the most appropriate stress testing.

It might be difficult for plan members and trustees to understand the stress testing and how to use the stress testing results in the decision making. But that should not be a reason to avoid stress testing.

6. Do you agree that a NCPP should have AGCE in order to improve benefits?

Yes. NCPPs need excess (Available Going Concern Excess) to manage through periods of adverse experience. The exact amounts may be subject to debate but the concept is sound.

7. Do you feel that there should be rules in the Regulations regarding the order of benefits to be reduced to meet the solvency tests?

Why reference solvency tests?

The plan trustees, working with the plan actuary, are in the best position to determine which benefits should be reduced first. Maintaining flexibility at the governance level is important and the Superintendent still has the flexibility to review and ask for a revision on the priority of benefits.

The plan text should be required to specify the order of benefits to be reduced when circumstances require benefits to be reduced. The trustees should be provided the flexibility to determine this order but again this order should be specified in advance and documented in the plan text. The regulator could provide guidance or principles to guide the trustees when determining the specific order that the specific plan would use in the event that benefit reductions would be required.

8. Would the NCPPs that you are involved with be interested in GC CVs?

No comment from ACPM. We are providing our comments on all plans not in relation to any specific plan.

9. Are there any significant issues respecting preparation of an AVR, member communications, or inequity where an NCPP provides for both methodologies of calculating commuted values (i.e. CIA CV and GC CV)?

There should be no significant issues in the preparation of the AVR (Actuarial Valuation Report). Member communications could be challenged. Having two methods for calculating commuted values will most likely cause confusion with some members. This will be mitigated over time as more commuted values in the future will be based on the GC CV method and eventually the benefits based on the CIA CV will be paid out and future service will all be based on the GC CV.

An additional thought would be to give the Board the option to discontinue the CIA CV basis immediately. This might result in a loss of value to a particular plan member but would not result in a loss of pension benefit. This option would clarify that the focus in an NCPP is the promised pension benefit and not the variable pension value.

10. What are your views on the proposed methodology used to calculate the GC CV?

ACPM recommends using the GC CV as the only basis for settling benefits via a lump sum transfer. The primary benefit from a defined benefit pension plan, a monthly pension payment, does not depend on the use of a commuted value basis.

Advantages of using GC CV

- Reflects the amount of assets (proportionate basis through the use of funded ratio) available from the plan's portfolio to settle the member's obligation.
- Member has options. Can choose to leave benefit in plan and receive a pension (immediate or deferred).
- Mitigates actuarial losses to the plan for terminations when the actuarial basis produces a much larger liability than under the Going Concern basis. (this is currently the case, but has not always been so, many years ago the solvency discount rate was higher than the going concern discount rate)

Disadvantages of using GC CV

- Member will have a different termination basis than non-NCPP plans in Saskatchewan and the rest of the country.
- Increases the administration complexity.
- If a PFAD is added to the liability and the plan has a deficit, a terminating member is essentially paying a termination fee equal to the proportion of the liability due to the PFAD (e.g., if liability without PFAD is \$90,000 and \$100,000 with PFAD, then if assets are \$90,000, a terminating member would receive only 90% of their benefit even though the plan is fully funded without a PFAD).

11. Given that members could be entitled to a GC CV (a CV that reflects the funded status), should plans that provide use of the GC CV methodology be required to file periodic updates on their funded position to ensure that commuted values more accurately reflects the funded position of the plan at the time of transfer?

It should be reasonable to use the most recent funded ratio available. Providing for updates could lead to a cycle of providing more and more current updates (with an extreme case of updating daily).

Members should be informed of the plan provisions. Member communication, although difficult to engage members, is important. Periodic updates would add administration cost and complexity. If the primary focus is on a monthly pension benefit from the plan, with secondary focus on a lump sum, then using the funded ratio in the most recently filed AVR would be a reasonable accommodation. The member is not required to receive a lump sum as it is at their option. If the member is not satisfied with the GC CV then the member need not exercise that option and would then receive the benefit that was originally designed to be provided, namely, a monthly pension for the members' life (with possibly survivor benefits).

One possible concern is an extreme drop in the value of financial markets. This could lead to anti-selection by plan members who try to cash out before taking a hit to their commuted value. If this is a concern, solutions can be derived to address this concern.

12. Should the ability to convert past benefits to benefits calculated using the GC CV methodologies be provided at this time to NCPPs?

