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

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ACPM Comments on the Recommendations of the Expert Committee on the Future of the Québec Retirement System

A Presentation to the Québec Public Finance Committee

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FOREWORD

<u>The Association of Canadian Pension Management (ACPM)</u>

The Association of Canadian Pension Management is the informed voice of Canadian retirement income plan sponsors, administrators and their allied service providers. We are a non-profit organization and our objective is to advocate for an effective and sustainable Canadian retirement income system. Our membership represents over 400 retirement income plans consisting of more than 3 million plan members, with assets under management in excess of $330 billion.

The ACPM promotes its vision for the development of a world-leading retirement income system in Canada by championing the following Guiding Principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders' interests; and
- Excellence in governance and administration

<u>Introduction</u>

The ACPM appreciates the opportunity to provide our input to the Québec Provincial Government. ACPM has made numerous submissions to the Canadian federal and provincial governments on potential improvements that are designed to improve the retirement income system. Assisted by our ACPM Québec Regional Council, we are now pleased to provide you with our observations and comments on the D'Amours Report.

1. A new plan – Longevity pension at age 75:

a) We recognize there is a need to change how Canadians save for retirement:

- Many cannot make rational decisions on how much to save and where to invest
- Many are choosing products with high fees
- Private sector employers are transferring pension responsibilities to their employees
- Canadians are not converting their retirement capital into income efficiently.

b) There is no consensus within ACPM on whether these issues should be addressed through changes in the private sector system or whether there should be a partial transfer of responsibilities from the private sector to the public sector.

c) If the government chooses a partial transfer of savings from private arrangements to a new public sector Plan, the following conditions should be met:

- The new Plan is separate from the C/QPP
- The Plan is fully funded without transfer of cost to the next generation
- The normal date of first payment is later than 65, such as 75 as proposed
- The governance of the Plan is independent from the government. We do not think that the Board of the Régie des rentes is sufficiently independent
- The new Plan is available across Canada
- Low income earners are not required to contribute or the current GIS is adjusted
- Employers in the private sector who already have a registered pension plan should be allowed to decide unilaterally to integrate their current plan with the longevity pension plan (as it is proposed to be done automatically for public sector pension plans)

2. Revised funding rules for DB pension plans:

a) ACPM is in favour of applying the same funding rules for the private sector and the public sector (e.g., municipalities and universities), (i.e., no solvency requirement and same discount rate regulations) but with some differences in deficit amortization periods in order to reflect better the level of risk involved for plan members; for example, public sector plans should be permitted to take an additional 5 or 10 years to amortize deficits.

b) ACPM believes that it might be appropriate for the Government to consider carefully whether the same funding rules should apply also to public employee plans (e.g. RREGOP and SQ). It is understood that those plans were outside the mandate of this committee, but maybe the same funding rules should apply to those plans, unless the government provides acceptable justifications against it.

c) ACPM recognizes that implementing these new funding rules may cause substantial increases in public sector contributions, since they were exempted from solvency valuations a few years ago. This problem may be addressed with a long transition period and a longer amortization period even after such a transition period. For example, instead of beginning with a 15 year amortization period and gradually bringing it to 10 years, maybe the amortization period in the public sector should begin at 20 or even 25 years, and transition to a final period of 15 or 20 years.

d) ACPM is pleased with the recommendation that deficit amortization payments be calculated by consolidating all experience losses over a new amortization schedule, but is concerned about the suggestion that experience gains could not produce reductions in amortization payments but instead would be used to reduce the length of the amortization schedule. ACPM would prefer that gains and losses be treated in a consistent manner and that amortization payments be adjusted over the full amortization schedule.

e) ACPM is concerned that there is no mention of letters of credit and would prefer that they be permitted under the new funding basis, even though they were permitted until now only under the solvency basis. Furthermore, ACPM believes that there should no longer be a limit of 15% on such letters of credit. If that limit had been implemented because of uncertainty over the creation of a new mechanism, maybe that uncertainty has diminished since they were implemented; alternatively if that limit had been implemented because of the risk of concentrating too much on the issuer of such a letter of credit, maybe this could be replaced with a limit applicable to any one issuer (e.g., allowing two amounts of 15% backed by two different banks).

f) ACPM recognizes that the recommendation to revise the actuarial valuation assumptions in order to take into account the investment risk premium during the members' active period, but not during their retirement (except for a small premium reflecting corporate bonds), represents a compromise between the current going concern and solvency rules; ACPM considers that such a compromise is probably close to an acceptable solution. However, ACPM considers that the proposed corporate bond reference may be inappropriate because of its very limited market, so a better alternative might be a combination of various types of bonds, such as the DEX universe or a long-term basket that includes corporate (high and medium quality), provincial and federal bonds.

