

Intelligence MEMOS



From: Barry Gros and Barbara Sanders

To: Canada's Pension Regulators

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Re: **PENSION REGULATIONS HEADED IN THE WRONG DIRECTION**

With the demise of defined-benefit pension plans in the private sector, so-called “contingent” pension plans with benefits conditional on financial performance are rising to the fore. But the direction pension regulators are taking with regard to this new breed of plans is missing the point and likely to do more harm than good.

The pension world was once split in two: defined-benefit plans and defined-contribution plans. The single-employer DB plan is in palliative care in the private sector, well beyond hope; defined-contribution plans, while growing gradually, still only cover a minority of pension plan members.

The growth in coverage numbers, which we expect to continue, has been in contingent pension plans, which is why it's important how these plans are regulated. This category of plans include target-benefit plans, multi-employer plans, shared risk plans, and jointly sponsored pension plans with conditional indexing for inflation.

Unfortunately, pension policymakers, whether at the provincial or federal (for federally regulated plans) level, seem to believe they can deliver sustainable pensions by regulating the end result of a complex process. They are focusing on short-term minimum standards for a plan's financial position and contribution levels that have no connection to the long-term strategies that boards managing those plans have developed. This is akin to a sports team focusing on the score it wants in a single game without ensuring it has the players, processes and strategies in place to achieve it.

Regulations that are highly prescriptive on financing matters made sense 60 years ago when traditional single-employer DB plans dominated the landscape, when employers were in total control. They were both the plan sponsor and the fiduciary. With the growth of contingent pension plans we have moved away from the single-employer model. Virtually all of these contingent plans are managed by boards with significant member representation. Combine that with the fact that the pension deal is fundamentally different – the benefit is not guaranteed and the benefit risk profile of these plans is different and varies widely.

Consequently, we need a different regulatory framework. Simply imposing the worn out single-employer DB framework, no matter how it's reworked, just doesn't cut it.

For a recent C.D. Howe Institute [study](#) we interviewed 30 key players across Canada directly involved with delivering contingent pension plans. The results often surprised us. All saw long-term planning as critical to achieving sustainability. But they did not see statutory actuarial valuation, required at least every three years, as an important tool in managing long-term sustainability. Furthermore, while financial management is obviously critical to sustainability, all interviewees agreed that plan design and governance were just as critical, and member communication also played an important role.

The real power of this study was that it tapped into collective wisdom that tends to be hidden in pockets across types of plans and across geography. Everyone has bits and pieces of knowledge but no one has it all.

Just as plans can't deliver specific investment returns, they can only manage the processes that will deliver those returns; the same goes for pension plan sustainability. Unless policymakers are prepared to design and legislate an entire risk management framework, prescriptive financial measures will continue to get in the way of sensible decision-making in contingent pension plans.

So let's move away from limiting management options and focus instead on creating the right process and the right environment for solid decision-making that is tailored to each plan's circumstances.

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