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By email: tami.dove@gov.sk.ca

Pensions Division
Financial and Consumer Affairs Authority
Suite 601, 1919 Saskatchewan Drive
Regina, SK S4P 4H2

Subject: Revised Proposed Regime for Negotiated Cost Pension Plans – Consultation Paper

Dear Sir/Madam:

On behalf of PBI Actuarial Consultants Ltd., we wish to thank you for providing us with the opportunity to comment on the Consultation Paper with respect to the Revised Proposed Regime for Negotiated Cost Pension Plans.

Our firm, PBI – as the top provider of actuarial services to MEPPs in Canada and actuary for the largest private sector MEPP in Canada – is very familiar with the operation of negotiated cost pension plans (NCPPs), *a.k.a.* MEPPs, across Canada. We believe that the extension of NCPPs, if done right, can be the most important pension reform initiative to the future of workplace pension plans in general and to meaningfully increase pension plan coverage in all of Canada.

We are pleased that solvency funding will be eliminated for NCPPs and that an alternative approach for funding has been proposed. The fact that the nature of the pension promise in a NCPP is very different than in a traditional defined benefit (DB) plan leads to the conclusion that the regulatory going-concern funding requirements for NCPPs should not be as onerous as for guaranteed DB plans. In addition, we are supportive of the continuing requirement to perform solvency valuations and disclose the solvency position of the plan to the membership in order to be able to show the approximate reduction in benefits in the event of plan wind-up.

With respect to the proposed regime for NCPPs presented in the consultation paper, we have the following comments.

Part 2: Funding

2.4 Provisions for Adverse Deviations

Provisions for Adverse Deviations (PfADs) should not be prescribed – there are simply too many variables and considerations involved, making it impossible to do without having an extremely complex multi-dimensional structure that would nonetheless inevitably be excessive in many situations.

Fundamentally, the purpose of the PfAD should be to reflect the particular plan's Board of Trustees' determination of the relative importance of the plan's key but often conflicting objectives: adequacy of benefits, affordability of contributions, stability of contributions/benefits, security of benefits and inter-generational equity. The Board of Trustees represents the best interest of plan members and has a fiduciary responsibility to them.

Therefore, because the appropriate level of the PfAD is dependent on the particular plan's relative balancing of these key factors and is therefore different for each plan, it would not be appropriate for it to be prescribed by regulation, as suggested in the Consultation Paper – one size does not fit all.

In addition, the Consultation Paper does not consider the plan's assets in the context of liabilities, and relies solely on asset volatility. The table of PfAD requirements is based on the portion of the fund invested in "equities". A clear definition of what is an "equity" is required. There is no distinction by type of equity investment. For example, a plan utilizing low volatility Canadian equity strategies, which have about 2/3 of the volatility of the TSX index, does not attract a lower margin requirement. Presumably a fund which invests in volatile emerging market equities would have the same margin requirement as a passive or low volatility Canadian equity.

There is no recognition of risk reduction due to matching fixed income strategies. For example, a fund which invests in a Universe bond portfolio is treated the same as a plan which invests in a matching fixed income portfolio with the same duration as the liabilities. The additional degree of risk reduction from the matching fixed income portfolio should result in a much lower PfAD requirement.

NCPPs should have the discretion to reflect the asset allocation and risk control features of the specific plan. Alternative investments such as real estate investments, credit strategies, and overlay strategies will require modeling of the unique characteristics of the risks. Relying on a table with equity weighting is insufficient.

By not considering the investment strategy of the plan, all plans with similar equity percentages would have the same PfAD regardless of how the fixed income investments are invested or the different types of equity investments.

Asset allocation is one of the largest (if not the largest) source of volatility in a pension plan. The simplified approach in the Consultation Paper does not take into account, and in fact punishes, plans that have been designed successfully with more complicated liability driven asset approaches that have greatly reduced this source of volatility. This is a significant problem.

2.6 Funding/Benefit Policy

We believe that a NCPP should be required to develop a Funding/Benefit Policy, however it should not be required to be filed with the regulator, but rather should be available on request.

