PBI ACTUARIES & CONSULTANTS

LEGISLATIVE UPDATE

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Canadian Institute of Actuaries Releases New Commuted Value Standards

On January 24, 2020, the long-awaited revised pension commuted value (CV) standards were released by the Canadian Institute of Actuaries (CIA). The CIA's review of Section 3500, Pension Commuted Values, began in 2015. One of the purposes of the review was to assess the appropriateness of the current standard for target benefit pension plans, multi-employer pension plans and other defined benefit pension plans that have the ability to reduce member benefits when contributions do not meet minimum funding requirements.

Concept of Target Pension Arrangements

While there are adjustments to the general commuted value rules, one of the most significant changes is the introduction of distinct rules for determining commuted values under a "target pension arrangement". The new standards define a "target pension arrangement" as "a pension plan for which applicable legislation contemplates the reduction to the accrued pensions of plan members and beneficiaries while the pension plan is ongoing as one of the available options for maintaining the funded status of the pension plan, and where the reduction in accrued pensions is not necessarily caused by the financial distress of the plan sponsor or sponsors." This definition includes certain target benefit plans, multi-employer pension plans (MEPPs) and negotiated cost plans.

Commuted Values for Plans that are Target Pension Arrangements

A new section of the CV standards addresses target pension arrangements (TPAs), as defined above. CVs under these plans are calculated "using the same going concern assumptions as used in the most recent funding actuarial valuation report or cost certificate". This section goes on to stipulate that the interest rate would be net of investment expenses, however, both non-investment expenses and any margins or provisions for adverse deviation in the going concern valuation should be excluded for the purpose of calculating CVs unless their inclusion is required by legislation or the terms of the plan. The value of the pension on this basis is then adjusted to reflect the plans funded status or the member's share of the plan assets but only to the extent required by legislation or the terms of the plan.

The first draft of the TPA standards included a prescribed adjustment based on the going concern funded ratio. The ultimate decision to allow but not mandate an adjustment means some plans will have the freedom to amend the plan text (or appropriate documentation) so that a portion of any surplus or deficit will be allocated to a member who transfers their entitlement out of the plan. In other cases, the adjustment will be dictated by the applicable legislation. For example, plans with target benefit provisions registered in BC or Alberta must multiply the going concern value of the pension by the target benefit funded ratio (capped at 100%) to calculate the commuted value.

As a general rule, CVs calculated using going concern assumptions will be lower than CVs calculated according to the current CV standards if no adjustments for the funded status are made. This is due to the fact that going concern discount rates are usually higher than the current CV discount rates. Where an adjustment is included, the impact is less predictable.

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Because the definition of TPA depends on the applicable legislation, the impact of these alternate CV standards will vary by the jurisdiction in which a plan is registered. The table below identifies by jurisdiction the types of plans that will be impacted as well as if the CV standard change is automatically recognized within the legislation or whether an amendment to applicable legislation is required.

Jurisdiction	Types of Plans defined as TPAs	Automatic or legislative amendment required
British Columbia	Negotiated cost plans and jointly sponsored plans that are not target benefit plans.	Automatic as the current pension legislation refers to the CIA standards as amended from time to time
Alberta	Collectively Bargained Multi-Employer Plans that are not target benefit plans and have not already elected to calculate CVs on a going concern basis. Negotiated cost plans and jointly sponsored plans that are not target benefit plans.	
Saskatchewan	"Limited liability plans" that have not already elected to calculate CVs on a going concern basis.	
Manitoba	"Multi-unit pension plans".	
Federal	MEPPs where employer contributions are limited by agreement, collective agreement, statute or regulation.	
Ontario	MEPPs. Plans where employer contributions are limited by a collective agreement.	Ontario is currently reviewing the Regulations in relation to the new CV standards.
Quebec	MEPPs where the plan text as of February 18, 2015 allowed reductions in benefits (or qualified as such under Bill 34).	An amendment would be required. Instead of making this amendment, the regulator has indicated that they plan to review the transfer value rules for all types of plans in the next few months.

It should be noted that TPA CV rules do not apply in the case of a full or partial wind-up. Therefore the changes will have no effect on solvency valuations for TPAs.

The revised CV standards come into effect on August 1, 2020. However, TPAs may choose to adopt the new standards prior to this date as long the plan adopts all revisions on the same date.

Commuted Values for Plans that are not Target Pension Arrangements

There are two main changes for plans that do not fall under the definition of a target pension arrangement (TPA). Firstly, the method for calculating the discount rates used to determine commuted values has been adjusted. Currently, the commuted value discount rates are based on the Government of Canada (GoC) bond yields, plus a 90 basis point spread to reflect the illiquid nature of pension benefits. In the new standards, this static spread is replaced by a dynamic spread based on provincial and corporate bond spreads relative to federal bonds. It is expected that this adjustment will reduce the volatility in the monthly CV discount rates compared to the current standard.

The second change is in the pension commencement date assumed in the CV calculation. Under the current standard, it is assumed that members would choose to commence their pension on the date that produces the greatest value. This optimal date is not necessarily the earliest date at which the member could receive an unreduced pension. In the revised standards, it is assumed that there is a 50% chance that the member will elect the optimal commencement date and a 50% chance that they will elect the earliest possible date to commence an unreduced pension.

Effectively, the new commuted value will be the average of the value of the pension commencing on the date that produces the greatest value and the value of the pension commencing on the date the member is first eligible to receive an unreduced pension. The result will be a CV that is either identical or lower than the CV based on the current standard, depending on the member's age and the plan provisions. Plans which provide unconditional early retirement subsidies will see lower CVs for members younger than the plan's earliest unreduced pension age.

These modifications of the CV standards are effective August 1, 2020.