A Permanent Framework for Target Benefits

2023
Ontario Consultation Document

Ontario

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Purpose

The Ministry of Finance is launching consultations on proposed regulations necessary for implementing a permanent target benefit framework in Ontario. This permanent framework would replace the temporary funding regulations currently in place for Specified Ontario Multi-Employer Pension Plans (SOMEPPs), which expire beginning in 2024.

The objective of the proposed target benefit framework is to strengthen governance, improve transparency and support long-term plan sustainability for plan members and employers through written policies, disclosures and funding requirements.

This consultation document sets out the key elements of the proposed permanent framework and is intended to support engagement meetings and review of the proposed regulations. The Ministry of Finance encourages interested stakeholders to provide feedback on all aspects of the proposed target benefit framework. Interested parties can take part in the consultation by meeting with Ministry officials and through submissions made on the Ontario Regulatory Registry.

To request a meeting with Ministry officials, please email pension.feedback@ontario.ca.

Written submissions can be sent to:

pension.feedback@ontario.ca

or

Pension Policy Branch
Ministry of Finance, 5th Floor Frost South
7 Queen's Park Cres
Toronto, ON M7A 1Y7

Background

In 2007, temporary regulations were introduced to give eligible Multi-Employer Pension Plans (MEPPs) that could reduce accrued benefits a temporary exemption from solvency funding requirements. These plans are known as specified Ontario multi-employer pension plans. Over 50 MEPPs have elected to become SOMEPPs.

The solvency funding exemption and temporary regulations for SOMEPPs were intended to be in place only until a permanent and comprehensive legislative and regulatory framework was developed for these MEPPs to ensure that they were well-funded and well-governed.

Legislative provisions were introduced in the Pension Benefits Act (PBA) in 2010, 2017 and 2019 to establish the legislative framework for MEPPs that would provide target benefits, and consultations were held in 2015 and 2018. Legislative provisions remain unproclaimed as they require regulations to be implemented.

In the 2022 Ontario Budget, the government committed to consulting with affected stakeholders on proposed regulations before implementing a permanent target benefit framework in 2023.

Policy Objectives

The government's objective is to implement a comprehensive and permanent regulatory framework for target benefits provided by MEPPs that strengthens plan governance, improves transparency and supports long-term plan sustainability.

A comprehensive framework would reflect best practices from the pension sector and include regulations for critical elements such as plan governance, member communication and funding requirements.

