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

[UNOFFICIAL ENGLISH VERSION]

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BY E-MAIL

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Subject: Draft Regulation respecting the funding of defined-benefit pension plans of the municipal and university sectors

Mr. Dufresne,

The Association of Canadian Pension Management ("ACPM") is the leading advocacy organization for plan sponsors and administrators in the pursuit of a balanced, effective and sustainable retirement income system in Canada. Our private and public sector retirement plan sponsors and administrators manage retirement plans for millions of plan members, including both active plan members and retirees.

We are pleased to provide you with the ACPM's comments with respect to the draft *Regulation respecting the funding of defined-benefit pension plans of the municipal and university sectors* ("**Draft Regulation**") published on April 5, 2023.

First, the ACPM welcomes the initiative, which aims, among other things, to harmonize certain legislative provisions applicable to pension plans in the municipal, university and private sectors. The ACPM supports any changes aimed at simplifying the applicable rules.

We understand that the Draft Regulation follows extensive consultations with various stakeholders from the municipal and university sectors. We also understand that there is consensus on most of the proposed modifications.

Amortization payments funded from the reserve

Certain measures had been considered at the time of the consultation but were not retained in the Draft Regulation. The main one is the possibility of modifying the plan provisions in order to allow for the use

of the reserve to cover up to 100% of the amortization payments required to finance an actuarial deficit in the *prior component*.

We believe that such a measure would have allowed for much better management of financial risks and would have been potentially beneficial for everyone (sponsors, active members, and retirees).

Instead, maintaining the limit of 50% of amortization payments financed from the reserve will mean that once the *prior component* is well funded, plan sponsors will probably want to eliminate investment risks as much as possible to avoid any future deficit, which will also significantly reduce the potential for gains that could lead to the improvement of benefits.

We understand that this provision was not changed due to lack of consensus. However, if there were flexibility to fund up to 100% of the amortization payments from the reserve (the Regulation would not impose it) and this would have to be provided for in the plan text, then the lack of consensus in Québec should not be an impediment to this modification. Those who do not want to increase the 50% limit could maintain the current provisions in accordance with the agreement applicable to their situation.

Considering that the reserve is only composed of technical gains and not of additional contributions, if one wanted to better protect the rights of members, this flexibility could be permitted only after reaching a minimum funding threshold (for example, when the reserve reaches the threshold of the provision for adverse deviations, or any other minimum financial threshold deemed sufficient).

We therefore recommend that the Draft Regulation be amended to provide the flexibility to fund up to 100% of the amortization payments from the reserve.

Amortization period

The progressive reduction of the amortization period from 15 to 10 years will increase the amortization payments required to finance actuarial deficits by approximately one third.

Although we understand that the reduction of the amortization period is intended to harmonize with the rules applicable to private sector pension plans, we believe that the specific context of the municipal and university sectors may justify certain differences in the funding rules.

When there is cost-sharing as provided for in the *subsequent component*, the shorter amortization period can allow the transfer of costs between different generational cohorts of plan members to be limited. However, for the *prior component*, a reduction in the amortization period will increase the financial risks borne by the plan sponsor resulting in the same consequence as that raised above regarding the use of the reserve, i.e. a reduction in investment risks when the plan becomes well-funded, limiting the potential for future benefit improvements.

We believe that the reduction of the amortization period should only be considered if it is combined with the option of allowing up to 100% of the amortization payments to be financed from the reserve in the *prior component*.

Plan asset smoothing

Asset smoothing is generally an effective tool for promoting the financial stability of a pension plan, since it limits the consequences of short-term fluctuations in financial markets.

However, using an asset smoothing method in the specific context of funding rules in the municipal and university sectors could produce undesirable effects, particularly with respect to the *prior component*. The implementation of a new asset smoothing method should be gradual to prevent any technical gains already transferred to the reserve or to the stabilization fund from being used again for smoothing purposes. Thus, when implementing a smoothing method, only the gains and losses of the years elapsed since the last actuarial valuation should be used for smoothing purposes.

The use of an asset smoothing method could also lead to negative consequences when technical gains are recognized and transferred to the reserve, even though these gains no longer exist on the basis of a fair market value. These negative consequences could easily be avoided if the Draft Regulation were amended to allow for funding of up to 100% of the amortization payments from the reserve in the *prior component*.

The use of an asset smoothing method should also make it possible to limit the use of advance filings of actuarial valuation reports for the sole purpose of avoiding an excessive increase in amortization payments, which is beneficial in the long term to limit actuarial costs.

Therefore, to avoid the above-mentioned problems with asset smoothing, we reiterate our recommendation to provide the option to fund up to 100% of the amortization payments from the reserve in the *prior component*.

Deferment of contributions

Section 47 of the Draft Regulation provides that the funding policy must set out the conditions for the deferment of the current service contribution, stabilization contribution or technical amortization payment. Section 50 of the Draft Regulation states that if no conditions are set out in the funding policy the deferment would apply by default.

Since plan texts must now specify that any additional commitment resulting from an amendment must be paid in full as of the day following the actuarial valuation, we believe that the provisions on the deferment of contributions could also be integrated into the pension plan regulations.

We therefore recommend an amendment to sections 47 and 50 of the Draft Regulation to allow either the funding policy or the plan text to set out the conditions for the deferment.

Residual rights

The ACPM welcomes the elimination of residual rights for plans that pay members' benefits regardless of the solvency ratio or in the case of benefit payments for members who cannot leave their entitlements in the pension plan.

We do not expect this measure to have a significant impact on the financial health of pension plans, and it will significantly simplify their administration.

Use of surplus assets during the life of a pension plan

The Draft Regulation provides that the current provisions of the *Supplemental Pension Plans Act* ("**SPPA**") on the use of surplus assets will now also apply to pension plans in the municipal and university sectors. As a result, any provisions agreed to between the parties within the framework of the restructuring agreements regarding the use of surplus assets may be applied without requiring a new consultation process. We are of the view that this will simplify the application of provisions already agreed to.

We understand that the consultation process provided for in the SPPA will only apply when there is a modification to provisions in the plan text on the use of surplus assets. It would be important to clarify whether the application of a provision in restructuring agreements stipulating that the parties are required to agree on the use of surplus assets must automatically go through the consultation process required by the SPPA.

We remain available to discuss this at your convenience.

Your sincerely,

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