Municipal Pension Board of Trustees

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Financial and Corporate Sector Policy Branch
Ministry of Finance
PO Box 9418 Stn Prov Govt
Victoria BC V8W 9V1

via email: pbsa.solvencyreview@gov.bc.ca

Dear Sirs/Mesdames:

RE: Solvency Funding Framework

We are writing to provide feedback on the Province of British Columbia's 2018 public review of the solvency funding framework for defined benefit plans under the Pension Benefits Standards Act (PBSA).

We understand that the focus of this review centres on defined benefit plans required to fund on a solvency basis, namely single-employer private-sector or quasi-public sector defined benefit plans. The review does not directly impact the four public sector pension plans. However we feel an obligation to participate in the review for several reasons:

1. We want to ensure the plan continues to thrive as a successful model of a healthy and sustainable defined benefit plan. In order to achieve that, we need to ensure a) the plan's current exemption from the PBSA's funding requirements continues, and b) any changes to the PBSA do not threaten the successful public sector defined benefit governance model.
2. We believe that large well-managed defined benefit plans are a cost-effective way to provide predictable and reasonable levels of retirement income to everyday British Columbians. We want to support a regulatory framework that enables affordable and sustainable defined benefit (DB) plans to thrive in both the public and private sectors – whether existing or new DB plans.

Background

By way of background, the Municipal Pension Plan (plan) is the largest pension plan west of Ontario. We are the sixth largest pension plan in Canada with more than $50 billion in assets, more than 300,000 members and more than 900 employers in the health, local government, education and community health and social services sectors.

We are a multi-employer, contributory, defined benefit pension plan governed by a joint board of member and employer appointed trustees. We are jointly sponsored, jointly managed and jointly funded; our members contribute significantly towards their benefits.

The Municipal Pension Board of Trustees (board) is the plan administrator. Composed of an equal number of employer and member appointees, our trustees act in the best financial interests of our plan members, who represent more than 30% of all members of pension plans registered in BC. Our fund represents 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.

While we are exempt by statute from all of the PBSA's funding requirements, our trust document requires that the plan complies with the PBSA's going concern funding requirements. Our trust document also requires that when an unfunded liability arises, the board must increase employer and member contributions equally to fund the liability.

The plan is currently exempt from the PBSA's solvency requirements for good reason. First the board takes a long-term view to investments, and the public sector nature of the plan means that it is extremely unlikely to wind up any time soon. Secondly, unlike what is usually the case in a private sector plan, if the plan is wound up, the government employers will still be in existence and therefore liable to meet their obligations, while the members have a direct financial interest in doing the same. Thirdly, the plan is well-managed by a joint board composed of labour and management stakeholder-appointed trustees. Together, the board ensures the plan successfully balances benefit security with affordable contributions, a risk-smart investment approach and sustainable design.

The board takes a long-term view to funding and investing the plan. The plan is currently funded on a going concern basis, which includes margins for adverse deviation. These margins are discussed with the plan actuary as part of each valuation, and are amended, as appropriate, to reflect the specific risks underlying the plan. If BC adopts a "solvency plus" approach, it may have unintended consequences by virtue of the plan's trust document, increasing the required contributions to the plan by 2% or more of payroll; this would negatively impact employers, members and the sustainability of the plan itself. We see no reason for solvency reform to needlessly negatively impact currently stable multi-employer pension plans. In addition, we believe the current margins for adverse deviation included in the going concern valuation are appropriate for this plan, and that the margins should not be rigidly prescribed.

Having said that, we appreciate the toll that solvency funding requirements have taken on single employers and private sector or quasi-public sector defined benefit plans generally. As the target benefit approach is only available to collectively bargained plans, its introduction to B.C. has not provided broad relief from the solvency funding requirements. We support the ministry's review, which focuses on assessing whether changes to the regulatory framework could better support plan sustainability and benefit security so that defined benefit plans continue to provide lifetime pensions to plan members and other beneficiaries. We note that the current regime of solvency funding has not prevented many defined benefit plan members from facing serious benefit reductions in the face of major corporate insolvencies across the country. We believe this necessarily includes preserving plan administrator governance levers and ensuring contributions are affordable to all participants.

