Bulletin

Alberta / B.C. Joint Expert Panel for Pension Standards releases report: *Getting Our Acts Together*

December 4, 2008 – The Alberta / B.C. Joint Expert Panel for Pension Standards ("Panel") has completed its review; the report *Getting Our Acts Together* ("Report") was made public on November 28. The Report follows a 13-month consultation period in which the Panel requested and received submissions from stakeholders and conducted additional follow-up meetings, culminating in its Report.

The 256-page Report provides an exhaustive, thorough review of the pension system, examining virtually every nook and cranny of the issues that are troubling the private pension system and contributing to the decline in private sector participation. We found the Paper to be completely thorough, with analysis of the multiple, often competing perspectives of the issues, leading to recommendations that most stakeholders will find to be fair and balanced. Links to the full report and the Executive Summary can be found at:

http://www.ab-bc-pensionreview.ca/panel_report.html

Early in the process, our firm made a submission to the Panel, commenting on a number of issues. We later met with the Panel to discuss certain aspects of our submission. As the actuary to several negotiated cost multiemployer pension plans (NCMEPPs) in B.C., we were particularly concerned about the solvency rules in the current legislation. And we are truly delighted by the Panel's recommendations.

The Panel recommended a new system of funding for these plans, that they refer to as "going-concern-plus," to replace the solvency rules. The recommended rules are similar to those suggested in our submission. Much work is still to be done to put these rules into place. We hope that will happen soon, as the proposed rules will create a rational approach to securing benefits without the significant disadvantages of the current rules.

Where to from here?

The Panel has invited comments on its Paper, accepting submissions up to March 2. From there, a process will be undertaken to draft new legislation. New legislation, potentially much better than current legislation, is still many months if not years away.

Unless financial markets substantially re-trace in December the decline in the markets since August, actuarial valuations as at the end of 2008 will show very unfavourable results. In the meantime, the trustees of NCMEPPs in B.C. still have the opportunity to apply for relief under the solvency moratorium announced in October 2007, which allow NCMEPPs to be funded on a going concern basis with 10 year amortization of deficits.

The Panel's proposal on NCMEPP funding is a vast improvement over the current system; it is hoped that the BC government will accelerate the process of setting new funding rules. Our analysis of the proposed rules follows.

For more information call **Harry Satanove** at 604-323-9363 or email: harry@satanoveflood.com

Analysis of the New Rules for Negotiated Cost Multiemployer Pension Plans

A new name for a different kind of pension plan

At the outset, the Panel recognized that negotiated cost multiemployer pension plans are neither defined contribution pension plans nor defined benefit pension plans. Current pension legislation substantially treats these plans as defined benefit plans. The Panel recognized that these pension plans are different, and even gave them a new name: specified contribution target benefit plans (SCTBs). SCTBs have unique features:

- Employer contributions (and employee contributions, if any) are set at fixed levels, typically through a collective bargaining agreement
- There is a pension formula set out in the plan document, but it is a target benefit that is subject to reduction if funding is not sufficient.
- The sole obligation of the employers is to provide the specified contributions; there is no obligation to top up benefits to the target level on plan wind-up.

New funding rules for the new kind of pension plan

The Panel recognized that the two sets of rules that are used to fund defined benefit pension plans, going concern funding rules and solvency rules, are not well suited for SCTBs. The Panel devised a new set of rules, referred to as "going-concern-plus," for the valuation of these plans.

The "going concern" part of the rules states that liabilities should be estimated using "best estimate" assumptions of future conditions, assuming the plan continues to operate as a long-term going concern.

The "plus" part of the rules states that a buffer should be included to absorb the impact of adverse experience such as poor investment returns, lower than expected contributions (due to reduced hours of work) or the withdrawal of one or more of the largest participating employers. The greater the potential volatility of these variables (for instance from a high equity allocation), the greater the buffer needed. The Panel anticipates that a plan's actuary would conduct "stress tests" to determine the appropriate size of the buffer. The result would be a target going-concern funded ratio of 100% (i.e. plan assets at least equal to plan liabilities) plus a buffer that depends on the plan's risk exposure.

The challenge at this point is that the actuarial profession has not yet developed standards for the development of the "plus" part of the actuarial valuation. Nonetheless the proposed methodology is a vast improvement over the current funding requirements.

