

Target Benefit Multi-Employer Pension Plans: Description of Proposed Funding Framework

Overview:

On June 29, 2017, the government announced that it would be implementing a framework for target benefit multi-employer pension plans (TB MEPPs) to replace the time-limited funding regulations currently in place for specified Ontario multi-employer pension plans (SOMEPPs). These changes are intended to help ensure workers' retirement benefits are protected and maintained, while helping businesses compete and attract skilled workers.

The proposed TB MEPP framework for eligible MEPPs includes:

- A permanent exemption from solvency funding;
- Lengthening the amortization period from 12 to 15 years for funding a plan's going concern deficiency;
- New funding rules that would include a reserve called a Provision for Adverse Deviations (PfAD) to help manage future risk and help ensure benefits are secure;
- A new basis for calculating benefits paid when a member terminates participation in a plan or when a plan is wound up;
- Rules to ensure plan benefits are appropriately reduced when funding requirements are not met;
- A requirement for plans to develop policies on funding and governance;
- Opportunities for retirees to participate in plan governance; and,
- Enhanced disclosure to plan beneficiaries regarding the status of their plan.

To help implement this framework, this announcement was followed by amendments to the *Pension Benefits Act* (PBA) related to TB MEPPs in Bill 177, the *Stronger, Fairer, Ontario Act (Budget Measures), 2017*, which received Royal Assent on December 14, 2017. The amendments included rules for eligible MEPPs that wish to convert accrued defined benefits (DBs) to target benefits as well as authority to prohibit benefit improvements in prescribed circumstances.

The details outlined in this posting are intended to provide substance to the majority of the proposed TB MEPP funding rules. These rules would apply to eligible MEPPs that convert DBs into target benefits under the rules outlined in unproclaimed section 81.0.2 of the PBA as well as to any newly established TB MEPP. Generally speaking, the proposed TB MEPP funding framework is intended to ensure these plans are healthy

and sustainable over the long term. Consistent with actuarial literature¹ the proposed rules are intended to provide a reasonable likelihood that a fully funded MEPP with typical SOMEPP characteristics would remain fully funded after 3 years.

The Ministry of Finance encourages interested stakeholders to provide feedback on all aspects of the proposed TB MEPP funding rules so that they can best achieve the government's objectives of helping to ensure that these plans are sustainable over the long term. Comments should be received by the Ministry by **May 4, 2018**.

Proposed DB Funding Rules:

On December 14, 2017, the government posted a description of proposed regulations related to the new funding framework for DB pension plans announced on May 19, 2017. The intention is that this new framework would apply to valuation reports dated on or after December 31, 2017 and filed after the new framework comes in force. The proposed DB funding rules include requiring funding on a solvency basis if needed to improve a plan's funded status to 85 per cent on a solvency basis, modifying the amortization of funding going concern shortfalls and requiring the funding of a PfAD. If approved, these changes would not apply to jointly sponsored pension plans (JSPPs) that are listed in section 1.3.1(3) of Regulation 909 or to SOMEPPs. However, these rules would apply to MEPPs providing DBs that are not SOMEPPs. All MEPPs that do not provide target benefits would be subject to the DB funding requirements. The DB funding posting can be found at the following website:

<http://www.ontariocanada.com/registry/view.do?postingId=25526&language=en>

Types of Pension Benefits:

The PBA currently classifies pension benefits into two broad categories.

1. **Defined benefits:** DB pension plans are designed to provide plan members with a monthly pension throughout their retirement years that is determined by a formula set out in the plan terms. A plan member's pension benefit is usually based on how long the member works and possibly other factors, such as the member's salary.

The PBA requires DB plans to have sufficient funds to finance the benefits that will be paid out in the future. Contribution requirements to the pension fund are calculated by an actuary. Contributions must be made to fund the plan's normal cost, which is the ongoing cost to fund the benefits members are accruing. However, if an actuary prepares a valuation report which identifies either a solvency or going concern funding deficiency, then additional contributions (known as special payments) are required to eliminate the funding shortfall.

¹ See for example, the Research Paper, "Provisions for Adverse Deviations in Going Concern Actuarial Valuations of Defined Benefit Pension Plans", published by the Canadian Institute of Actuaries in January 2013.

2. **Defined contribution (DC) benefits:** DC pension plans provide each plan member with an individual investment account. Each member's retirement income is determined by the total contributions made into their account in addition to any investment returns. Plans may offer members a choice of investment options, but this is not required. Plan funds are pooled for members who choose the same investment, but longevity risk (i.e., the risk that a retiree outlives their retirement benefits) is not pooled. While no specific monthly pension is paid to retirees, an advantage of DC plans is that employer and employee contribution rates are known in advance since they are specified in the plan terms.

The proposed TB MEPP framework would establish a third category of pension benefits which would strive to balance plan members' desire for a predictable income stream in retirement with employers' desire for predictable contributions. As such, TB MEPPs would target a specified retirement pension funded by fixed contributions. Unlike DB pension plans, TB MEPPs could reduce accrued benefits to address funding shortfalls, including retirees' pensions.

