Intelligence MEMOS

From: Barry Gros

To: Ontario Pension Observers

Date: October 23, 2024

Re: **ONTARIO'S NEW TARGET BENEFIT PLAN FRAMEWORK: ONE CAVEAT**

Last week, Ontario's Ministry of Finance announced the finalization of regulations concerning its target benefit pension plan framework, to be implemented on January 1. The target benefit pension (TBP) plan framework is a welcome clarification of the rules around these plans, which play an important role in providing Ontario workers retirement security.

However, there is one key area regarding the draft regulations, related to a commentary I provided earlier this year, worth focusing on.

Regulations concerning the minimum contribution test in Section 10. (5) introduce an overlay that could in fact work against what the required funding and benefits policy is meant to accomplish. This section introduces a set of rules for minimum contributions that mimic those required for employer defined benefit plans, but which runs counter to some of the best management practices for target benefit plans. The funding and benefits policy is a critical part of managing a TBP, and this conflict illustrates a lack of appreciation as to how these plans operate.

TBPs are managed differently from single employer defined benefit plans. The latter focus on the risk to the employer of any adverse impact to its financial statements and the risk of variable and significant increases to its required contributions. The former – TBPs – focus on long term benefit and contribution sustainability.

The investment focus and the investment horizon of TBPs also differs from that of single employer defined benefit plans. In the case of the latter, the interest rate sensitivity of plan solvency liabilities and short-term funding requirements are generally key considerations in setting investment strategy. For TBPs, interest rate sensitivity in not an issue, with liability discount rates driven by the expected fund return based on the target asset mix of the plan. Plan asset mix is determined consistent with a long-term view of plan benefit objectives.

Different management processes often require different tools regarding actuarial funding methods. The regulations presume that one set of tools is adequate for all types of pension plans where a retirement benefit is defined. I disagree.

The policies section of the final regulations lay out very nicely what is expected in the funding and benefits policy required for every TBP. The regulations stipulate that the policy contain "the process and metrics the administrator must use to assess … i. Whether the funding and benefits objectives … are expected to be achieved over both the short and long term. ii. Whether changes to contributions or benefits are necessary." This requirement is fundamental to the operation of a TBP and exactly what we'd expect to see in a TBP funding and benefits policy. Nothing further is needed.

The additional requirement of a minimum contribution test represents a misplaced application of principles more in line with how defined benefit pension plans work. This unnecessary complication was highlighted in my previously referenced *Intelligence Memo*.

The Ontario government, between now and January 1, should review the minimum contribution aspect of the regulations and demonstrate why it believes it is necessary in its current form. Its removal would cause no harm to plan members and would also provide model TBP regulations for the rest of Canada.

Barry Gros is a retired actuary and was chair of the pension board of the UBC Staff Pension Plan from 2016-2023, the longest running target benefit plan in BC.

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