Guideline

PfAD for Pension Plans with a Target Benefit Provision

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Distribution: Administrators and Service Providers of Pension Plans That Include a Target Benefit Provision

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INTRODUCTION

The Government of British Columbia has amended the *Pension Benefits Standards Regulation* (“PBSR”) to reform the definition of provision for adverse deviation (“PfAD”) applicable to pension plans with a target benefit provision registered in B.C. For the purposes of this Guideline, a TBP is defined as a pension plan with a target benefit provision.

This Guideline sets out the Superintendent of Pensions’ (“Superintendent”) expectations with respect to the development and documentation of the PfAD for TBPs. The Superintendent expects that the plan’s funding policy, as well as all actuarial valuation reports filed with a review date on or after December 31, 2022, will reflect the new PfAD definition.

BACKGROUND INFORMATION

The PfAD for TBP has been amended by Order in Council No. 505. The new PfAD consists of two components:

- 7.5 per cent; and
- A supplementary percentage.

The intended method for identifying the supplementary percentage must be documented in the funding policy.

For more information, please read BCFSA’s Advisory #22-040.

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REGULATORY EXPECTATIONS

The PfAD provides a minimum buffer intended to promote benefit stability. It is one of the primary risk management tools available to TBP administrators to better achieve the plan's long-term funding objectives.

This Guideline informs the development of the PfAD in the context of the plan's risk management framework and the documentation of the PfAD in the plan's funding policy.

LEGISLATIVE REQUIREMENT

Section 44(a) of the *Pension Benefits Standards Act* ("PBSA") provides that the administrator of a pension plan that contains a benefit formula provision "must ensure that a funding policy is established that meets the prescribed criteria respecting funding objectives and the intended method for achieving those objectives". The policy must include the items set out in Section 52 of the PBSR and the intended method for achieving them.

A new funding policy requirement under Section 52(b.1) of the PBSR is that the TBP administrators set out the intended method for identifying a PfAD that is expected to:

(i) Achieve the funding objectives set out in the funding policy; and

(ii) Manage the material risks identified in the funding policy.

The supplementary percentage is a percentage that the administrator identifies as appropriate in achieving the expectations of the PfAD described in Section 52(b.1) of the PBSR. Under the PBSA and PBSR,

1. The administrator must ensure that the contractually required contributions of participating employers are sufficient to cover the plan's normal actuarial cost plus PfAD, as applied to the normal actuarial cost, and any unfunded liability payments; and

2. The administrator may not improve accrued benefits unless the PfAD, as applied to the going concern liabilities, is fully funded and remains so immediately following the benefit improvement.

For clarity, the administrator may determine that a different supplementary percentage apply to (1) and (2) above.

APPROACH

The Superintendent may assess the appropriateness of the PfAD of a TBP relative to this Guideline and the PBSR. Further, the PfAD, as one of the components of the actuarial valuation report, must be satisfactory to the Superintendent in accordance with Section 38(1) of the PBSA. Administrators are expected to file a copy of the funding policy with the valuation report.

The specific steps for documenting the plan's risk management framework described in this Guideline are foundational to good governance and apply to all TBPs regardless of size. However, the Superintendent will use the principle of proportionality in assessing a PfAD, considering the nature, size, complexity, and risk profile of the plan.

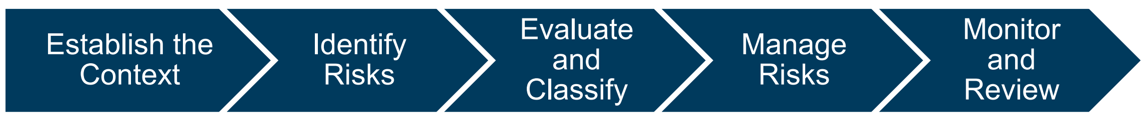
RISK MANAGEMENT FRAMEWORK

The administrator is responsible for ensuring that a funding policy is established. The administrator should document a clear "strategy suited to the objectives of the plan and designed to reduce the risks and costs of providing the expected retirement income".[1]

Prudent risk management is a key characteristic of a well-run TBP and an important part of delivering on the benefit objectives of the plan that have been communicated to plan members. By having a robust system for identifying and assessing relevant risks, administrators are better positioned to develop risk mitigation strategies, including the identification of an appropriate PfAD, and determine strategies on how plans will respond to adverse events and experience.

