Municipal Pension Board of Trustees

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November 30, 2017

via email

Conrad Ferguson, Chair
Actuarial Standards Board
CFerguson@morneaushepell.com

Gavin Benjamin, Chair
Designated Group
gavin.benjamin@towerswatson.com

Dear Conrad Ferguson and Gavin Benjamin:

Subject: Amendments to Section 3500 of the Practice-Specific Standards for Pension Plans – Pension Commuted Values

We are writing further to our September 12, 2017 letter from Judy Payne, Executive Director, Municipal Pension Plan (plan). Thank you for the extension of time to provide feedback on the July 2017 exposure draft of proposed amendments to commuted value standards.

By way of background, the plan is the largest pension plan west of Ontario and the sixth largest pension plan in Canada with more than $46 billion in assets, more than 300,000 members and more than 900 employers in the health, local government, education and community services sectors. We are a multi-employer, contributory, defined benefit pension plan governed by a joint board of trustees. Our members contribute significantly towards their benefits, and our trust document requires that contributions be increased equally between employers and members in the event of a deficiency.

Our plan alone represents more than 30% of all members of pension plans registered in BC, and approximately one third of all pension assets in the province. As a large plan provider, we strive to be an industry leader and an effective participant in the pension industry.

With respect, we agree with our Local Authorities Pension Plan (LAPP) peer's suggestion that "there exists an entire spectrum of risks and the ASBs two bucket approach is an oversimplification[1]." Pension plans have evolved greatly over the past few decades, well past the traditional labels of defined benefit and defined contribution. Today plans are better described along a continuum of who bears funding and investment risk. The methodology for calculating commuted values should evolve too – to align, not just with economic value, but also with a plan's funding and risk-sharing model:

- Where an employer bears the entire funding and investment risk, it continues to be appropriate to calculate commuted values on a risk-free basis.

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[1] September 28, 2017 Local Authorities Pension Plan submission with respect to proposed amendments to Section 3500 of the CIA standards of practice covering the determination of pension commuted values.

Reg. T.M. Municipal Pension Board of Trustees

- However where members share in the plan's funding and investment risk (such as through the potential for future benefit reductions or future contribution rate increases), it is inappropriate to calculate commuted values on a risk-free basis; instead commuted values should more appropriately reflect how funding and investment risk is shared within the plan.

As interest rates and investment returns plummeted, like many others, our defined benefit plan adapted our investment strategy and took on more and more investment risk in order to fund promised benefits. Our members that continue in the plan share those risks. It seems imminently reasonable that a terminated member, who takes their entitlement from the plan, should be expected to take at least the same level of investment risk as a continuing active member.

We would note that members always have the choice to leave their entitlement in the plan, pool their risk with other members, and avail themselves of a lifetime benefit at retirement; this continues to be the primary objective and design framework for the plan. Members who continue in the plan should be more protected - not less - than members who choose to leave the plan. In fact, benefits standards legislation offers plans the ability to require terminated members to remove their entitlement from the plan as a risk mitigation strategy; it's ironic that such a policy would have the effect of increasing risk in our current model.

Many public sector plans, like ours, are appropriately exempt from solvency funding requirements. While we do not expressly contemplate the reduction of benefits, underlying that solvency exemption is the assumption that our plan remains a going concern, and much of our risk management approach hinges on that assumption, including benefit and contribution rate security:

- We are proud to say that we are fully funded on a going concern basis, after allowing for the value of previously established amortization requirements to address going concern unfunded liabilities at prior valuations. The total contribution requirement includes 3.02% to fund these going concern unfunded liabilities, which amounts to approximately $2.6 billion. In the unlikely event that the plan wound up tomorrow, there is no entity legally obliged to fund any shortfall, and benefits would have to be pro-rated.

- While our volume of terminating members is not materially affecting the plan's funded status or contribution rates today, theoretically a larger volume of members withdrawing their commuted value entitlements from the plan could cause contribution rates to increase or even threaten the plan's sustainability.

- Participating members and employers jointly share in the management of the plan, and similarly share in the risks and rewards of the plan. Small surpluses provide a mechanism to manage funding risk and contribution rate volatility.

- The plan's trust document requires that contribution rates increase as required to fund deficits. In the event of an unfunded going concern liability, the plan raises contribution rates and meets the pension promises. However it seems probable that at some future as yet undefined level, our plan sponsors or the regulators may set a ceiling on what they

consider to be reasonable funding limits. At that point, accrued benefits would be reviewed and may shift to being at risk. Other jurisdictions have seen this occur.

We are agnostic as to whether the CIA should set the standard for commuted value methodology or whether this is a responsibility better suited to provincial regulators. Our main concern is that the commuted value methodology should appropriately reflect the plan's funded and investment risks and assumptions.

Finally, we have observed that our members are retiring later and later, and this appears to be a trend with other plans too. We believe that it is no longer reasonable to assume terminating members will take their pension benefit at their optimal retirement age (the earliest retirement age, in our case). It would be more appropriate to calculate commuted values on the basis that members start their pension at the plan's normal retirement age.

In summary, we believe:

1. Subsection 3570 provides a fair basis for the calculation of commuted values in MEPPs and TBPs, namely as the product of the actuarial present value of the member's entitlement and the funded ratio, both using going concern assumptions.
2. Other risk-sharing plans, like ours, should also fall within the scope of Subsection 3570. More specifically, plans that are exempt from solvency requirements should not be required to pay commuted values on a solvency basis.
3. The funded ratio used in Subsection 3570 should be capped at 100%, to prevent the premature distribution of "surplus" assets to terminating members.
4. It would be better to calculate commuted values on the basis that members start their pension at the plan's normal retirement age.

One final thought for your consideration: it would be useful to circulate any future exposure drafts for periods longer than 60 days, particularly during the summer months. This would provide stakeholders with more time for reflection and to make thoughtful submissions.

Thank you for your consideration.

Sincerely,

Gary Yee
Board Chair

pc Hilary Brown, Vice Chair, Municipal Pension Board of Trustees
Judy Payne, Executive Director, Municipal Pension Plan
Irene Schamhart, Board Secretary
Chris Fievoli, Actuary, Canadian Institute of Actuaries