January 29, 2018

Funding rules for Defined Benefit Pension Plans
Pension Policy Branch
Ministry of Finance
5th Floor, Frost Building South
7 Queen's Park Crescent
Toronto, ON M7A 1Y7

Via email: Pension.feedback@ontario.ca

To Whom It May Concern:

RE: Reform of Ontario's Funding Rules for Defined Benefit Pension Plans (incl. Annuity Liability Discharge and PBGF Assessments)

ACPM is the leading advocate for plan sponsors and administrators in the pursuit of a balanced, effective and sustainable retirement income system in Canada. We represent plan sponsors, administrators, trustees and service providers and our membership represents over 400 companies and retirement income plans that cover more than 3 million plan members.

We are writing to comment on three recently released proposals affect pension plans in Ontario: a) defined benefit funding reform; b) annuity liability discharge and; c) the basis for calculating PBGF assessments.

GENERAL COMMENTS

ACPM continues to support Ontario's implementation of new funding rules in order to improve the sustainability of single employer defined benefit (DB) pension plans as well Multi-employer Pension Plans (MEPPs) providing defined benefits that are not Specified Ontario MEPPs (SOMEPPs). We appreciate the opportunity to respond to the government's description of proposed new funding rules for DB plans.

ACPM has provided previous commentary on this subject. Our DB Pension Plan Funding paper dated May 13, 2014 (DB Pension Plan Funding: Sustainability Requires a New Model) laid out four principles that we recommend be adhered to when the government makes its decisions related to funding policies.

The new model:

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

To achieve the goals laid out above, in 2016, we responded to the Ontario's Solvency Funding Consultation (ACPM Response to Ontario's Solvency Funding Framework for Defined Benefit Pension Plans) by recommending a funding regime that is similar to Québec's that eliminates the need for solvency funding while requiring a Provision for Adverse Deviation (PfAD).

ACPM supports the proposal to replace the current funding regime that is focused on solvency requirements by a new framework that places greater emphasis on a going concern requirement and PfAD. We reiterate the principles we outlined in our August 4, 2017, discussion paper to Lynn Lawson.

However, when constructing a new funding framework, it would be preferable to aim for harmonization with other jurisdictions within Canada. Moreover, we understand that there could be plans that are currently in both a solvency and going concern surplus position and that are largely de-risked who will be faced with increased contributions as a result of the PfAd and significantly higher PBGF premiums, which should not be the result of these reforms. When finalizing the reformed funding rules, it is important to not increase the burden of administration and cost on plan sponsors, which could simply further discourage employers from offering defined benefit plans.

In light of the above, this submission provides a summary of ACPM's recommendations, with a more detailed explanation following.

<u>SUMMARY OF RECOMMENDATIONS</u>

Defined Benefit Funding Proposal:

PfAD:

- The government should release its policy rationale for the PfAD and allow actuaries to calculate a plan specific PfAD that meets the core policy objectives;
- To allow for harmonization with the way in which Québec calculates its PfAD, and to better reflect funding risks, a grid should be developed reflecting the two main factors of risk - – the percentage of assets in variable securities (as proposed), and the duration mismatch between assets and liabilities;
- The flat 5% minimum PfAD for all plans is too high. It should be varied based on risk or integrated into the asset mix scale;
- Clarify that margins in actuarial assumptions are not required;

- Remove the distinction in the calculation of the PfAD based on plan status (i.e. closed vs open);
- Instead of defining the BDR component in the regulation, it would be preferable for FSCO to adopt guidelines that could be revised more easily if and when warranted by evolving market conditions, as done already by OSFI and Retraite Québec.

Notional Reserve Accounts

- Permitting use by employers of such accounts is an essential element necessary to balance other elements of the proposals;
- Employer contributions to fund solvency deficits and to fund the PfAD should be tracked through a notional reserve account that is available to employers for contribution holidays or refunded on plan wind up. This account can be used to address trapped surplus issues.

Contribution Holidays:

- A contribution holiday should be allowed if the PfAD is funded and the plan has a solvency ratio of at least 100%.

Transition period:

- The proposed phase-in for the new framework should be extended from 3 years to 5 years;
- Phase-in towards 10 year going concern special payments schedules should be done gradually over 5 years.