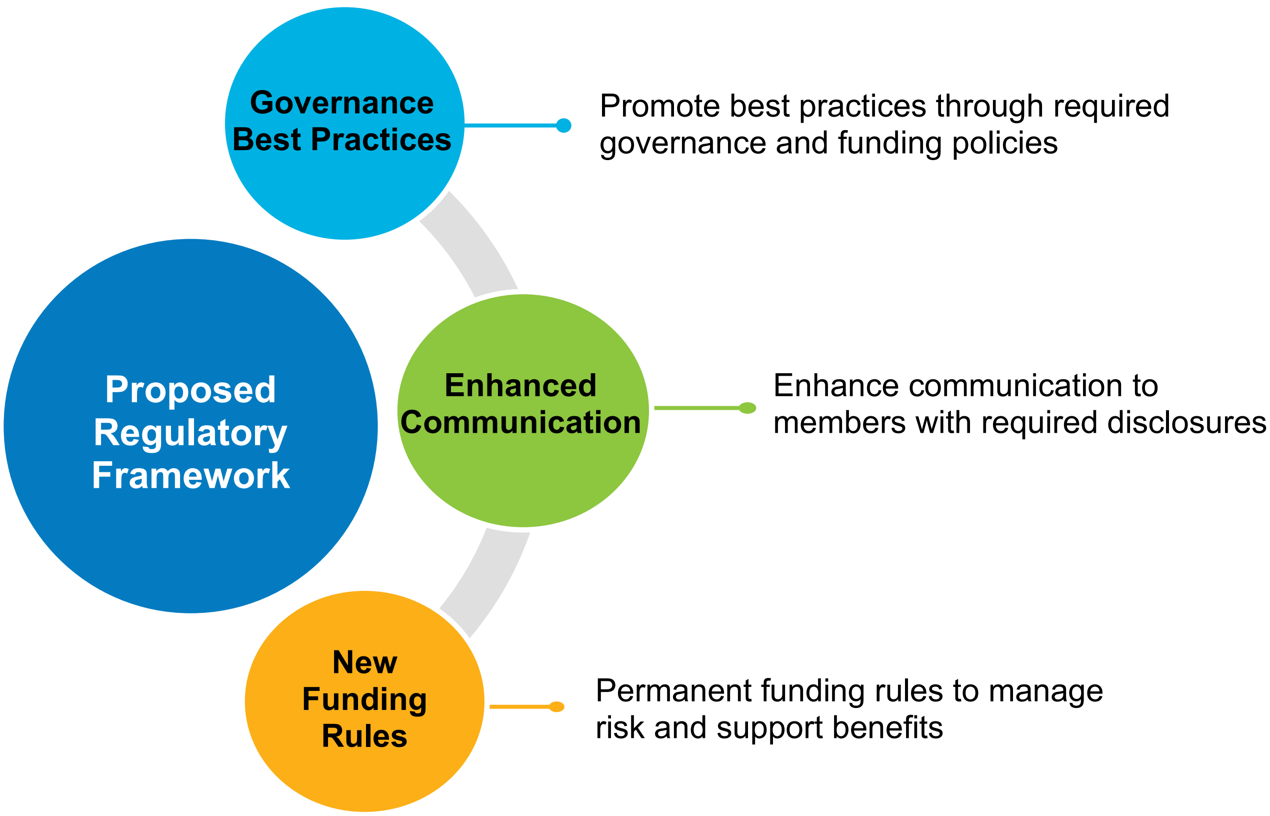
The proposed permanent framework is designed to:

Provide Certainty: Enabling MEPPs to build funding and governance practices around regulatory requirements.

Increase Transparency: Including new target benefit-specific rules for information disclosure in member communications to ensure that members understand that their accrued target benefits may be reduced.

Improve Equity: Encouraging prudent investment strategies so that adverse events or lower than expected returns are not borne exclusively by future members.

Proposed Framework and Fundamental Pillars



Eligibility

Multi-employer pension plans established by collective agreement or trust agreement that can reduce accrued benefits would be able to provide target benefits. For eligible MEPPs to convert their existing benefits to target benefits, plans would be required to apply to the Chief Executive Officer (CEO) of the Financial Services Regulatory Authority of Ontario (FSRA).

This conversion process will be important to ensure transparency to the plan's membership, and consultation with unions.

Under the PBA, in order for MEPPs to be eligible to convert their benefits to target benefits, specific criteria must be met, including:

- Employer contributions must be fixed in one or more collective agreements or other plan documents; and
- The administrator must be authorized under the pension plan to reduce the benefits, both while the plan is ongoing and upon wind up.

In addition, regulations would set out the following requirements that are based on the criteria in place for SOMEPPs, including:

- At the end of the previous year, no more than 95 per cent of the members of the plan were employed by one employer; and
- During the previous year at least 15 employers made contributions to the plan or at least 10 per cent of the members of the plan were employed by two or more employers.

Understanding that some existing MEPPs whose accrued benefits can be reduced have both a defined benefit and a defined contribution component, these plans will be eligible to apply to convert the defined benefits to target benefits, provided the defined contribution component is treated separately.

Provisions in section 81.0.2 of the PBA outline the process to apply for conversion of benefits to target benefits. These proposed conversion measures are outlined further in this consultation document, along with transitional measures.

Pillar One: Strengthen Governance Through Minimum Standards in Policies

Once target benefit provisions come into force, the PBA would require that plans establish and maintain a governance policy and a funding policy. These policies would reflect industry best practices and are based on the Canadian Association of Pension Supervisory Authorities (CAPSA) guidelines. A number of MEPPs are already following these best practices.

