Intelligence MEMOS

From: Barry Gros

To: Canada's Pension Regulators

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Re: **Is It Too Late to Change the Conversation on Target Benefit Plans?**

Why is it that when I'm in conversations about the viability of target benefit (TB) pension plans I keep hearing that "contribution adequacy" or "contribution sufficiency" seems to be the primary concern?

I've been following the evolution of TB over the past decade and I've always thought that the basic tenet of TB design was that the contributions are fixed, and the benefits, even if they are formula driven, end up being what the contributions can support. The concept of contribution adequacy comes from a defined-benefit mindset where the benefit is guaranteed (not the case with TB). In that case, the conversation logically turns to: what contribution is required to deliver that guaranteed benefit? But with TB, the conversation needs a different focus: what benefits can the contributions reasonably support?

Is it too late to change this conversation? You might think that's the case by reviewing TB legislation across the country, which has this contribution focus, exhibited in the going concern plus (GC+) funding rules that predominate. But it's worth a try. Why? For two reasons.

Firstly, legislation unfortunately has the power to influence design and the current GC+ regime has the potential to greatly restrict the expansion of TB and the breadth of TB design, just when the industry has been looking for more innovation in pension design. For those not that familiar with TB it's important to understand that there is a wide range of possible TB designs. These include those with a strong focus on delivering a defined benefit-type benefit with a high level of certainty, such as multi-employer pension plan TBs, to those where benefit variability from year to year is the norm, such as the Collective Defined Contribution design in the UK.

Secondly, adding restrictions to TB contributions can make it more difficult for the plan to treat current and future plan members on an even-handed basis. This is even more so when a restriction (e.g., the GC+ provision for adverse deviation, or PfAD) has a tendency to vary widely over short periods of time.

I often hear the concern that plan members won't put up with benefit variability, complaining loudly if their pensions are ever reduced. But those complaints tend to come from plan members who don't have any appreciation of the deal, or where the deal has never been communicated properly.

We don't have to try to make plan members pension experts for them to have some fundamental understanding of risks inherent in the pension plan to which they belong. People don't have to be experts on the science behind climate change to have an appreciation for its potential negative effects. And there's solid evidence that plans that are well governed and have well designed communication programs can deal with this.

So how do we change the conversation? Well, we can start by putting the focus where it should be, on the benefits. After all, that's what the plan is all about. This conversation starts at the board level covering important questions, such as:

- What level of benefit adequacy would we like to attain
- Which version of intergenerational equity do we want to adopt (there's more than one)
- How much benefit variability are we willing to tolerate
- What levers do we want to incorporate into the plan design to protect certain aspects of the plan design, such as base benefits, over others, such as post retirement indexing
- How will we extend the conversation to plan members so that they will have an appreciation of the deal.

This is exactly what well-managed plans do – focus on the benefits. So let's see if we can move the dial on this conversation instead of monkeying around, trying to determine the optimal contribution restrictions. Remember that decades-long experiment with solvency funding that never worked? Let's not make that same mistake with TB.

Barry Gros is a retired actuary, currently Pension Board Chair, University of British Columbia Staff Pension Plan and member of the BC Financial Services Authority Target Benefit Provision for Adverse Deviation (Pfad) Working Group.

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