Clear communication and transparency are fundamental to the successful functioning of a TBP. It should be made clear to the members that future or accrued benefits may be adjusted depending on the financial status of the plan. The Superintendent expects that administrators regularly review their member communications for clarity and consider conducting member feedback sessions to gauge the effectiveness of member communications.

The risk management framework generally includes the five steps explained below.



A. Establish the Context: Set the Benefit Outcomes and Priorities

1. Identify the plan objectives, including expected outcomes and priorities. These objectives could include some, but not necessarily all, of the following:

    i. Benefit adequacy: for meeting pensioners' financial needs in retirement;

    ii. Benefit stability: including the acceptable frequency and magnitude of adjustments to benefits;

    iii. Benefit security: reducing the likelihood of downward adjustments to accrued benefits; and

    iv. Equity between different cohorts and generations within the plan: such as one generation of members taking on larger benefit security risks compared with other generations.

2. Describe the key plan financial metric(s), such as the plan's funded ratio, that will guide decisions concerning any adjustments to plan benefits, in particular downward adjustments to existing benefits and/or future benefits. Separate metrics may be established for accrued benefits and future benefit accruals in line with plan objectives.

3. Utilize these objectives as a cornerstone of the plan's strategy for communicating to plan members and other stakeholders. Administrators should ensure that any future changes to the funding policy are well documented.

4. Determine the frequency for reviews of plan objectives and financial metrics used in decision-making.

[1] Report of the Joint Expert Panel on Pension Standards, November 14, 2008, (89)

B. Identify the Plan's Risk Profile

1. Identify risks that could affect the plan's ability to achieve the stated objectives and that could potentially be addressed by a PfAD. Generally, the following risks apply to all TBPs and should be considered as part of the risk profile:

   i. Changes to the actuarial assumptions in the base economic model from when benefit rates were set to current time. For example, changes to:
      a) Expected returns,
      b) Standard deviation of specific asset classes, and
      c) Correlations between asset classes;

   ii. Adverse plan experience from economic and demographic factors compared to that expected in the actuarial valuation assumptions. For example, expected rates of return below expectations or membership longevity above expectations;

   iii. Material changes to the composition of plan membership. For example, increasing inactive membership or increasing age of active membership;

   iv. Any asset or liability mismatch inherent in the plan's investment policy;

   v. Any industry-specific risk such as a significant decline in new members or hours worked; and

   vi. Sponsor or participating employers' risk such as the failure or withdrawal of a sponsor, or one or more participating employers.

The risks listed above should not limit the administrators from discussing other risks that are relevant to their plans.

C. Evaluate and Classify Risks

1. Evaluate the identified risks, adopt processes to determine the degree of impact those risks could have on the plan's objectives, and rank the risks in relation to the impact. This assessment could involve strategies such as:

   i. Examine financial results under alternative funding methods (e.g., aggregate funding method), and

   ii. Perform stress testing and/or sustainability testing involving the use of deterministic or stochastic modelling.

2. Classify the risks either individually or collectively into categories. Examples of categories may include:

   i. Risk reduction: risks that will be managed by reducing the impact and likelihood of the risks to the plan,

   ii. Risk transfer: risks that will be managed by a transfer of the risk,

   iii. Risk retention: risks that will be managed by the plan's absorption of unfavourable outcomes, and

   iv. Risk acceptance: risks that will be managed through monitoring but taking no action.