g) ACPM would like the new funding rules for the period before retirement to allow a better recognition of the plan's investment policy in cases where the administrator might prefer to utilize a more sophisticated approach. For example, instead of using different interest rates for two discrete groupings representing active periods and retired periods, a comparable but more sophisticated approach could define a more gradual transition from a risky portfolio to a conservative portfolio. This would avoid the simplification of assuming that the assets related to a member's liabilities as he reaches retirement are switched abruptly from a fully balanced fund to a bond fund. This would also reflect the fact that all active members are not expected to retire at a single age. Such a refinement would be comparable to the popular use of life cycle funds as investment options in DC plans, or to the current rules that allow a plan's PfAD to treat members who are currently eligible to retire as if they became retirees at the valuation date.

h) ACPM welcomes the possibility of considering separate funds for retired and non-retired members. Using separate accounts may allow plan administrators to implement more effective measures to manage investment risks. However, ACPM believes that the interest rate assumption to be used in the new funding basis for the period before retirement should reflect the risk premium for the non-retired fund only, rather than for the total plan assets. In addition, it should be permitted for plans to implement a gradual transition from the active to the retired fund, in the few years just before retirement age (and possibly in the few years just after retirement), so that a given member's assets and liabilities may be partly in each of the separate funds (e.g., 20% transition each year from age 60 with a minimum of 50% transferred by retirement age).

i) The report does not comment on the actuarial assumptions other than the interest rate, so ACPM would like to confirm that those other assumptions are intended to represent the actuary's best estimate. There is no mention of incorporating a margin for conservativeness but there is a recommendation for a funding policy to be developed. ACPM believes that the pension legislation should make it clear that such a funding policy is to be defined by the plan sponsor and the policy should include instructions on what margin should be incorporated (or not) by the actuary in the valuation assumptions. ACPM understands that there is already an implicit margin that is incorporated into the new funding basis because of the requirement to use a bond rate after retirement, in addition to the precaution imposed for the utilization of surplus only in excess of the new PfAD.

j) ACPM is pleased to note that the proposed funding rules would still allow the use of asset smoothing, but wonders why it should be restricted to a maximum period of three years; it would prefer smoothing to be permitted up to five years.

3. Revised transfer values:

a) ACPM welcomes the suggestion to reduce transfer values, apparently with the intention to reflect a certain risk premium. Until now, terminating members could gain by receiving a value that is calculated based on bond yields, while investing this value in their individual account in the future in other types of investments, such as a balanced portfolio, thus potentially earning higher returns than the assumed bond yield. Their gain could be considered more or less to be at the expense of the other plan members, since the funding of their benefits under the plan had been based on the assumption that the plan would make future investment gains, although this would involve a certain degree of risk.

b) ACPM wonders whether prescribing the use of two interest rates, for a select and ultimate period, might be unnecessarily simplistic; a better approach might be to allow such a simplification for plan administrators who desire it, but also to allow a more refined approach for plan administrators who prefer it, such as using different bond yields over a wider range of durations (e.g., 5 periods instead of 2, or even a string of 30 distinct annual rates).

c) ACPM believes that if the intention behind the proposed changes is to attempt limiting the losses for the pension plan when a member transfers out a commuted value, then it might be appropriate to consider the possibility of changing the transfer value basis even further in order to be closer to the new funding basis, i.e., using the higher bond yield after retirement (revised according to our earlier comment) and using a proxy for the expected fund return before retirement, thereby reflecting a reasonable expected asset mix in the future. In order for this proxy to be comparable between plans, ACPM suggests that one possible alternative might be to assume a 50/50 equity/bond mix for all plans.

d) ACPM considers that changing the transfer value basis does not mean that the current basis is incorrect but rather considers that the new basis should reflect a new premise. ACPM recommends that revisions to the transfer values be developed in consultation with the CIA.

e) ACPM notes that it is awkward to determine a commuted value for an indexed pension, given the state of the market for indexed annuities, and this challenge has been highlighted previously by the CIA. Therefore it might be useful for the rules to allow greater flexibility in converting indexed pensions into another form that can be considered practically equivalent.

4. Restructuring accrued benefits:

a) ACPM welcomes the proposal to allow reductions in ancillary benefits related to accrued benefits under certain conditions. It is important to recognize that if changes were made only to pension accruals for future service, it would not be sufficient to alleviate the burden of financing the promises made to date, especially for mature plans. It is also worth noting that some of those past promises had been made in a context that did not contemplate even remotely the current unexpected pressures on financing them, including the prolonged low interest environment and the continuing longevity improvements; it is likely that if the parties had foreseen such developments, they would not have agreed to make such generous promises.

b) ACPM suggests whether restricting reductions only to ancillary benefits, while not allowing reductions in pensions, might not give sufficient latitude in certain cases, especially for plans in which retirees account for the majority of the plan liabilities and in which no indexation is provided after retirement. In such a case, it might be unreasonable to expect that active members could accept cutbacks while retirees are not affected; and even if the active members accept cutbacks, this might not improve the plan's financial situation sufficiently. Therefore, ACPM believes that some consideration should be given to the possibility that the new rules might allow some other type of concession from the retirees, such as a temporary or postponed reduction in their pensions or a revision in their death benefit (form of pension). Such concessions could be structured in a manner that reverses some of the ancillary benefits that were provided in the past, especially the very recent past (as the current law specifies in case of a plan wind-up of a bankrupt employer), thereby approaching what is done for active members. They could also focus on more recent retirees in order to take into account that they might be able to get another job (or already have one). Alternatively, such concessions could take the form of temporary "contributions" to the plan, even though this has never been contemplated by current legislation, including the Income Tax Act - one way of accommodating such contributions might be to link them to future additional benefits (such as indexation) that would depend on the plan’s future financial condition. This approach might be more acceptable when combined with the implementation of a separate fund to manage risks more conservatively for retirees.