Annuity liability discharge:

- Plans should not be required to fund up to the 85% level. Sponsors should only be required to maintain the lesser of 100% and their pre-purchase solvency funded ratio when discharging liabilities;
- Annuities purchased more than three years prior to plan wind up should not be eligible for distribution of surplus on plan wind up.

Proposed Changes to Pension Benefits Guarantee Fund (PBGF) Assessments:

- PBGF contributions should be based on the size of the deficit, not the value of the liabilities;
- There should be transparency in the analysis underlying the proposed new contribution requirements;
- PBGF contributions should continue to be payable from surplus.

RATIONALE FOR RECOMMENDATIONS

PfAD:

Recognizing that many Plans operate in multiple jurisdictions, we continue to advocate for a framework that is more, rather than less, harmonized with other jurisdictions. As a jurisdiction with two years of PfAD implementation, we believe there are valuable lessons that can be learned from the Québec experience. Alberta and British Columbia have also introduced concepts, such as the reserve account, that we support.

The development of the PfAD should be based on a public policy objective to enhance benefit security. The current proposal, as it stands right now, does not indicate what principles underlie the proposed calculation of the PfAD . ACPM strongly encourages the government to release its policy principles explaining the rationale behind how it has structured the proposed PfAD. This was done in Québec and was met with strong support. We would also suggest that the rules allow actuaries to calculate a plan specific PfAD that meets the defined public policy objectives.

Thus, ACPM recommends that the government release its policy rationale for the PfAD and allow actuaries to opt-out of the prescribed calculation and calculate a plan specific PfAD that meets the core policy objectives. We also emphasize that it is necessary to clarify that there is no requirement for margins when setting actuarial assumptions as a result of the PfAD.

ACPM supports the government's objective to include investment risk as a means of calculating the PfAD. However, we feel that the criteria used to evaluate risk does not go far enough. The current proposal does not address duration mismatch as is the case in Québec. **To allow for harmonization with Québec, and to better reflect investment risk, a grid should be developed reflecting the two main factors of investment risk** – the percentage of assets in variable securities (as proposed), and the duration mismatch between assets and liabilities. Moreover, the government should continue to consult with experts, including ACPM, on the treatment of alternative investments. This has been straightforward to implement and use in Québec.

The flat minimum 5% PfAD for all closed plans is too high. For example, in a plan that has been de-risked through the purchase of buy-in annuities, it does not make sense to force the employer to fund such a PfAD. Plans that are largely de-risked to interest rate risk through liability duration matching also should not have such a high PfAD. **The minimum PfAD for closed plans should vary based on risk or be eliminated and built it into the asset mix scale.**

While ACPM understands that there may be public policy objectives behind the proposal to calculate the PfAD based on plan status (open or closed), we believe that it will not be easy to define and may even encourage manipulation. **Thus, ACPM recommends the removal of the distinction in the calculation of the PfAD based on plan status.**

Notional Reserve Account

We strongly recommend that any employer **contributions to fund the PfAD and to fund solvency deficiencies should be tracked through the use of a notional reserve account**. In doing so, the government can address issues related to trapped surplus. Should a plan terminate and have a surplus, these contributions can then be returned to the employer. The amounts within the reserve account should also be available to support an employer contribution holiday, as discussed below.

While there may be some concerns with this measure from certain groups, ACPM believes it is important that funding reform be balanced and transparent with respect to surplus ownership resulting from additional contributions towards a PfAD or solvency deficit (under the new 85% threshold level). The notional reserve account is essential for maintaining balance and transparency within this package of proposals (which includes significantly higher PBGF premiums, an obligation that does not exist elsewhere in Canada) and has been successfully implemented in other jurisdictions that have reformed defined benefit solvency funding. We note that the implementation of such rules in Québec (the "banker's clause") has not caused difficulties.

Contribution Holidays:
According to the government's proposed changes, the value of assets that could be used to take a contribution holiday for a year would be limited to 20% of the plan's available actuarial surplus. This is overly restrictive on plan sponsors and their members and could result in trapped surplus. It could also serve to encourage benefit improvements to reduce surplus that further increase liabilities and, ultimately, plan sponsor costs and funding risk in the future. Alberta's approach with respect to Solvency Reserve Accounts struck a balance between creating a reserve in the event it is needed for funding but avoiding overfunding by the employer. This proposal does not appear to strike such a balance.

