Intelligence MEMOS

From: Barry Gros

To: Ontario's Pension Policy Branch

Date: April 21, 2023

Re: **Achieving Sustainability in Target Benefit Pension Plans**

The Ontario Ministry of Finance released its Consultation Document on the regulation of target benefit pension plans (TBs) last month with a request for comments by June 30.

Yesterday we evaluated it against recommendations previously proposed in a C.D. Howe Institute Commentary. Today, we look at its proposals for delivering a long-term sustainable target benefit.

The approach taken to sustain a targeted benefit can be heavily influenced by one's starting point. The Consultation Document is a great example. If one were to read it while ignoring its references to TBs, focusing on the proposals regarding funding rules and setting the provision for adverse deviation (PfAD), one might conclude that the Consultation Document was addressing issues related to single employer defined benefit (DB) pension plans. This makes sense given that the Consultation Document starts with specified Ontario multi-employer pension plans, for which funding rules have always followed a defined benefit model.

However, if one uses the traditional Defined Contribution pension plan as the starting point, we end up with something different. This is exactly what happened in the United Kingdom with its collective defined contribution pension plan, which has a targeted formula benefit and where there is no requirement for an explicit PfAD. Under a collective defined contribution plan, the targeted formula benefit varies annually to reflect plan experience, subject to some restrictions.

Using Ontario's public sector jointly sponsored pension plans (JSPPs) as the starting point, I suggest that you could again end up with a totally different approach to sustainability. Over time, the Ontario Pension Benefits Act has been amended to provide JSPPs with much greater flexibility in how they manage the sustainability of their plans. This is very interesting because TBs and JSPPs have far more in common than TBs and DBs, including: they both are typically multi-employer pension plans, they both are typically governed by multi-member boards rather individual employers, and they both typically have a contingent nature to their benefits, if only post-retirement indexing.

Too much TB legislation to date has been focused on reducing benefit risk rather than the options available to sustain a benefit aspiration. Little can be found in any provincial policy paper or consultation document about the breadth of TB options available and the range of options regarding how to sustain them.

A Canadian Institute of Actuaries task force report has much to say about achieving a sustainable TB: "Best practice would involve the use of stochastic valuations at the design stage. For ongoing assessment of benefits in relation to the target, a simple deterministic affordability test with clearly defined trigger points for action may be sufficient. . . . To supplement the deterministic affordability test, a BFI (benefit/funding/investment strategy) could require more frequent stochastic analysis, either at regular intervals or when certain triggers are met." None of this has been reflected in any subsequent provincial TB legislation.

That actuaries' commentary is supported by a recent Ontario Financial Regulatory Services Authority of Ontario report: "Leading risk management practices observed from the thematic review include . . . . Articulating how the financial health of the plan is to be assessed. This includes, for example, Principles of selection of actuarial assumptions and methodologies …". My reading of this indicates support for plans to determine and articulate to all stakeholders their own risk management policies and practices and not have them dictated by regulation.

The preceding quotes are technical but crucial to grasp the attributes of actuarial tools and their suitable application. Only at a technical level can one assess the feasibility of proposals for TB sustainability as I outlined in a Memo last year.

Perhaps the most crucial aspects of any TB regulations are the procedures for establishing, supervising, and modifying benefits. Although the Consultation Document may align with practices in other jurisdictions, it's essential to recognize that common practice is not necessarily best practice.

Ontario has a significant number of multi-employer pension plans, which could easily become TBs in the future. It's critical these plans get a regulatory framework designed for the way they operate, not rules more suited to other types of pension plans. Here are some of my top recommendations:

- Delete significant portions of Pillar Three on funding requirements, starting with amortization of deficiencies and continuing up to and including the use of surplus;
- Move the funding policy commentary in Pillar One on strengthening governance into Pillar Three, expanding it as appropriate; and
- Expand Pillar Three to include more transparency in filed actuarial valuation reports, including details on the risk management practices employed and full disclosure of methodologies and assumptions used to test benefit sustainability along with the most recent testing results.

By implementing these three measures, we can elevate the sustainability testing framework for TB plans, attain enduring sustainability, and help these plans grow.

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