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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

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ACPM Response to Saskatchewan's Consultation Paper: *The Pension Benefits Act, 1992* A Review of the Pension Funding Framework For Single Employer Defined Benefit Plans In the Private Sector And Other Complementary Reform Measures Applicable to All Defined Benefit Plans

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ACPM OVERVIEW

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 millions of 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 workplace and individual savings arrangements ("Third Pillar") and mandatory public programs ("First and Second Pillar").

Empowering Choice in Coverage
Third Pillar arrangements should be encouraged and play a meaningful, ongoing role in Canada's retirement income system.

Adequacy, Security and Affordability
The components of Canada's retirement income system should ensure a healthy balance between these three objectives to enable Canadians to receive adequate and secure retirement incomes at a reasonable cost for members and employers.

Innovation in Plan Design
Canada's retirement income system should encourage and permit innovation in plan design in all three Pillars.

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 always strive for better harmonization.

Clarity and Transparency
Legislation, regulations and retirement income arrangements should be clearly defined and pension plan beneficiaries should be appropriately informed of risks, costs and benefits.

Good Governance
Excellence in governance and administration in the retirement income system.

INTRODUCTION

ACPM supports Saskatchewan's review of its pension funding rules for Single Employer defined benefit plans in the private sector in order to address the current circumstances and improve the sustainability of defined benefit (DB) pension plans for the long-term. We also support the review of contribution holidays and annuity discharge provisions applicable to all defined benefit plans. We are pleased that the considerations highlighted in the Consultation Paper recognize the issues of prolonged low interest rates, and contribution volatility, that were similarly laid out in our DB Pension Plan Funding paper dated May 13, 2014, (*DB Pension Plan Funding: Sustainability Requires a New Model*).

Our May 2014 paper had four objectives that we recommend be adhered to when the government makes its decisions.

The new model:

1. Should be clear to all stakeholders,
2. Should not increase the cost burden on plan sponsors,
3. Should be based on sound funding and risk management principles, and
4. Should be reflective of the long-term nature of DB plans.

We understand that the consultation paper deliberately did not propose one solution, rather it lays out a number of options for pension funding reform with an overall objective to assess whether Saskatchewan's funding framework for single employer DB pension plans should be changed so that it better supports plan sustainability and benefit security over the long-term, in a way that balances the interests of all pension stakeholders.

We also understand that a balance between benefit security and affordability/sustainability require compromises and this submission provides commentary on the options presented with that in mind.

Thank you for your consideration.

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FUNDING FRAMEWORK FOR DEFINED BENEFIT PENSION PLANS

The Consultation Paper sets out two general options to consider:

1. Change the way in which solvency deficiencies are funded;
2. Partial solvency funding or no solvency funding, with enhanced going concern funding.

ACPM prefers Approach 2, because we do not believe that the changes under Approach 1 significantly removes the issue of high funding costs in low interest rate environments. Approach 1 starts with the existing solvency rules and attempts to address the cost, volatility and asymmetric risk issues to the plan sponsor with options that will reduce or eliminate contributions that would otherwise be required.

With all these modifications, one must therefore question the very rationale behind the solvency liability as a measure of the pension benefit to be funded in the first place. It is preferable to start with the ongoing measure of the pension obligation and then strengthen those funding rules to improve benefit security. Therefore, we agree with a version of Approach 2 and strongly encourage its adoption – eliminating or at least reducing solvency funding requirements and strengthening going concern funding.

In this submission, we provide comments on each of the approaches (and options within each approach) as well as providing responses to the specific questions posed in the consultation paper.

Approach 1 – Change the way in which solvency deficiencies are funded

- Option i. Lengthened amortization period: Lengthening the amortization period (and consolidating payment schedules) would help by reducing volatility of special payments required to amortize solvency deficiencies. In order to have a material impact, the period would need to be at least 10 years.