Proposed regulations would require that a plan's **governance policy** address:

- The roles, responsibilities and reporting relationships of the persons involved in the administration of the pension plan and pension fund.
- The operational policies in place to support the administration of the pension plan or pension fund, including any applicable organizational structures.
- The measures in place for carrying out the supervision of the persons involved in the administration of the pension plan or pension fund, including measures to monitor, review and assess their performance, skills and knowledge and to provide them with training to maintain and enhance their qualifications.
- The skills, knowledge, experience and other attributes required of persons involved in the administration of the pension plan or pension fund to enable them to meet their obligations under the Act and regulations.
- The systems in place to identify, quantify and manage material risks to the pension plan or pension fund.

- The processes in place to assess what changes to the pension plan or the administration of the plan may be appropriate based on the results of the stress testing in filed reports. A requirement to perform a stress test would enhance governance processes for risk management but would not affect funding requirements.
- The processes in place to ensure that persons involved in the administration of the pension plan or pension fund have access to relevant, timely and accurate information.
- The processes in place for the communication of relevant, timely and accurate information to members, former members, retired members and other persons entitled to benefits under the pension plan, to employers participating in the pension plan, to trade unions representing members of the plan and to the CEO.
- The code of conduct established for persons involved in the administration of the pension plan or pension fund, including the process for identifying, monitoring and addressing conflicts of interest.

In addition, because accrued benefits can be reduced, a **funding policy** is a critical tool to establish and describe how risk is managed. The proposed regulations would require that a plan's funding policy address:

- The funding objectives for the pension plan as they relate to:
    - The pension benefits provided under the plan and the stability of those benefits;
    - The stability of the contributions required under the plan; and
    - The equitable treatment of current and future members of the plan.
- The methods for achieving the funding objectives mentioned above, including use of any additional funding margin that may be appropriate.
- The material risks relating to the funding of the pension plan, including the risk of reductions to accrued benefits provided under the plan, and the measures to be taken to quantify and manage those risks.
- The method and process to be applied to reduce benefits, including accrued benefits, under the pension plan, if the circumstances require a reduction of those benefits.
    - The method must specify default reductions that would apply to reduce benefits if no other action is taken.
- Circumstances when benefit improvements could be made and how improvements would be funded, including any use of surplus.
- The circumstances that will cause the funding policy to be reviewed and amended.

For the purposes of subsections 10 (6) and (7) of the PBA, a pension plan's funding policy and its governance policy would need to be filed within 60 days after the effective date of the conversion to target benefits.

The administrator of a pension plan shall periodically conduct a review of the plan's funding policy and its governance policy. The first review would need to be completed within three years after the day the funding policy or governance policy is established. Each subsequent review would be completed within three years after the day the previous review was completed.

At the request of the CEO of FSRA, the administrator would need to provide the CEO with evidence that the plan's funding policy or its governance policy has been reviewed.

Any changes to the funding policy or governance policy would need to be filed within 60 days for the purposes of subsection 12 (3) of the PBA.

Pillar Two: Enhance Communication to Members with Required Disclosures

It is important to ensure that plan members understand that their accrued target benefit may be reduced and the risks that could trigger a benefit reduction. Disclosure of information takes on added significance in a plan that provides target benefits. Members must have sufficient information to understand their benefit entitlement, including the risk that benefits may be reduced.

The proposed framework includes enhanced disclosures and information that plans must make available to members to support transparency and ensure members are provided with clear information regarding the plan and how accrued benefits may be reduced.

These minimum standards would apply to various communications between the plan administrator and members, former members, retired members and others entitled to benefits. For example, the proposed regulations would require the following disclosures.