D. Manage Risks

1. Establish appropriate risk management strategies in accordance with the risk classification. These strategies could include the following examples:

   i. Establish a PfAD which:

      a) May be fixed or variable depending on certain factors,
      b) May or may not be different when applied to normal actuarial cost and going concern liabilities;

   ii. Time the filing of actuarial valuations so that the plan is not adversely affected by significant experience losses over a short period of time;

   iii. Establish actuarial asset-smoothing methods to help reduce short-term volatility of asset returns;

   iv. Include additional margins in the valuation such as the excess of contributions above the cost of future benefits and expenses;

   v. Make certain benefit adjustments (e.g., indexing of pensions in payment, indexing of accrued benefits, and accrued benefits above a minimum floor) contingent upon the plan achieving or maintaining certain quantifiable metrics; and

   vi. Amortize deficits over prescribed periods of time.

E. Monitor and Review

1. Monitor the risk factors and the effectiveness of risk management strategies for alignment with benefit outcomes and priorities.

2. Regularly review material risks identified in the funding policy and document any actions or events that change the status of a risk or if a new risk may be identified. Risk management should be an ongoing process.

DOCUMENTATION OF PfAD

Section 52(b.1) of the PBSR expressly requires the administrator to document the intended method for identifying a PfAD in the plan's funding policy. Administrators should clearly document how the PfAD is appropriate to achieve the expectations set out in the funding policy for the plan.

The Superintendent expects that the rationale and the method/approach for identifying the PfAD be well-documented for transparency in the decision-making process.

1. **Rationale:** The PfAD must reasonably follow from the plan's stated objectives, risks, and other plan-specific considerations. Further, there should be a sound explanation of how these factors lead to the intended method for identifying the PfAD.

2. **Method**: In establishing the risk management strategies described in this Guideline, administrators must explain the process that identifies the PfAD. Examples of the method or approach include, but are not limited to, the following:

   i. A fixed PfAD;
   ii. A quantitative method or approach where the PfAD may vary; and
   iii. A qualitative approach that explains the decision-making process for determining the PfAD.

BEST PRACTICES TO FOLLOW

The Superintendent encourages administrators to also consider the following best practices:

1. Consider the Special Considerations for Target Pension Arrangements in CAPSA Guideline No. 7: Pension Plan Funding Policy, as part of the plan's funding policy;

2. Develop and implement a member communication policy which includes the following steps:

   i. Identify the key audiences,

   ii. Develop a communication plan with goals, objectives, and risks, and

   iii. Assess the effectiveness of the member communication plan;

3. Incorporate stress test results as part of an appropriate risk management strategy for the plan which may include the following steps:

   i. Develop an approach on how stress test results would factor into an appropriate risk management strategy,

   ii. Verify that the plan's stress test results are sufficient for the administrator to establish an appropriate risk management strategy,

   iii. Include the stress test results in the plan's risk management strategy, and

   iv. Monitor the effectiveness of the integration of the stress test results with the plan's risk management strategy.

APPENDIX: QUESTIONS ADMINISTRATORS SHOULD CONSIDER

Administrators should consider the following types of questions as they develop and document the PfAD for their TBPs. The list below is not an exhaustive list. Administrators should consider other questions that are specific to the risk profile of the TBPs.

Has the administrator:

1. Identified and explained the objectives of the plan, including expected outcomes and priorities?
2. Utilized the plan objectives as a cornerstone of the plan's strategy for member/stakeholder communication?
3. Described the key plan financial metric(s), such as the plan's funded ratio, that will guide the administrator's decisions concerning any adjustments to plan benefits?
4. Determined the frequency for reviews of plan objectives and financial metrics used in decision-making?
5. Identified the risks that could affect the plan's ability to achieve the stated objectives and that could potentially be addressed by a PfAD?
6. Evaluated the identified risks and adopted processes to quantitatively determine the impact that the risks could have on the target objectives in order of priority?
7. Ranked the risks in relation to the impact on the objectives?
8. Established strategies to mitigate risks, where appropriate?
9. Classified and discussed the mitigation strategies used to manage the risks?
10. Monitored the risk factors and the effectiveness of risk management strategies on an ongoing basis for alignment with benefit outcomes and priorities?
11. Explained the method or approach that make up the process for determining the PfAD at each actuarial valuation?
12. Provided a sound explanation of which considerations led the administrator to come to a chosen method or approach to determining the PfAD?