Deficit funding

The Panel recommends that if the assets are less than the going-concern liabilities plus the required buffer, the negotiated level of future contributions would have to be sufficient to fund future benefits plus the shortfall over 15 years (or shorter in very mature plans). If contributions cannot be increased, the trustees would be required to reduce benefits to restore the plan to the target funded ratio.

Benefit Improvements

The Panel recommends that benefit improvements should be valued on the same going-concern-plus basis as required for funding. No benefit improvements would be permitted unless there was at least a 100% going-concern-plus funded ratio; no benefit improvements would be allowed that would reduce the plan's funded status below the target ratio.

To provide more flexibility in plan design, temporary benefit improvements would be permitted if there was sufficient going-concern-plus surplus. Full disclosure to plan members would be required of the temporary nature of the benefit.

Valuations

The Panel recommends that the current requirement for triennial valuations be retained. The regulator would continue to have discretion to require more frequent valuations and/or additional stress testing as part of risk-based monitoring. In an SCTB plan with an elevated chance of wind-up, the actuary would be required to take into account the wind-up scenario in setting the going-concern-plus assumptions.

The valuation report would state the target funded ratio and how it was calculated, with an explanation of the development of the buffer. The valuation report would include an estimate of the amount that would be required to settle all liabilities at the valuation date (previously referred to as the solvency valuation), and state the settlement ratio. Importantly, the settlement (solvency) calculation would be used only for disclosure, and not for funding.

Termination Benefits and Plan Wind-Up

On termination of membership while the plan continues in operation, an individual's termination benefit would be valued using the same assumptions as were used in the most recent valuation, that is, on a going-concern-plus basis. The maximum termination benefit any individual might receive would be 100% of the going-concern liability (without the "plus"). If the funded ratio is less than 100%, terminating members who elect to remove their funds would receive a pro-rated amount, based on the funded ratio at that time.

In the event of a plan wind-up, every member would receive a portion of the fund assets as determined by the trustees applying the principle of even-handedness.

Governance

In addition to the funding rules for SCTBs, the Panel recommended that SCTBs be required to put into place enhanced governance practices (including some that apply to all plans) that reflect the unique features of these plans.

Every plan would be required to have a governance policy that would be updated regularly and made available to the members. Amongst other elements, the governance policy would include:

- a list of stakeholders and a description of their interests in the plan
- a detailed description of the roles and responsibilities of each party included in the governance structure
- the basis on which decisions are made and implemented
- an explanation of how benefits are determined
- an explanation of how the fund is managed and invested
- standards for appointing and evaluating agents and advisors
- a remuneration and expense policy for trustees

Every SCTB would be required to have an investment policy (as is required currently) and a funding policy. Elements of the funding policy would include:

- a summary of the risks to which the plan is exposed
- a description of the policies adopted to protect the plan's funded position against the risks (for instance, funding margins, funding thresholds for benefit increases and decreases)
- an explanation of how the funding policy was developed
- a policy on benefit increases

The actuary would be required to opine in the actuarial report on whether there is anything in the funding policy that is inconsistent with sound actuarial practice for the particular plan.

Trustees would be required to certify that the plan has been managed in accordance with its governance policy, funding policy and investment policy. The trustees would be required to conduct an annual assessment of the plan's administration, its compliance with legislated minimum standards, governance, funding and investment policies, and the performance of the trustees, administrative staff and significant external professionals.

Trustees would be required to obtain the education and training required to properly meet their responsibilities and would be required to ensure that those with administrative responsibilities were appropriately trained.

Disclosure to Members

In return for eliminating the requirement for solvency valuations, the Panel recommended substantial disclosure requirements that would inform the members of the fact that the plan's benefits are target benefits, and are not guaranteed. The Panel recommended:

- The SCTB's settlement (solvency) ratio would be disclosed annually to all persons with entitlements under the plan
- The disclosure would explain the contingent nature of the target benefit and the circumstances under which it would be necessary to reduce plan benefits.
- Disclosure of the settlement ratio should be accompanied by an explanation of what it means, for instance the consequences of it being less than 100%, and that an individual's benefit might be ultimately be higher or lower than that percentage.

For more information contact **Harry Satanove** 604-323-9363 or email: harry@satanoveflood.com