Yes. ACPM believes that the GC CV methodology should be applied to all benefits (past & future) for benefits settlements on and after the effective date of the legislation. Allowing the GC CV basis for both past & future service reduces the administrative and member communication complexity and while not impacting the main benefit provision of the plan which is a monthly pension on retirement.

This only affects those members terminating and taking the lump sum option. The current solvency discount rates result in a higher CV than would most likely occur with the GC CV. But, this could change if interest rates increased and thus the CIA CV could result in lower lump sums than GC CV in the future. Nevertheless, think about the lump sum as a benefit that happens to change over time. Of note, CIA CVs are currently providing lump sums in excess of what would be required to purchase an annuity from an insurance company (look at the CIA CVs and the Annuity Purchase proxy).

13. Is the communications framework appropriate for NCPPs?

The biggest challenge will be the communications with plan members. Difficult to explain but at the same time required. It is important for these plans to effectively communicate to plan members the plan provisions, the structure of the pension deal, the risks to plan members, transition provisions and their rights. This is a reasonable approach but NCPPs will need to be realistic and engaging with plan members when communicating with them.

14. Should there be more or less rules regarding NCPP governing bodies (Administrator and/or sponsor)? For example, should the regulations prescribe the proportion of plan members and retirees, presence of independent trustees, required knowledge and skills, etc.?

We suggest a principles based approach (as opposed to a prescriptive approach).

Generally, having some independent trustees is considered good Board governance. In addition, Boards require a variety of skill sets.

Unless appropriate remuneration is made available, the recruiting of independent and experienced individuals with varied professional skill sets (investment, accounting, legal and actuarial) will be a challenge for pension Boards. These individuals have realized that the compensation as a service provider (actuary, investment manager, lawyer & accountant) is more lucrative. However, some larger pension plans in Canada are starting to recruit and compensate professionals to serve as independent trustees on pension Boards.

Increasing the diversity of skills on a Board and increasing the Board's effectiveness in plan governance has the potential to improve the decision making of NCPPs (and all other plans). Retired professional advisors could be a source from which to recruit. In addition, encourage education and training of current trustees. A reasonable budget for training and education is expected and encouraged.

15. Should the legislation or regulations be more prescriptive regarding the governance policy for NCPPs (e.g. require that such plans have a governance policy; set-out the minimum contents of a governance policy)?

Suggest a principles based approach. Require a governance policy be developed for each NCPP. The Trustees would determine the governance policy that is most appropriate for the plan. The Trustees can seek professionals to assist them in developing the governance policy.

16. Is the transition framework appropriate? Have all issues been addressed?

One AVR cycle might be too quick. Suggest transitioning over two triennial valuations. Have a waiver on benefit reductions for at least two AVRs.

17. Do you agree with transitioning the PfAD on the CSC over a 3 year period?

Most likely too quick. The plans need time to build PfADs. Suggest five plus years or at least two triennial actuarial valuation periods.

18. Do you feel the "Enhanced Going Concern" option would be an acceptable regime as opposed to the Proposed Regime?

No. The Saskatchewan Enhanced Going Concern option was designed mostly for non-NCPPs. The Proposed Regime has a better fit for NCPPs.

19. Should a framework similar to the Proposed Regime be an option available to other types of pension plans registered under the Act?

The Proposed Regime should only be available to target benefit plans and NCPPs although the GC CV option might be considered for all defined benefit plans. Having the same basis to determine the lump sum to transfer from a defined benefit provision would reduce complexity and mitigate communication issues that could occur with multiple basis for lump sum determination.

20. What issues do you foresee will need to be addressed with respect to the GC CVs and multi-jurisdictional plans?

Plan members' benefits are determined in accordance with the plan provisions (as documented in the plan text) and the pension legislation as it affects individual entitlements in the province of residence.

This is less of an issue as most of these plans only have members in a single province.

The principles and suggestions in this Consultation Paper, in our opinion, are a positive for NCPPs so should not be a reason to not proceed. The solution is to have the NCPP pay the CV based on the applicable pension laws in the member's province. Again, most NCPP's do not have many members in other jurisdictions so should not be a material amount of commuted values.

Non-NCPPs would typically have more members in other jurisdictions so it would be bigger issue to deal with.

21. Please provide any additional comments or information related to this paper.

The plan text should be required to specify the order of benefits to be reduced when circumstances require benefits to be reduced. The trustees should be provided the flexibility to determine this order but again this order should be specified in advance and documented in the plan text. The regulator could provide guidance or principles to guide the trustees when determining the specific order that the specific plan would use in the event that benefit reductions would be required.