c) ACPM is concerned about the usefulness of specifying a five-year period for allowing benefit reductions. In some cases, parties might not feel compelled to act urgently and might postpone concrete action near the end of that period, so there could be some arguments to reduce that period. On the other hand, if parties agree on some reductions within that period and later realize that those reductions were not the most appropriate, they might prefer to continue having the possibility of reducing benefits, so there would be some arguments to extend that period. Maybe a compromise could be to devise some incentive to act quickly but to allow later actions with less incentive. For example, such incentive could be in the form of transition rules for funding, possibly by offsetting deficit amortization payments to a greater extent over a certain period (e.g., liability reductions in the first year producing credits in the amortization schedule over five years, but liability reductions in the fifth year producing credits in the amortization schedule over ten years).

d) ACPM finds it useful to allow employers the possibility of unilaterally imposing benefit reductions in cases where there is no agreement with the unions or plan members. However, limiting such action to a short period between three and five years from the legislation date may not be appropriate, depending on the likelihood that an agreement might be attainable and depending on how the new funding rules might be phased in. ACPM also finds it too restrictive to allow unilateral reductions only in respect of indexation, instead of other ancillary benefits, especially for plans that do not even include indexation currently. ACPM considers that the condition imposed for unilateral reductions, namely to require special employer contributions equal to the value of the reductions, is sufficiently demanding for employers to hesitate using this approach (and rewarding for plan members to be compensated for the employer’s unilateral decision). ACPM would prefer that such special contributions be spread over a number of years instead of being due immediately, such as five years (which would already be more demanding than the new 15-year amortization schedule). Once again, an incentive should be incorporated to encourage quick actions.

e) ACPM is not convinced that parties will manage to agree on benefit reductions, because employees and retirees in some cases may have nothing to gain by consenting to reductions. One way to create an incentive for employees and retirees to agree on benefit reductions might be to link them to accelerated funding of an equivalent portion of the remaining deficit, as suggested above for the unilateral cutbacks, along with an adjustment for quick actions; this could also serve as a deterrent on the employer to push for excessive benefit reductions.

f) ACPM is unsure as to how the implementation of the new funding rules is to be coordinated with the benefit reduction window. It might be unwise to apply new funding rules before the restructuring exercise is accomplished. On the other hand, delaying the new funding rules should not influence parties to delay the restructuring. Careful attention should be paid to devising an appropriate transition.

g) ACPM is very concerned about the possibility that some plan members may retire before the restructuring is accomplished and thus affect the usefulness of the restructuring. Therefore, it is recommended that all plan members who were not yet retired before the report was published could be subject to restructuring similar to active members rather than retired members, depending on how the parties decide to proceed.

5. Management of DB pension plans:

a) ACPM supports the proposed measures that will facilitate the management of DB pension plans, including the following options:

- The purchase of annuities from an insurance company without a requirement to terminate the plan for a full transfer of risk

- The adjustment or reduction of accrued benefits without the requirement of individual consents - the union consent or the rule of 30% opposition would be sufficient

- Regulations that would allow cost-sharing with participants for current and past service

- A separate fund for retirees within a Plan, with its own accounting and investment policy (details to be included on how this would work)

- DC participants could be offered an option similar to a “Life Income Fund“

b) ACPM supports a mandatory 50%/50% cost-sharing formula for the public sector because of the need for greater transparency and the justification of generous plans

c) ACPM supports the requirement of funding policy to be established by the sponsor

d) The Committee supports the concept of Target Benefit Plans. We urge the publication of specific regulations that would govern these types of plans.

e) The Committee has chosen not to address the issue of surplus ownership (including the ownership of the Provision for Adverse Deviation). This will continue to be a source of major concern for shareholders of private sector sponsors. We continue to argue that the legislation should allow the concept of separate account where some employer contributions would be accounted for separately and could be returned to the employer

f) A PfAD at 15% of solvency liabilities will represent a significant concern for private sector sponsors and will result in derisking of investments when full funding will be attained. Shareholders will not accept to support investment risk if higher returns go to a large PfAD without clear ownership. We recommend that the PfAD remains at a level of around 7%. Similarly, the 20% limit on the use of excess surplus for contribution holiday is too low. It should be significantly increased.

6. The PRPP (RVER):

a) We intend to present our views on the RVER to the other hearings that are scheduled on September 6th to review Bill 39.

We thank you for the opportunity to appear before the hearing. Should there be further questions about the content of this report or the need for clarification, we would be pleased to respond accordingly.