PROPOSED TARGET BENEFIT FUNDING FRAMEWORK

Permanent Exemption from DB Solvency Funding Requirements:

As of the date of this posting, in general, DB pension plans that are not SOMEPPs or JSPPs listed in regulations must fund on both a solvency and going concern basis. Since 2007 SOMEPPs, a subset of MEPPs, have been exempt from solvency funding requirements on a temporary basis.

Under the proposed TB MEPP funding framework, a pension plan that offers target benefits would not be required to fund on a solvency basis. However, TB MEPPs would continue to be required to provide solvency valuations, determined on a DB basis, in all filed valuation reports and disclose the plan's transfer ratio to plan beneficiaries (which would be indicative of the plan's funded status should it wind-up). Valuation reports would be required to be filed with the pension regulator at a minimum on a triennial basis.

Bill 177 introduced section 81.0.2 to the PBA which governs the conversion of DBs provided by MEPPs to target benefits, where the conversion is proposed to be implemented by a plan amendment. In general, upon conversion to target benefits, the obligation to make special payments related to past solvency deficiencies identified in prior valuation reports for the benefits converted would be cancelled.

Extension of the Amortization Period for Going Concern Funding Deficiencies:

Under the proposed TB MEPP funding framework, the amortization period required to fund going concern unfunded liabilities would be 15 years. It is also proposed that plan administrators will have a one-time opportunity to consolidate existing going concern

special payments established in previous valuation reports into a new 15-year payment schedule (i.e., a fresh-start). The start of special payments related to any going concern unfunded liabilities could be deferred up to 12 months after the valuation date.

PfAD and Related Contribution Requirements:

A PfAD would be a percentage used to determine additional contributions to the plan. These contributions would be determined by multiplying the PfAD (calculated below) by the normal cost. No additional contributions for the PfAD would be required in respect of a PfAD for accrued going concern liabilities. Instead, the PfAD on accrued liabilities would be funded through emerging surplus (i.e., experience gains), if any, and would be aided by restrictions on benefit improvements. Costs for future indexation would be excluded from the normal cost to determine PfAD contribution requirements.

Similar to the proposed PfAD for DB pension plans as described in the December 14, 2017 posting, the proposed PfAD for TB MEPPs would be the sum of the following three components:

- A fixed component of 4% to help reduce the risk of future benefit reductions if plan experience is unfavorable.
- A component based on the plan's asset mix to recognize the higher risks that may be associated with equities and similar investments. This may encourage a plan administrator to choose investments that are appropriate for the funding of long-term pension obligations. This component would depend on the proportion of assets that are not considered fixed income in the target asset mix that would be required to be set out in the plan's Statement of Investment Policies and Procedures (SIP&P) in effect on the valuation date.
 - The determination of non-fixed income (NFI) assets would be the same as that proposed for DB pension plans.
 - This PfAD component would be determined by the table below. The PfAD values set out below are generally higher than the corresponding PfAD values previously proposed for open DB plans.
 - If the percentage of NFI assets is between two values in the table below, then this PfAD component would be determined by a linear interpolation between the corresponding PfAD values. For example, if a TB MEPP's investments are 55% NFI (i.e., midway between 50% and 60%), then the PfAD component for the asset mix would be 8% (i.e., midway between 7% and 9%).

Percent of NFI assets	NFI Component for TB MEPPs
0%	0%
20%	1%
40%	5%
50%	7%
60%	9%
70%	11%
80%	13%
100%	18%

- A component based on the plan's going concern discount rate, added only if the discount rate exceeds a benchmark discount rate (BDR). This component would reduce the likelihood of inadequate contribution requirements that could result from the use of inappropriate assumptions. Specifically, this component would cause the total PfAD to be increased by the duration of the plan's going concern liabilities multiplied by the difference between the plan's best estimate discount rate and the BDR. In this context, the duration would be the percent increase in liabilities due to a one percent decrease in the discount rate. The BDR, which would be the same as the one proposed for DB pension plans, would be the sum of:
 - CANSIM V39056 (Government of Canada long bond per the [Bank of Canada website](#)) yield on the valuation date;
 - The proportion of the plan's target asset mix allocated to NFI assets times 5% (i.e., a risk premium of 5% on NFI assets);
 - The proportion of the plan's target asset mix allocated to FI investments times 1.5% (i.e., a risk premium of 1.5% on FI assets); and
 - 0.5% for diversification.