Discussion

The review paper is sub-titled “a review of the solvency funding framework under the Pension Benefits Standards Act”, and notes two general approaches for potential reform, then poses questions for each approach. The paper expressly requests that stakeholders comment on the options without indicating a preferred approach or option. We have attempted to do that in the balance of our submission.

Approach A – Maintain Solvency Funding with Modifications
Questions for Comment

1. *Do you agree or disagree with the approach of maintaining current solvency funding requirements with one or more of the above modifications?*

   If solvency funding requirements continue, then we assume some existing tools will also continue, such as letters of credit and solvency reserve accounts. It also seems reasonable to adopt one or more of the five modifications noted. However, we would caution against adopting (or enabling a plan to adopt) more than several of the modifications, as the adoption of a majority of the modifications might threaten the objective of benefit security.

2. *Would an option or a combination of options under this approach effectively balance the interests of the primary stakeholder groups listed on page 7? Why or why not?*

   If solvency funding is maintained with some modifications, then the extension of the amortization period (option 1) and permitting the consolidation of solvency deficiencies (option 2) appear reasonable steps to mitigate cost and risk to employer sponsors, while still protecting member benefit security. The following questions address the implications of options 3-5.

3. *With regard to Option 3, should smoothed asset values be allowed for solvency valuations? If so, what should be the maximum period over which recognition of investment-related gains or losses may be deferred?*

   We do not have a position with respect to whether smoothing is a good practice or not in solvency valuations. On one hand, smoothing seems counter intuitive if a solvency valuation is being completed at all. On the other hand, permitting smoothed asset values for solvency valuations may be reasonable with some limits on those values, including a maximum five-year asset smoothing period.

   For example, the plan uses a five-year smoothed asset value in our going concern valuation methodology, and the smoothed value is limited to no more than 108% and no less than 92%

of the market value of assets. This corridor is adjusted periodically as our assets grow; as the plan matures, it is important the corridor narrows as the contributions required to amortize investment-related gains or losses will otherwise grow. Our actuary monitors the difference between the smoothed and market value of the plan's assets and discusses those differences and their implications with the board.

4. *With regard to Option 4, should the use of an average interest rate be allowed for solvency valuations? If so, what should be the maximum averaging period?*

   We do not have a position with respect to the use of average interest rates in solvency valuations. It seems to us that the prescribed interest rate used in solvency valuations may be the factor which puts the most financial pressure on defined benefit plans. If solvency funding is maintained, then it would be prudent to implement some mechanism that addresses this. Average interest rates might behave differently than intended in a rising interest rate environment (such as we are seeing now), and may not be necessary if other tools (such as options 1 & 2) are available. If average interest rates were allowed, then five years seems a reasonable window again.

5. *With regard to Option 5, should solvency funding requirements be reduced to a level less than 100 per cent? If so, what would be an appropriate level?*

   We would be cautious to reduce the solvency funding requirements to a level less than 100 per cent without some way of assessing solvency risk and being more satisfied than not that an individual plan's insolvency risk was low. Otherwise, what is the point of a solvency valuation?

Approach B – Eliminate Solvency Funding and Enhance Going-Concern Funding
Questions for comment

1. *What are the advantages and disadvantages of eliminating solvency funding requirements in favour of enhanced going concern funding requirements?*

   Implications of eliminating solvency funding requirements and moving to enhanced going concern funding requirements would include:
   - Increased alignment with other regulatory requirements across Canada. We understand that Ontario, Quebec, Nova Scotia and others have already moved in this direction, and others are considering it.
   - Increased sustainability of defined benefit plans in the private sector. We firmly believe that defined benefit plans provide the most benefit security to members. They also can provide the biggest benefit for every dollar of contribution. Their chief drawback is the cost to employer-sponsors, so developing funding requirements that ease sponsor risk without unduly increasing member risk is a good thing. Depending

on the requirements adopted, the change might or might not unduly increase member risk.