For New Members:

- An explanation of how benefits are funded, including a statement that contributions are fixed and benefits may be reduced.
- A summary of the plan's funding policy.
- A statement that benefits are not guaranteed by the Pension Benefits Guarantee Fund.
- If any benefits provided by the plan have been adjusted within the last 10 years, a description of when the adjustment occurred and the amount of the adjustment.

- The most recent going concern funded ratio and transfer ratio of the plan and an explanation of what those ratios mean and how they impact funding.

On Annual Statements:

- A statement that benefits may be reduced.
- A statement that the plan's funding and governance policies are available to view.
- The plan's transfer ratio and going concern funded ratio and how it relates to the level of funding of members' benefits.
- An explanation of any amendments, including benefit reductions, affecting the member made to the pension plan during the period covered by the statement.
- If any benefits provided by the plan have been adjusted within the last 10 years, a description of when the adjustment occurred and the amount of the adjustment.

On Plan Amendments:

- The most recent going concern funded ratio and the going concern funded ratio if the proposed amendment is put in effect.
- The pension or benefit payable to the member without the proposed amendment.
- The pension or benefit that would be payable to the member under the proposed amendment.
- If an amendment is made to meet the contribution sufficiency test (see below for more detail), information regarding the valuation date of the most recent report, a statement that the contributions are not sufficient without the amendment, the action proposed to be taken, and information on who can view the funding policy.

Pillar Three: Enhanced Funding Requirements

The permanent target benefit framework would seek to support the long-term sustainability and reliability of target benefit pensions through providing a comprehensive set of funding requirements.

No Solvency Funding Requirement

The proposed target benefit framework would not require funding on a solvency basis. Since plans providing target benefits would be MEPPs, it is unlikely that the insolvency of a single employer would lead to the wind up of the plan. The ability of the plans to provide benefits over the long term would be supported by the governance and funding requirements included in the rest of the proposed comprehensive framework.

However, as an important diagnostic for plan health, plans would continue to be required to provide solvency valuations in all filed valuation reports for reporting purposes only.

Valuation Frequency

Continuing with current practice, plans would be required to file a valuation report every three years.

If a plan falls below 85% funded on a going concern basis, then valuation reports would be filed annually. This rule is intended to ensure plans take timely action to address deteriorated performance.

Commuted Values

In 2020, the Canadian Institute of Actuaries (CIA) published new standards of practice regarding calculations of commuted values (CVs) for pension plans. Under the CIA standards, the CV of target benefits is calculated using going concern assumptions since accrued target benefits may be reduced. This methodology accounts for how the variability in expected investment returns and other plan experience may affect benefits. This method uses different assumptions than the calculation of CVs for defined benefit plans.

For all MEPPs that can reduce benefits, CVs would be determined as in the CIA standard (e.g., using the going concern discount rate based on expected investment returns instead of long-term bond rates). This approach would help ensure harmonization with practices in other jurisdictions and supports CV calculations more appropriate to target benefits.

Since this approach already accounts for how plan experience may affect benefits, plans would not be permitted to adjust CVs by the funded status of the plan.

For the purposes of family law matters, the same going concern approach would be used when calculating commuted values of pension benefits, for example, to determine the preliminary value and imputed value of benefits.

As outlined during the government’s 2018 consultations, the new basis for calculating CVs would only be used for members with a termination date or family law valuation date on or after the effective date of the proposed regulations.

Amortization Period for Deficiencies

Consistent with the existing rules for SOMEPPs, special payments related to going concern unfunded liabilities (excluding those related to benefit improvements) would be amortized over 12 years starting one year after the applicable valuation date.

Unlike the case for defined benefits, schedules of going concern special payments would not be redetermined in each valuation report (i.e., no “fresh start”).

Under the proposed framework, if previously scheduled special payments are not needed to satisfy funding requirements, current schedules could be shortened, but the monthly rate of special payments would remain the same if some are still needed. Note, in particular, that schedules of special payments to fund benefit improvements could only be shortened (or eliminated) if the assets fully fund going concern liabilities and the provision for adverse deviations (see below) in respect of the liabilities.