As a core principle, ACPM believes a plan should be considered well funded when the assets would at least equal going concern liabilities plus the PfAD, as well as have a solvency ratio of at least 100%. Thus, **a plan should be able to use actuarial surplus towards a contribution holiday if the PfAD is funded and the plan has a solvency ratio of 100%**. Plans should not be required to maintain a transfer ratio of 1.05.

Again, notional reserve accounts are an essential element of funding reform. **The amounts held within the notional reserve account should be available to support employer contribution holidays if the above conditions are met**.

Transition Period:
In light of the government's proposal around PBGF premiums, plans may now face increased PBGF premiums and contributions overall due to PfAD requirements. As such we believe that the transition period for plans should be extended. If the total contribution requirements for a plan under the proposed framework are greater than the total contribution requirements under the current rules, the **proposed phase in for the new framework should be extended from 3 years to 5 years**. Along those lines, we also recommend that the **phase in towards 10 year going concern special payments schedules should be done gradually over 5 years**.

A NOTE ON JOINTLY SPONSORED PENSION PLANS (JSPPs)

In our 2016 submission, we recommended that JSPPs should be exempt from single employer DB funding rules as existing going concern funding rules are best suited for JSPPs, given their joint governance and shared funding responsibility. As such, we agree that the proposed funding rules should not apply to JSPPs that are listed in s.1.3.1(3) of Regulation 909 (the Regulation) under the Pension Benefits Act. There should be no change to the funding rules for those JSPPs.

As noted above, the new funding model should be grounded in sound risk management principles. In this regard, the level of regulation should be tailored to apply in proportion to the level of risk to members' benefits. Accordingly, JSPPs not listed in s. 1.3.1(3) of the Regulation, whose funding policies and governance structures are substantially similar to the exempted JSPPs' structures and policies and in respect of which the risk to member benefits is similarly low, should be similarly exempted from the new funding regime and subject only to the existing going concern funding rules.

***Discharge of liabilities in respect of annuity purchases*:**
In our 2016 submission, we advocated that a plan administrator and sponsor should be discharged of the pension liability should a buy-out annuity be purchased. We support the government's efforts to move forward in this area along with its proposal that sponsors of underfunded plans must contribute a lump sum payment when such transactions take place.

However, we are concerned with the proposal that in order for an annuity purchase to occur, the new solvency ratio of the plan must be at the higher of the plan's solvency funding ratio immediately before the purchase; and a solvency funding ratio of a 100% (85% if new rules are adopted).

Annuities are increasingly being considered as a method to de-risk the plan and reduce funding volatility, and for that reason, should be encouraged. However, the lack of a discharge and the related ongoing burden of administration under the current scheme can be a deterrent countering these de-risking benefits, which benefit not only the plan sponsor but the annuitized members. Requiring a plan to be fully funded on a solvency basis in order to obtain a discharge could serve to further discourage what might otherwise be a prudent step.

We recommend that plans should only be required to maintain the lesser of their pre-purchase solvency funded ratio when discharging liabilities and 100%. Forcing plans to fund up to the 85% or 100% level will greatly discourage plans from purchasing annuities and securing member pensions.

Finally, we recommend that Ontario should implement a similar provision to Québec, whereby, if a plan winds up and has a surplus, only members whose liabilities have been **annuitized within the previous three years would be eligible for surplus distribution**.

PROPOSED CHANGES TO PENSION BENEFITS GUARANTEE FUND (PBGF) ASSESSMENTS

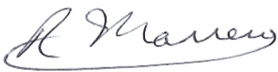
The proposals introduce a component of the calculation that would base PBGF contributions on the plan's liabilities. The policy rationale and relationship to risk is not clear. ACPM supports a calculation based on size of the solvency deficit only; it **should not be based on total liabilities**.

More generally, there should be **transparency in the analysis** underlying the proposed new contribution requirements so that they can be understood and fairly evaluated by the industry. This is particularly important in light of the significant increases that employers may experience under this proposal.

Lastly, we see no policy reason to change existing rules that **permit PBGF contributions to be payable from surplus (or as a minimum, from the Reserve Account)** and, in fact, we would argue that maintaining such rules maintains balance between plan security and employer contributions within the full package of proposals.

We appreciate the opportunity to provide input on this issue. Please do not hesitate to contact us if you have any questions.

Sincerely,



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