Intelligence MEMOS

From: Barry Gros

To: Pension Observers

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Re: **BC Has Lessons for Target Benefit Pension Plans**

With the era of private sector defined-benefit (DB) pension plans fading into history, it's important to understand other alternatives.

One such alternative, which still focuses on providing a lifetime benefit, is the target-benefit plan (TBP), a middle path between DBs and the defined contribution plans that have largely replaced them in most of Canada. A TBP generally targets a benefit level developed from a set contribution and allows benefits to be adjusted up or down contingent upon meeting specific financial metrics, thereby providing greater financial flexibility than traditional DB .

TBPs play a significant role in British Columbia, encompassing 22 percent of members in registered pension plans. They cover three times as many members as DC plans in the province. Additionally, TBPs in BC hold 45 percent more in plan

My recent C.D. Howe Institute **E-Brief** uncovered lessons that can be used by provinces that haven't yet finalized their TBP regulatory policy.

TBPs resemble a long-established type of pension plan, specifically the negotiated cost, defined- benefit, multi-employer pension plan (DB MEPP). The regulation of DB MEPPs has traditionally occurred in lockstep with that of the traditional single-employer DB plans, even though the former often exist with no guarantee of benefits being earned, and the latter have existed with the understanding that benefits are guaranteed. As TBPs have emerged, distinct regulations have been developed for them.

One of the key challenges for TBPs and their advisors has been to create a sustainability framework for something that is formula-based but not guaranteed (benefits being subject to the sufficiency of the assets available). Key issues related to this challenge include the following:

- assessing methodologies for converting contributions to targeted benefits, including the need for and magnitude of provisions for adverse deviation and any requirements to provide equal treatment to different member cohorts;
- assessing the sustainability of intended benefits based on the assets and contributions that are available;
- developing methods for the conversion of existing programs into a TBP structure and under what conditions; and
- dealing with the potential reinstatement of benefits that had previously been reduced.
- And this is all being managed where contributions to these plans are determined entirely independently of the benefits.

Furthermore, all of these issues are being dealt with by an incredibly diverse group of plans, as revealed in my recent E-Brief. These plans varied as follows:

- being in a significant number of different industries;
- having widely varying demographics, from new plans that have no pensioners to overly mature plans with very few active members;
- having widely different expected active membership groups, including those that are growing, those that are declining and those that are relatively stable.

The processes that TBPs use to manage the sustainability of their plans continue to evolve and I know from my own involvement with one of BC's more prominent that this evolution can see significant advancement over a relatively short period of time. Meanwhile, legislation governing these plans has been relatively static and has not evolved at the same pace as actual practice.

TBPs are complex financial entities, but it is not realistic for policy makers to develop appropriate regulations that can work across the broad spectrum of plans. In fact, based on my interviews with actuaries who advise these plans, none of them see the current state of TBP regulation as being useful to helping them ensure the sustainability of these plans for their members.

So if regulations can't have a meaningful impact on the financial management of these plans, then where can regulation have its biggest impact? The answer is simple and it's in the areas of governance and member communication. Members of TBPs deserve to receive clear and transparent communications about the nature of these plans in order to have an appreciation of how these plans operate and to build trust in those who oversee their operations. These plans need strong guidance and oversight at the board level to ensure members receive the benefits they deserve. Pension regulation and oversight can play a key role in providing guidance in these important areas of plan operation.

Experience has shown that prescriptive regulations, once implemented, can be very difficult to change; it usually takes many years. Unfortunately, boards can fall into a pattern of doing what's required by law. Having less prescriptive regulation regarding the financial management of these plans tends to force boards to better focus on what needs to be done for the benefit of the plan rather than just what is required by the law.

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