Provision for Adverse Deviations

A provision for adverse deviations (PfAD) is intended to protect against future benefit reductions due to adverse events (e.g., lower than expected returns) by helping the plan build a margin of assets above liabilities.

A PfAD is a component of most target benefit models across Canada. A number of SOMEPPS already account for some form of margin as part of prudent investment management.

The PfAD would be funded in respect of the plan's normal cost as well as any increase in the plan's going concern liabilities due to benefit improvements.

Under the proposed framework, a PfAD would be based on two factors:

- **Non-fixed income (NFI) portion**. The proposed regulation would require plans to base a portion of the PfAD on the degree to which the plan's target allocation is invested in NFI assets, given the greater degree of risk associated with these assets. As the proportion of a plan's target allocation to NFI assets increases, the NFI portion of the PfAD increases, to a maximum of 35%.
- **Benchmark discount rate (BDR) portion**. The proposed regulation would require plans to compare their discount rate to a BDR that is calculated in accordance with the regulation. The BDR would be based on Government of Canada long bond rates (CANSIM series V39056), allowing for risk premiums based on the plan's target asset mix. Where a plan's discount rate is greater than the BDR, it would result in a larger PfAD.

PfAD = NFI portion of PfAD + BDR portion of PfAD

Non-Fixed Income Factor:

Plans would use the table below to obtain the NFI portion of the PfAD based on the degree to which the plan's target allocation is invested in NFI assets. A plan's target NFI allocation would be determined in the same way as it currently is for plans that provide defined benefits. The purpose of this portion of the PfAD is to account for investing strategies that could increase the risk of not realizing the target benefit. The NFI portion of the PfAD would be set to range from 0% at 0% NFI allocation; to 7% at 60% NFI allocation; to 35% at 100% NFI allocation.

NFI Portion of PfAD Table	
Plan's Target NFI Allocation	NFI Portion of PfAD
0%	0%
20%	1%
40%	2.5%
50%	4.5%
60%	7%
70%	12.25%
80%	18%
100%	35%

The target benefit PfAD would account for alternative investments (e.g., real estate, infrastructure) by incorporating 50% of those investments into the NFI calculation. For example, if a plan has 50% of its investment portfolio in equities, 10% in real estate, and 40% in bonds, then the NFI allocation would be 50% + (0.5 x 10%) = 55%.

If the percentage of NFI assets is between two values in the table, then this portion of the PfAD would be determined by linear interpolation between the corresponding PfAD values.

Benchmark Discount Rate Factor:

The BDR portion of the PfAD would be determined in the same way as it is for plans that provide defined benefits. The purpose of this portion of the PfAD is to discourage the use of overly optimistic assumptions in calculating the plan's discount rate, which can affect the long-term funding stability of the plan.

This element of the PfAD would compare the plan's discount rate to its BDR, obtained by taking the Government of Canada long-term bond rate and incorporating reasonable risk premiums based on the plan's target asset mix.

The risk premiums proposed to be applied to the plan's target asset mix are 1.5% for fixed income investments and 5.0% for non-fixed income investments. The calculation would also include an additional 0.5% to account for potential higher returns from diversified investments.

BDR = GoC bond rate + (FI x 1.5%) + (NFI x 5%) + 0.5%

To determine the BDR portion of the PfAD, the plan's BDR would be subtracted from its discount rate, and then multiplied by the duration of the plan's going concern liabilities.

BDR portion of PfAD = (discount rate – BDR) x duration of liabilities

Note that the BDR portion of the PfAD would only apply if the plan's discount rate exceeds its BDR; otherwise, it is 0%. This portion of the PfAD increases as the plan's discount rate exceeds the BDR by larger amounts and the more sensitive the plan's going concern liabilities are to changes in the discount rate.

To calculate the total PfAD for the plan, the NFI and BDR portions of the PfAD would be added together. (See Appendix A for an example of the proposed PfAD).