  Further, we recommend that amortization periods commence one year after the valuation date. This delayed amortization commencement would harmonize with the approach taken by Ontario and would allow plan sponsors time to plan for changes in required funding levels, rather than having to react to retroactive funding requirements.

- Option ii. Consolidation of Solvency Deficiencies: The approach suggested is consistent with the federal funding rules and changes proposed or adopted in other provinces. We agree that this approach would help stabilize the funding requirements by avoiding multiple schedules of payments piling up on each other. If solvency funding rules are retained, with some or all of the other modifications discussed, we would also recommend that amortization periods commence one year after the valuation date, as mentioned in Option i., above.

- Option iii. Solvency Reserve Accounts: ACPM strongly supports the consultation document's proposal to introduce solvency reserve accounts ("SRAs"), as they will be an important step towards promoting the retention of DB plans and supporting retirement security for plan members and retirees.

  ACPM also recommends expanding the definition of the SRA to include the portion of going concern contributions to fund any provisions for adverse deviation (PfAD). As such, a different name for any such reserve account may be warranted, but for consistency with the consultation document, we refer to "SRA" in our submission.

  As employers continue to make solvency contributions and may face increasing contribution requirements to fund mandatory PfADs in the coming years, we encourage implementing this proposal without delay to ensure that these contributions are eligible for SRAs as soon as possible. Further comments and recommendations regarding SRAs for defined benefit pension plans are provided below.

Support for SRAs

Security of the pension promise is a key objective of a pension funding regime. However, it must be accomplished through reasonable and fair contribution requirements for employers. Unfortunately, pension funding requirements make unreasonable and unfair demands in certain situations. A going concern valuation, using best estimate assumptions and without margins or PfADs, is the best estimate of the financial position of a defined benefit pension plan that is not terminating.

Nonetheless, we recognize the potential for adverse experience, and understand that it may be prudent to secure benefits at a level that is more conservative than the best estimate. This is the intention of the PBA's requirements for solvency funding, and PfADs in going concern valuations. However, the PBA does not provide a mechanism for recovering these required additional contributions if experience later reveals that they were unnecessary for securing pension benefits.

Contrast this requirement with Canadian reserving requirements for life insurance and annuities. Insurers are required to set aside reserves that are greater than the best estimate amount necessary to fulfill obligations for insurance and annuity payments, but if experience ultimately shows that those reserves were more than necessary, the excess is returned to the insurance company as return of capital and profit.

Without a mechanism for employers to recover required over-contributions to pension plans, the PBA imposes unreasonable and unfair contribution demands in certain situations. SRAs will be an important step in correcting this flaw.

Contributions Eligible for SRAs

The consultation document proposes limiting SRA-eligible contributions to solvency deficiency payments, including both legislated minimum solvency special payments and additional payments in respect of a solvency deficiency. While ACPM strongly supports solvency special payments be included in SRAs, ACPM also recommends expansion of SRAs to include the portion of going concern contributions to fund PfADs.

- Option iv. Letters of Credit (LOC): Letters of Credit (LOCs) provide additional flexibility to plan sponsors on cash funding while providing security to participants. ACPM believes more funding options that provide choices to plan sponsors while providing benefit security to participants is desirable.

Questions related to Approach 1

1. If the solution is to modify solvency funding, which of the above options or combination of options do you feel provides the right balance between benefit security and affordability?

ACPM recommends the elimination of solvency funding rules and strengthening the going concern funding rules (Approach 2) rather than implementing modifications to the existing solvency funding rules. We do not believe that the proposed modifications significantly remove the affordability issue identified.

Approach 1 starts with the existing solvency rules and attempts to address the cost, volatility and asymmetric risk issues to the plan sponsor with options that will reduce or eliminate contributions that would otherwise be required. We believe it is preferable to start with the ongoing measure of the pension obligation and then strengthen those funding rules to improve benefit security.

Nevertheless, if Approach 1 is ultimately chosen, the addition of SRAs would improve benefit security, while removing asymmetric risk issues for the plan sponsor. SRAs could further assist in reducing funding volatility by allowing plan sponsors to feel comfortable adjusting their funding above minimum funding requirements in good times and reducing their funding to minimum levels in times of adversity.

