Intelligence MEMOS

From: Barry Gros

To: Canada's Pension Regulators

Date: June 25, 2020

Re: **Rules-based Regulations a Poor Fit for Target-benefit Pension Plans**

Regulations for target-benefit pension plans have been developed across the country in several jurisdictions and without consistency.

But as I outline in my recent C.D. Howe Institute paper, their basic direction is actually a bad fit for the way target-benefit pension plans are meant to work.

The fundamental challenge for target-benefit pension plans is to provide a reasonable targeted pension to members given fixed contributions going into the plan. The fundamental challenge for a traditional defined-benefit pension plan is to determine the level of contributions to provide the promised benefit.

So, very different challenges, and a very different focus for each.

According to the Canadian Institute of Actuaries (CIA), assessing target-benefit plans' financial health is best accomplished using forward-looking probabilistic tools that focus on the long-term sustainability of the intended benefit, not backward-looking tests that simply assess where things are today. Furthermore, both the CIA and one of Canada's major pension reviews, undertaken by the Joint Expert Panel on Pension Standards, recommend that the nature of target-benefit pension plans means they are better suited to regulation that allows each plan to implement risk management strategies that are appropriate for their plan circumstances. These recommendations seem to have been totally ignored – not even responded to – in the development of regulations for target-benefit pension plans.

The approach now in place in several jurisdictions is to impose a universal provision for adverse deviation on target-benefit pension plans, which has little recognition of the risks inherent in any particular plan and is prone to creating systemic intergenerational inequity. This approach seems to totally ignore the fundamental nature of target-benefit pension plans and seems to try to convert them to defined-benefit through the back door.

Interestingly, there is nothing in the current regulatory framework that reviews the process under which target-benefit pension plans determine a reasonable pension. Furthermore, it has been well recognized that having members materially involved in the running of a plan, involved in making all key decisions, fundamentally changes the nature of the overall risk inherent in the plan. Plus, it is well know by pension plan designers that plans with benefit levers that allow them to "bend not break" when stressed are significantly more resilient than those that don't. This concept of levers features prominently in the "DB Plus" offering from the Colleges of Applied Arts and Technology Pension Plan. None of this information seems to have been factored into the development of existing regulations for target-benefit pension plans.

Many pension jurisdictions have recently completed a review of funding regulations for traditional defined-benefit pension plans and implemented significant changes. The timing is right for these jurisdictions to review fully their regulations for target-benefit pension plans.

Innovation can often depend on the process taken. For example, British Columbia recently implemented innovative changes to its defined-benefit funding rules (e.g., basing the provision for adverse deviation primarily on the level of interest rates). They were the result of a process that involved complete collaboration with pension industry representatives from start to finish, way more involvement than simple "consultation."

I hope that this example can show the way for future innovation in the regulations for target-benefit pension plans, where I believe principles -based rules for financing standards definitely have a place.

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