Contribution Sufficiency Test

As with current rules for eligible SOMEPPs, for each year covered by a valuation report, plan contributions would be required to meet a sufficiency test.

Under the proposed framework, the contribution sufficiency test would require contributions to the plan to be no less than the sum of:

1. The normal cost of the plan;
2. The PfAD in respect of the normal cost;
3. Going concern special payments set out in previous valuation reports that remain to be paid;
4. Going concern special payments as determined in the most recent valuation report; and
5. Going concern special payments in respect of target benefits that are required to fund an increase in going concern liabilities and a PfAD on the increase in going concern liabilities, due to a plan amendment.

Plans that fail the contribution sufficiency test would be required to take such action as would result in the plan passing the test, such as increasing contributions or reducing the target benefit.

As benefit reductions are challenging decisions for plan administrators, this test underscores the importance of plans having a documented funding policy for how a plan will approach these decisions. Funding policies create a more predictable and transparent process when administrators make these decisions.

The proposed regulations would also set out rules for the equitable application of benefit reductions.

Benefit Improvements

The proposed framework would allow benefit improvements regardless of the plan’s funded level. Where a benefit improvement is made, any increase in going concern liabilities and PfAD on this increase would be required to be funded over 10 years.

Plans will be required to prioritize the restoration of previously reduced benefits over other benefit improvements.

Use of Surplus to Fund Normal Cost

In plans that provide target benefits, plan members bear the risks that benefits will be reduced. As such, the use of surplus to fund a plan’s normal cost or PfAD in respect of the normal cost would be prohibited.

Additional Measures

The proposed regulations would also deal with other matters such as asset transfers, wind-up, and administrative monetary penalties.

Multi-Jurisdictional Pension Plans

Pension plans that provide target benefits are not specifically addressed in the 2020 Agreement Respecting Multi-jurisdictional Pension Plans. The development of a target benefit framework must consider the impacts of the Agreement on members.

For example, given the different rules across the country regarding target benefits, it is important that Ontario's framework not disadvantage Ontario members of multi-jurisdictional plans registered in Ontario. Specifically, if reduction of benefits is restricted in a jurisdiction outside Ontario, benefits of Ontario members or other jurisdictions that allow reductions could bear additional risk creating an element of unfairness.

As such, under the proposed framework, plans would only be allowed to provide target benefits provided no more than 10% of their membership is in a jurisdiction in Canada that *does not* allow reductions in benefits.

Transition and Conversion

Section 81.0.2 of the PBA sets out the process for converting eligible benefits provided by MEPPs and SOMEPPs to target benefits. In particular, SOMEPPs that do not convert benefits to target benefits by the plan's first valuation date after January 1, 2024, would be subject to the general funding rules for MEPPs that provide defined benefits.

Application for Consent to Convert

The conversion process requires plan administrators to apply to the CEO of FSRA for consent to convert. Subsection 81.0.2 (2.1) of the PBA establishes the time period to apply for consent to convert, which is five years from the effective date of the proposed framework.

The requirements for the content of the application for consent to convert would be established through regulation. Under these requirements, the administrator would need to include in the application the following documents: copies of each type of notice given by the administrator to plan members, a copy of the proposed plan amendment reflecting the conversion, a statement certifying that the administrator has consulted with any applicable trade union, and a statement from the administrator certifying that the eligibility criteria in subsection 81.0.2 (2) of the PBA have been satisfied.

Notices of Conversion

The conversion process outlined in section 81.0.2 of the PBA includes requirements for the administrator to provide notices to affected parties regarding the conversion, including beneficiaries, participating employers, and any trade union that represents members of the plan. The required notices under section 81.0.2 include notice of the proposed conversion and notice of application for consent to convert.

The requirements for the contents of the notices would be established through regulation. The notice of proposed conversion would be required to include such information as a statement that benefits may be reduced and a statement that the plan is required to develop a funding policy that will be available upon request to members.

The notice of application for consent to convert would be required to include such information as how recipients of the notice can obtain copies of documents filed with the CEO of FSRA with respect to the conversion.