2. Are there other methods of modifying solvency funding which you feel should be considered?

While ACPM's preferred approach would be a strengthened going concern funding basis with no solvency funding requirements, if a concurrent solvency funding requirement is maintained, using an 85% solvency funding level (similar to other provinces, such as British Columbia and Ontario) would result in a measure of harmonization.

3. If the period of time for funding solvency deficiencies is lengthened, what is the appropriate new time period?

Lengthening the amortization period (and consolidating payment schedules) would help by reducing the volatility of special payments required to amortize solvency deficiencies. In order to have a material impact, the period would need to be at least 10 years.

If solvency funding rules are retained, with some or all of the modifications discussed, we would also recommend that amortization periods commence one year after the valuation date. This delayed amortization commencement would harmonize with the approach taken by Ontario and would allow plan sponsors to plan for changes in required funding levels, rather than have to react to retroactive funding requirements.

4. If SRAs are allowed, under what circumstances should the employer be allowed to withdraw payments that have been made into the account?

We appreciate that there needs to be an appropriate balance between allowing employers access to withdraw SRA funds and limiting access in order to maintain benefit security.

A minimum funding threshold on a market value basis should be maintained at the larger of 100% of solvency liabilities or 100% of going concern liabilities (which would include the best-estimate going concern liabilities plus any mandatory PfADs).

Provided the minimum funding threshold has been fully funded, the employer would be permitted to take a contribution holiday or make a withdrawal <u>of the excess over the minimum funding threshold</u> from the solvency reserve account. It should be clear that, upon plan wind-up, any portion of the solvency reserve account not needed to provide promised benefits would be returned to the plan sponsor.

Further restrictions could be placed on the amount of the withdrawal, such as only allowing a withdrawal of up to 20% of the excess over the minimum funding threshold from the solvency reserve account per year. It is the position of ACPM that requiring withdrawals to be spread over a period of, say, five years provides very little, if any, additional protection and may unnecessarily complicate the solvency reserve account.

However, this more cautious approach to withdrawals from the solvency reserve account may be warranted given that full funding on plan termination is currently not in place in Saskatchewan and that it is anticipated that the SRA will also hold going concern PfAD amounts.

5. If LOCs are allowed, should the amount be limited to a certain percentage of liabilities?

Letters of Credit (LOCs) provide additional flexibility to plan sponsors on cash funding while providing security to participants. A number of other jurisdictions have reviewed their policy on LOC limits and in a number of cases (e.g., BC, Alberta, Nova Scotia) have decided to eliminate any such limitations or never had limitations (e.g., Manitoba).

Allowing a letter of credit that could be up to 100% of solvency liabilities would provide more flexibility and still maintain the desired (or, in theory, even greater) security to participants. For example, a plan with a solvency ratio of 69% might decide to negotiate a 20% letter of credit to provide a margin above the potential 85% limit, thereby limiting the frequency of changing the amount of coverage.

Approach 2 – Partial Solvency Funding or No Solvency Funding, with Enhanced Going Concern Funding

An approach similar to the going concern funding rules recently introduced in Québec and Ontario could reduce the volatility and magnitude of DB plan funding requirements, although in some cases, the total funding obligations may be higher than under the current funding model.

We believe that a simple solution that is aligned with ACPM's new funding model of clarity, cost neutrality to plan sponsors, sound funding and risk management principles and reflective of the long-term nature of DB plans should be considered.

Questions related to Approach 2

1. **If the current solvency funding threshold of 100% is reduced to require only partial solvency funding, is a threshold of 85% appropriate?**

While ACPM's preferred approach would be a strengthened going concern funding basis with no solvency funding requirements, if a concurrent solvency funding requirement is maintained, using the 85% level as implemented in Ontario and BC would result in a measure of harmonization.