PfAD calculation example:

A TB MEPP's assets are 60% NFI and 40% FI. The actuary's best estimate discount rate is 6.4% and the duration of the plan's liabilities is 14. If the Government of Canada (GoC) long bond yield is 2.15% as at the date of the valuation, then the calculation of the PfAD for the TB MEPP is as follows:

The plan's BDR would be calculated as follows:

$$\begin{aligned} &= \text{GoC bond rate} + (\text{NFI} \times 5\%) + (\text{FI} \times 1.5\%) + 0.5\% \\ &= 2.15\% + (60\% \times 5\%) + (40\% \times 1.5\%) + 0.5\% \\ &= 6.25\% \end{aligned}$$

The BDR component of the plan's PfAD would be calculated as follows:

$$\begin{aligned} &= (\text{Best estimate discount rate} - \text{BDR}) \times \text{plan duration} \\ &= (6.4\% - 6.25\%) \times 14 \\ &= 2.1\% \end{aligned}$$

The plan's PfAD would be calculated as follows:

$$\begin{aligned} &= \text{Fixed component} + \text{NFI component} + \text{BDR component} \\ &= 4\% + 9\% + 2.1\% \\ &= \mathbf{15.1\%} \end{aligned}$$

Contributions in respect of the PfAD would be determined by multiplying the PfAD by the plan's normal cost.

Contribution Sufficiency Test:

The proposed TB MEPP funding framework would set out a new contribution sufficiency test which would recognize the new requirement to fund a PfAD. It is proposed that this new sufficiency test would require minimum contributions to the pension plan that are not less than the sum of:

- The normal cost of the plan;
- The PfAD in respect of the normal cost;
- Going concern special payments set out in previous valuation reports that remain payable; and,
- Going concern special payments determined in the most recent valuation report.

If a TB MEPP's negotiated contributions are less than the plan's required contributions, the TB MEPP would not satisfy the contribution sufficiency test. The proposed TB MEPP framework would include rules to ensure benefits are reduced when the contribution sufficiency test is not met. Rules related to benefit reductions would be included in a later consultation. Transition measures would help plans adjust to the new framework, see below for details.

Benefit Improvements:

Bill 177 amended unproclaimed section 14.0.1 of the PBA to allow the government to prescribe circumstances under which a benefit improvement could not be made for plans that offer target benefits.

Under the proposed funding framework, a TB MEPP could improve benefits only if after the improvement the plan is fully funded on a going concern basis and has a fully funded PfAD. This means that a TB MEPP would only be allowed to improve accrued benefits if the plan has sufficient excess assets (i.e., assets that exceed a plan's going concern liabilities and a fully funded PfAD).

Commutated Values (CVs) for TB MEPPs:

Currently in a DB pension plan, a member is entitled to transfer the full CV of his or her deferred pension upon termination of membership. If the plan is underfunded at the time of termination, the unfunded portion of the CV may be transferred within five years of the date of the initial transfer. A CV is intended to represent the economic value of the immediate or deferred pension that would have been paid from the pension plan. The CV cannot be less than the value determined in accordance with section 3500 of the CIA Standards of Practice as at March 31, 2015. This includes using an interest rate based on Government of Canada bond yields, which are also used in solvency valuations.

Recognizing that the benefits offered by target benefit pension plans are not guaranteed and the existence of possible equity issues in providing terminating members with a CV based on a solvency discount rate, the Actuarial Standards Board published proposed new Standards for CVs for comment² in July 2017 to solicit feedback. The CIA has proposed that the CV in a target benefit pension plan represent an approximation of the share of the pension plan assets reasonably attributable to the plan member in respect of whom the CV is being calculated. Consequently, the CVs in these plans would be based on the value of a member's benefit entitlement determined using the plan's going concern assumptions and the plan's going concern funded ratio. While the CIA has yet to finalize revisions to its Standards of Practice, consideration may be given to incorporating the new CIA Standard 3570 by reference.

² See the exposure draft entitled "Amendments to Section 3500 of the Practice-Specific Standards for Pension Plans – Pension Commuted Values", issued by the Actuarial Standards Board in July 2017.

It is anticipated that the new basis for calculating CVs would only be used for members with a termination date on or after the new Standard has been incorporated into the regulations. In addition, where an individual has received a partial payment with respect to their CV, calculated before any changes to the regulations, any remaining amount would still be payable on the same basis that the initial partial payments were made (i.e., on the original basis as at the member's date of termination). Future consideration may be given to legislative amendments to provide retirees with the option to receive the CV of their pensions on plan wind-up.

Transition:

Recognizing that contributions to TB MEPPs are made pursuant to collective bargaining agreements which are usually subject to three year cycles, it may be difficult for TB MEPPs to implement significant changes in benefit rates and contributions with multiple employers immediately upon conversion.

If the total contribution requirement (i.e., the total of normal cost requirements, including PfAD, and going concern special payments) for a plan under the new TB MEPP funding framework is greater than the total contribution requirement under the current SOMEPP or DB MEPP funding rules, transitional rules would allow the contribution increase to be phased in over a three year period following conversion.

As a further transition measure, the temporary SOMEPP funding regulations will be extended to expire one year after the proclamation of the TB MEPP framework. Depending on a plan's valuation cycle, this extension would allow eligible plans up to four years to transition to the TB MEPP framework once it is proclaimed. This may provide time to complete collective bargaining and negotiate higher contributions, if necessary.