- Inadvertently, the four public sector pension plans might become subject to the rules, see their contributions increase, and have their sustainability threatened. This risk could be avoided by careful legislative drafting, and/or an amendment to the plans' joint trust documents by their sponsors. We believe it would be appropriate to exempt the public sector plans from the "enhanced" aspects of an enhanced going concern funding requirements to effectively preserve the status quo.
- Removal of some of the governance levers that plan sponsors need to manage their pension plans, if the provision for adverse deviation (PfAD) is a prescribed requirement. This risk could be avoided by requiring plans to explicitly articulate a PfAD, but not prescribing its value.

2. *Which combination of the options described under this approach would best balance benefit security and contribution volatility?*

   The balance between benefit security and contribution volatility in an enhanced going concern environment is best achieved by shortening the amortization period and the adoption of PfADs. A reserve account for PfAD-related contributions should also be established.

3. *With regard to Option 2, if a PfAD were required, what factor or factors should be used to determine the PfAD? For example, should they be linked to the plan's investment policy or the level of plan maturity?*

   Factors relevant to the determination of the enhanced going concern PfAD include: funding policy, plan maturity, asset mix, investment policy, and plan design. However, we reiterate that PfADs should not be rigidly prescribed; PfADs should be set in accordance with a plan-specific funding policy and in accordance with a risk-based regulatory framework.

4. *Are there other measures to enhance going concern requirements that should be considered in the absence of solvency funding requirements?*

   In the absence of solvency funding requirements, the following other measures might enhance going concern requirements:

   - Benefit enhancements and contribution holidays should be limited if the plan is not fully funded. Exceptions might be permitted where the benefit improvement can be fully funded over a specified period of time or provided without impacting the security of historical benefit accruals.
   - Enhanced going concern requirements could require a plan to demonstrate that their PfAD will result in a specified probability that the plan will be fully funded over a specified period, such as the Nova Scotia legislation.

- The consolidation of going concern deficiencies would increase alignment with other jurisdictions in Canada, be easier for stakeholders to understand and could stabilize funding requirements.

Additional Complementary Reform Measures -- Modifying Commuted Value Transfer Rules Questions for Comment

1. *Would the modification to the commuted value rules described above be appropriate? If so, what increase in interest rates should be used to calculate the commuted values?*

   Yes. Terminating plan members should not take a risk-free benefit from a defined benefit pension plan, when the remaining members bear a higher risk. Pension plans are designed to provide a series of equal and periodic lifetime payments, not one-time lump sums. Pension plans are designed to pool risk. Individuals who choose to remove their entitlement should take a portion of the plan's risk; this is perhaps more acute in shared-risk models like ours, where employers and members share the risks and rewards of plan governance.

2. *Are there other, more appropriate, methods that could be applied to modify the commuted value calculation?*

   We believe risk-sharing plans and plans that are exempt from solvency requirements, like ours, should not be required to pay commuted values on a solvency basis. Instead, a fairer approach for such plans would be to calculate commuted values as the product of the actuarial present value of the member's entitlement and the funded ratio (capped at 100%), both using going concern assumptions.

3. *What other measures, if any, could be considered that would complement Approach A or Approach B or both approaches?*

   Whatever new measures are adopted, we submit that the focus should be on finding the appropriate balance between member benefit security and the contribution predictability, sustainability, pension coverage and affordability of DB pension plans in the province. In other words, the goal should be to create an appropriate balance of stakeholder interests. We understand that an appropriate balance of this sort requires compromises and trade-offs. With this in mind, any new measures should recognize the issues of prolonged low interest rates, increased longevity and funding challenges and be based on four objectives:
   - Be clear to all stakeholders
   - Do not increase the cost burden on plan sponsors
   - Have basis in sound funding and risk management principles
   - Reflect the long-term nature of DB pension plans.

Conclusion

We very much appreciate the opportunity to comment on the ministry's paper. We are also looking forward to meeting with ministry of finance representatives next month, as part of your round of focused consultation meetings.

Sincerely,

Gary Yee

Gary Yee
Board Chair

cc: Hilary Brown, Board Vice Chair
Judy Payne, Executive Director
Irene Schamhart, Board Secretary