2. **What is the main risk(s) that a PfAD should mitigate?**

The purpose of a PfAD is to assist in managing and mitigating risks to meet the objectives of the plan, primarily which is to pay the benefits as they come due. These risks may include asset/liability mis-match risk, investment risk, interest rate and mortality and other demographic risks.

3. **What do you feel is the best method of determining the level of PfAD?**

Factors that could be considered in setting mandatory PfADs include duration of liabilities, investment policy and plan maturity. Other plan specific provisions which can drive higher or lower volatility (e.g. indexing) could be included in any flexible plan specific PfADs. It is important that any mandatory PfAD calculation not be so onerous that it would both prevent the plan sponsor from pursuing a reasonable allocation of risk for fear of increasing its immediate funding requirements and impose significant regulatory burden on the pension regulator.

In addition, while regulations and guidance are necessary to determine any mandatory PfAD for a given DB pension plan, the mandatory PfAD should not be so onerous that a plan sponsor would be unwilling to consider including an additional flexible plan-specific PfAD to enhance benefit security and assist in moderating contribution volatility.

We agree that some level of mandatory PfAD in funding contributions and going concern liabilities provides enhanced benefit security. As such, we recommend the use of best estimate actuarial assumptions with explicit PfADs.

We also recommend that liabilities covered through annuities or a longevity swap should be excluded from the calculation of any mandatory PfADs. Any mandatory PfADs could be prescribed in a similar manner to the mandatory PfADs already in the Saskatchewan PBA for Limited Liability Pension Plans where the mandatory PfAD (included in the funding contributions and in some cases in going concern liabilities) is determined in reference to the plan's target allocation to risky assets.

As stated above, contributions to fund PfADs should be eligible to be included in a Solvency Reserve Account.

ACPM does not recommend that a shortened amortization period be implemented on its own without the PfAD. We do not believe that best estimate discount rate assumptions are appropriate for long term sustainable pension plan funding, and there are currently no other applicable rules (including professional actuarial standards) which require a buffer in the going concern funding basis.

4. Should the method of determining PfAD be different if there is no solvency funding required than if there is a certain level of solvency funding required?

We believe that a strengthened going concern funding model that includes:

- a single effective method of determining any mandatory PfADs,
- SRAs which permit the allocation of mandatory PfAD funding to these reserve accounts, and
- limitations on contribution holidays that take into consideration a minimum funding threshold, supports the primary goal of benefit security. As such the method of determining any mandatory PfAD should be established regardless of the requirement for solvency funding.

5. Should the PfAD have to be funded on current service contributions, even if the plan is in a going concern surplus?

As PfADs are expected to be included on the balance sheet and going concern deficit funding would require unfunded PfADs to become funded, having multiple methods of funding the PfAD would be unnecessary. Therefore, we do not recommend having the PfAD funded on current service contributions if the going concern funded status is in surplus/above a minimum funded position, as is the case in other provisions that introduced a mandatory PfAD.

We also have concerns with increasing the costs for plan sponsors that already apply appropriate governance and risk management principles to their plans and are currently in a going concern surplus situation (after the inclusion of any mandatory PfADs).

6. If the period of time for amortizing going concern deficiencies is shortened, what is the appropriate period?

ACPM understands the rationale for shortening the going concern amortization period as a compromise for eliminating the amortization of solvency deficits. Our preference would be to have an amortization period of 10 years, with a consolidation of the total unfunded liabilities, i.e., a "fresh start" at each valuation rather than tracking and managing multiple amortization schedules.

We would also recommend that amortization periods commence one year after the valuation date. This provides sponsors with a period of time to prepare for changes in funding requirements without the funding requirements applying retroactively and would be consistent with the approach taken by Ontario.

7. Are there other methods of enhancing going concern funding which should be considered?

Benefit security and contribution volatility are only balanced by incorporating both a shorter amortization period and PfAD, i.e., both proposed options. We also believe that removing much of the asymmetric funding risk faced by plan sponsors by permitting funding of PfADs to be allocated to a solvency reserve account, would enhance benefit security.