A Funding/Benefit Policy is important for NCPPs in order to document the Board of Trustees' relative balancing of the plan's key objectives and risks, as stated above, and the associated rationale for the plan's level of PfAD. The Funding/Benefit Policy's further contents could include the triggers of action, levers for action, and the considerations involved in the use of surplus or in reducing benefits when/if necessary. In any event, a Funding/Benefit Policy should be considered as a guide only but not as a prescriptive set of rules for the Board of Trustees to follow.

Part 9: Consultation Questions & Process

9.1 Consultation Questions

1. *All of the NCPP respondents to the original paper wanted the ability to calculate CVs using the GC CV methodology retrospectively. More than half of those respondents wanted the GC CV methodology to be mandatory for NCPPs and the CIA CV to be removed all together. We are interested in better understanding the reasons why those respondents would prefer the GC CV's be mandatory and not an optional plan design feature for NCPPs.*

   The basis for calculating Commuted Values (CVs) should be as fair as possible to terminating members, non-terminating plan members, plan sponsors and other affected parties. Terminating members should not be treated better than the remaining continuing members. The current Canadian Institute of Actuaries (CIA) CV Standard assumes the benefit is guaranteed, which is not appropriate for NCPPs. The CV for a NCPP should include a reduction to reflect the lack of guarantee inherent with these types of plans.

   Allowing plans to pay out CVs on the CIA CV basis ultimately reduces the security of the remaining members in the plan, as the payouts for exiting members exceed the member's actuarial liability held within the plan, thus driving down the going concern funded ratio of the plan. The remaining members are put at a disadvantage as terminating members are receiving commuted value payouts based on risk-free discount rates while benefits offered under NCPPs are not fully guaranteed.

2. *Are you aware of any stakeholders who are opposed to the retrospective application of GC CVs?*

   Given the reduced calculated value of CVs on a GC CV basis versus a CIA CV basis, the stakeholders that would likely be opposed to retrospective application of GC CVs would be those terminating members who are transferring their benefits out of the plan. However, under the current regime the benefits provided by NCPPs are not guaranteed and therefore we would argue that determining the CV on a risk-free, guaranteed basis has never been appropriate. In addition, terminating members have the option to leave their entitlement in the fund and receive a deferred annuity upon retirement, thereby avoiding any perceived "penalty," and take the future risk along with the rest of the membership.

3. *In addition, we are interested in knowing how the NCPP Administrators intend to address the implementation of the retrospective application of the GC CV. What would be your transition plans? We note that members and former members not yet in receipt of a pension may be interested in commuting their accrued benefits using the CIA CV methodology prior the implementation of the GC CV. Do you have concerns with this and/or plans to manage this?*

   As with any plan amendment it is important to communicate the change of the benefit promise to all affected plan members in advance of such amendment coming into force. A part of the communication provided to members should summarize the methodology and provide an example of calculating the commuted value both before and after such amendment. The administrator could use this opportunity to demonstrate that commuted values calculated using the CIA CV methodology actually remove a higher proportion of assets from the plan thus leaving those members that do retire from the plan with less security. By switching to the GC CV methodology, members are receiving a more equitable value in benefits between those who remain in the plan and those that transfer their entitlements out of the plan.

   It is conceivable that a higher number of terminating active members than usual elect to transfer their entitlements out of the plan which will reduce the security of the remaining members in the plan, as stated above. However, this will only be on a temporary basis as this amendment will ensure that terminating members, non-terminating plan members, plan sponsors and all other affected parties are treated equally in the future.

   It is also conceivable that this amendment may cause deferred vested members to transfer their entitlements out of the plan, which would add to the reduction of security, however again this would only be on a temporary basis. As well, these members initially elected to receive a deferred pension benefit at retirement and for that reason they may still prefer receiving a monthly lifetime benefit over a one-time lump sum payment.

Once again, thank you for the opportunity to provide our input on this matter. We offer our support in whatever way we can to assist further and would be pleased to discuss our submission and provide any clarification to our comments as required.

Yours truly,
PBI Actuarial Consultants Ltd.

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