The notice of the registration of the plan amendment reflecting the conversion, which subsection 26(3) of the PBA states must be sent to beneficiaries, would also be required to be sent to participating employers and trade unions.

Effective Date of Conversion

The effective date of a conversion of benefits would be required to be within 12 months of the date that the CEO of FSRA consents to the proposed conversion.

The plan administrator would be required to prepare a valuation report under target benefit funding rules with a valuation date that is the effective date of conversion and file it with the CEO of FSRA within nine months of that valuation date

Time to File Funding and Governance Policies

The Ministry wishes to ensure that administrators have enough time to transition their plans into the target benefit framework appropriately once benefits have been converted.

Proposed regulations would give plans 60 days after the effective date of conversion to file funding and governance policies with the CEO of FSRA, which would allow time to obtain any required actuarial input and other advice to finalize these policies, where they do not already exist.

Cancelling Solvency Special Payments

As part of the conversion process, reduced solvency special payments and solvency special payments due after the conversion of benefits to target benefits would be cancelled, provided the following conditions are satisfied:

1. The CEO consents to the conversion under subsection 81.0.2 (14) of the PBA; and
2. The special payments relate to a solvency deficiency, or a reduced solvency deficiency (or a consolidated solvency deficiency) identified in a valuation report with a valuation date that is before the effective date of conversion.

Funding Transition Period

To give plans time to adjust to the funding requirements of the target benefit framework, the proposed regulations would provide a transitional funding period. In particular, for five years following the conversion of benefits to target benefits, transitional rules would provide that if contribution requirements under the target benefit funding rules are greater than the contribution requirements that would have applied if benefits had not been converted, target benefit contribution requirements would be satisfied based on the lower amount.

Conclusion

The government's objective is to promote and enhance retirement security in Ontario, and in particular to establish a framework for target benefits that strengthens plan governance, improves transparency and supports long-term plan sustainability. Implementing a permanent regulatory framework for target benefits is an important step forward in this work.

The Ministry wishes to hear your views on the proposed regulations, and ways to ensure the proposed regulations achieve this objective. As noted at the start of this consultation document, submissions can be sent to:

pension.feedback@ontario.ca

or:

Pension Policy Branch, 5th Floor Frost South
Ministry of Finance
7 Queen's Park Cres
Toronto, ON M7A 1Y7

Appendix A: Provision for Adverse Deviations

Illustrative example. For discussion purposes only.

Plan Characteristics				
Investment Mix		**Plan Discount Rate**	**Government of Canada Long-Bond Rate**	**Duration of Liabilities**
40% bonds	60% equities	7.25%	3.0%	15

Non-Fixed Income Portion	Benchmark Discount Rate (BDR) Portion
Using the reference table below, since the plan's target asset mix is 60% equities, the corresponding NFI portion of the PfAD would be 7%.	The BDR portion compares the plan's discount rate (7.25%) against a benchmark discount rate that takes bond rates and adds to this a risk premium for fixed income investments (1.5%), and risk premium for non-fixed income investments (5%) based on the plan's target investment mix and 0.5% for plan diversification.

Plan's Target NFI Allocation	NFI Portion of PfAD
0%	0%
20%	1%
40%	2.5%
50%	4.5%
60%	7%
70%	12.25%
80%	18%
100%	35%

$$BDR = \text{GoC bond rate} + (FI \times 1.5\%) + (NFI \times 5\%) + 0.5\%$$

$$BDR = 3.0\% + (40\% \times 1.5\%) + (60\% \times 5\%) + 0.5\%$$

$$BDR = 3.0\% + 0.6\% + 3\% + 0.5\%$$

$$= 7.1\%$$

The plan's discount rate (7.25%) minus the BDR (7.1%) is 0.15%

This difference is multiplied by the plan's duration of liabilities (15 years), to give an overall percentage of 2.25%

Added together, this plan's PfAD would be 9.25%