8. Are there any other features to the funding rules which should be considered, such as consolidation of unfunded liabilities?

One Year Lag for Amortization Payments

As mentioned in response to question 6, our preference is to consolidate the total unfunded liabilities, i.e., a “fresh start” at each valuation rather than tracking and managing multiple amortization schedules. We would also recommend that amortization periods commence one year after the valuation date. This provides sponsors with a period of time to prepare for changes in funding requirements without the funding requirements applying retroactively.

Commuted Value Calculations for all Plans Registered in Saskatchewan

An issued not raised in the consultation paper is the calculation and payment of commuted values (CVs). Events like the COVID-19 crisis highlight existing inequities in the way CV payouts are paid out or transferred. Different plans are subject to different funding requirements; however, not all plans are required to pay out CVs on the same basis. This imbalance has been recognized by the Canadian Association of Pension Supervisory Authorities (CAPSA), (i.e., 2019’s Recommendations - Funding of Benefits for Plans Other than Defined Contribution Plans).

CV payout standards should be more reflective of how plans are funded and the risks borne by remaining plan members. Such a change would better balance the interests of those remaining in the plan and those electing a payout, without requiring the employer to add additional funding above minimum funding standards. While we fully appreciate that current Saskatchewan CV payout rules allow the plan to pay out less than the full CV based on the plan’s transfer ratio, these rules ultimately require the plan to make up the difference, which can result in contributions to the plan above minimum funding standards.

This consultation provides the government with an opportunity to address this long-standing issue, and we suggest that FCAA explore and consider, with the government, the alignment of CV payout standards with the way in which the plan is funded. This would put plans on a more sustainable footing.

9. **Are there any options from the previous section (Change the Way in Which Solvency Deficiencies Are Funded) which should be incorporated if only partial solvency funding is required, or if it is eliminated completely? In particular, would solvency reserve accounts and letters of credit be useful mechanisms if a solvency deficiency has to be funded only to a certain level?**

We also believe that removing much of the asymmetric funding risk faced by plan sponsors by permitting funding PfADs to be allocated to a solvency reserve account, would enhance benefit security. We also believe Letters of Credit provide additional flexibility to plan sponsors on cash funding while providing security to participants.

QUESTIONS FOR COMMENT

Additional Change Applicable to Single Employer Defined Benefit Plans in the Private Sector (SEPPPs)

A. FULL FUNDING ON PLAN TERMINATION

1. **Assuming the solvency funding framework is changed, are there any types of SEPPPs for which an employer should not have to fully fund a deficit if the plan is voluntarily terminated? For example, if members are required to contribute towards a solvency deficit, the framework could be structured so that only a portion of the deficit has to be funded by the employer if the plan is wound up.**

ACPM generally supports full funding on plan wind up. This requirement would align with funding provisions in other jurisdictions.

We note that in other provinces where members and employers jointly fund the plan, members are jointly responsible with the employer for funding wind up deficits (such as for jointly sponsored pension plans in Ontario). It would be appropriate to allow members and employers to agree to such an arrangement and adjust the employer's obligation on wind up accordingly.

2. **Are there any options presented in "Two Main Approaches" which should not require the full funding condition, if the Regulations are amended to include only that option? For example, if the only change made to the Act or Regulations is to allow a longer period of time for amortizing a solvency deficiency, should full funding on plan termination still be a condition for electing the option?**

Please see our response to question 1. above.

Additional Change Applicable to All Defined Benefit Plans

A. RESTRICTIONS ON CONTRIBUTION HOLIDAYS

1. Should contribution holidays be restricted further than they are currently? If so, which method best protects member benefits?

ACPM believes that a minimum funding threshold on a market value basis should be maintained at the larger of 100% of solvency liabilities or 100% of going concern liabilities (which would include any mandatory PfADs). Once the minimum funding threshold has been fully funded the employer would be permitted to take a contribution holiday such that the minimum funding threshold is maintained.

Once the minimum funding threshold has been achieved (going concern funding (including any mandatory PfAD) ratio above 100% and solvency ratio above 100%), then contribution holidays should be allowed until the dollar amount of contribution holidays equals the dollar excess above the minimum funding threshold.
That being said, we believe the sponsor should have access to a solvency reserve account while it is ongoing. One approach would be to allow contribution holidays from the solvency reserve account provided the PfAD is funded and the plan has a 100% solvency ratio.

2. If a plan is required to be funded at a higher level than 100% on a solvency basis and/or a going concern basis before taking a contribution holiday, what is the appropriate level?

ACPM believes that a minimum funding threshold on a market value basis should be maintained at the larger of 100% of solvency liabilities or 100% of going concern liabilities (which would include any mandatory PfADs). Once the minimum funding threshold has been fully funded the employer would be permitted to take a contribution holiday such that the minimum funding threshold is maintained.

If funding is required at a level higher than the above minimum funding threshold before taking a contribution holiday, then in order to promote uniformity with other jurisdictions, we recommend 5% margin above any mandatory PfAD included in a going concern valuation and a 105% solvency ratio.

Given that a going concern PfAD already gives a high probability of a plan maintaining its fully funded status, a 5% buffer should be more than sufficient in most cases to ensure a very high degree of fully funded status and a reasonably high probability of maintaining the PfAD.

Once the minimum funding threshold has been achieved, then contribution holidays should be allowed until the dollar amount of contribution holidays equals the excess above the minimum funding threshold. That being said, we believe the sponsor should have access to a solvency reserve account while it is ongoing. One approach would be to allow contribution holidays from the solvency reserve account provided the PfAD is funded and the plan has a 100% solvency ratio.

3. **Should the ability to take a contribution holiday be determined on an annual basis, whereby a cost certificate would have to be filed each year to determine whether the plan remains in a surplus position?**

We do see some merit in requiring a certain level of annual update reporting if a plan is taking contribution holidays during the triennial period. A plan may be required to show at annual interim periods that the plan is still fully solvent and all reserves are funded to continue to take a contribution holiday during the subsequent annual period.

B. ANNUITY DISCHARGE

1. **If annuity discharge provisions are added to the Act, what are the appropriate conditions that a plan should have to meet in order to be eligible to qualify?**

ACPM believes that harmonization with other jurisdictions is a desirable goal. Ontario, British Columbia, Alberta, Québec, and the Federal government have made amendments to their respective pension legislation that include a discharge for the administrator and the employer.

To illustrate what might be appropriate conditions to satisfy for an annuity discharge, Ontario's requirements for a statutory discharge are, in addition to certain notice requirements:

- the benefit purchased must be the same – in amount and form – as the benefit provided under the pension plan;

- the insurance company must be authorized to sell annuities in Canada;

- the pension plan must meet the applicable prescribed minimum funding requirements; and

- the annuity contract must contain certain prescribed terms, including that no money payable under the contract will be assigned except in accordance with family law, that the pension payments will be in the form of a joint and survivor pension unless such right was waived, and that death benefits will be administered in accordance with the PBA, among other prescribed terms.

ACPM has identified a potential challenge with the Ontario amendments in respect of benefits provided under a pension plan that includes indexation tied, at some level, to inflation. For example: indexation can be equal to 75% of the increase in inflation each year. In the current annuity market in Canada, annuities indexed to some level of inflation can be difficult to place in the annuity market. One change to the Ontario amendments that we would recommend be considered is that indexation included in the benefits purchased be in a form that is an acceptable substitute to the plan members for the indexation benefits provided under the plan. Using the example above: an acceptable substitute may be a fixed level of indexation each year equal to 75% of the expected future average annual increase in inflation (such as a fixed 1.5% increase per year).

Thank you for the opportunity to provide our input on this consultation and we are available if you require any further assistance.