



FICOM Pension Stakeholder Engagement Forum

Target Benefit Plans—Funding and Design

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Fundamental Principles of a Target Benefit Plan

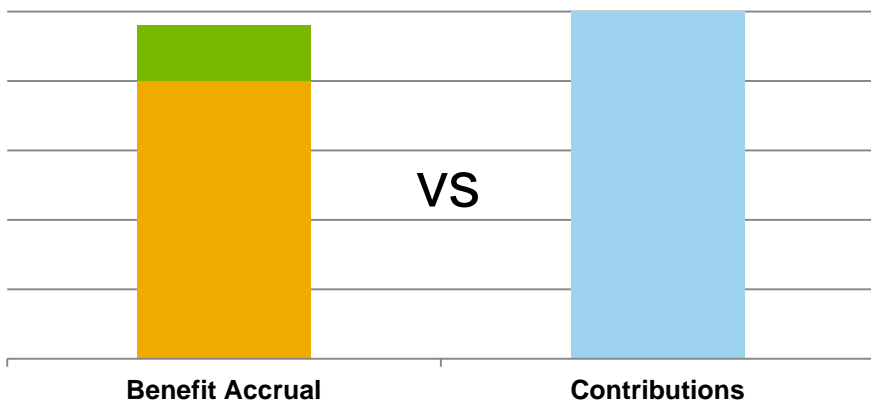
- The ideal characteristics of a target benefit plan:
 - **Principle #1**—The plan has stable benefit levels with limited chance of benefit reduction
 - **Principle #2**—The benefit earned is fair relative to the contributions made
 - **Principle #3**—There is intergenerational equity within the plan

We look at the PBSA Funding tests and the mechanics of these tests to see if they promote these principles

BC PBSA Funding Tests—Past and Future

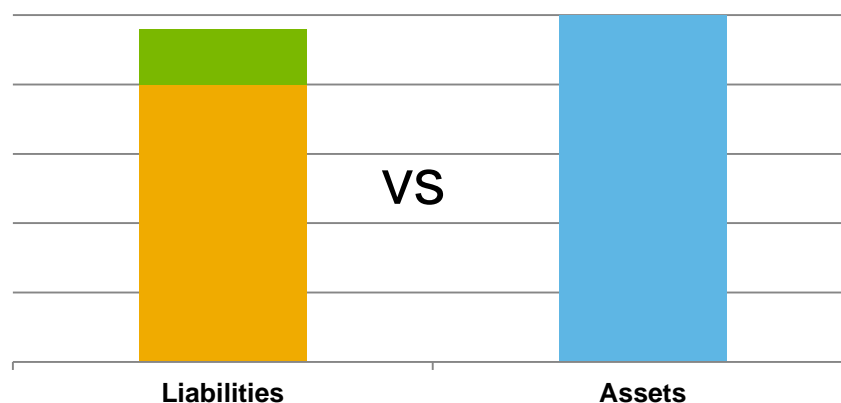
Test #1—Contribution Adequacy Test

Test must be passed



Test #2—Past Service Test

Test must be passed to able to provide a benefit improvement



Contributions *less than* **Benefit Accrual** *plus PfAD*

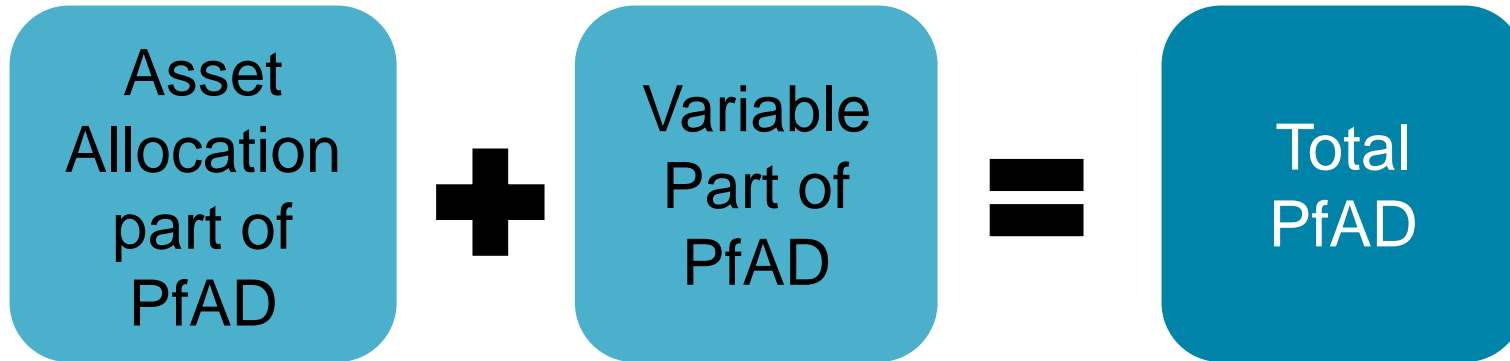
Some ability to meet any shortfall with accessible going concern excess
(Section 46 (4) (p))
(this is not defined, and only for fixed dollar negotiated cost plans)

Assets *less than* **Liabilities**

Deficit typically must be met over 15 years through additional contributions
(Section 58 of the Regulations)

Expenses?

Mechanics of the PBSA Tests—the PfAD



- **Asset Allocation part of PfAD:**

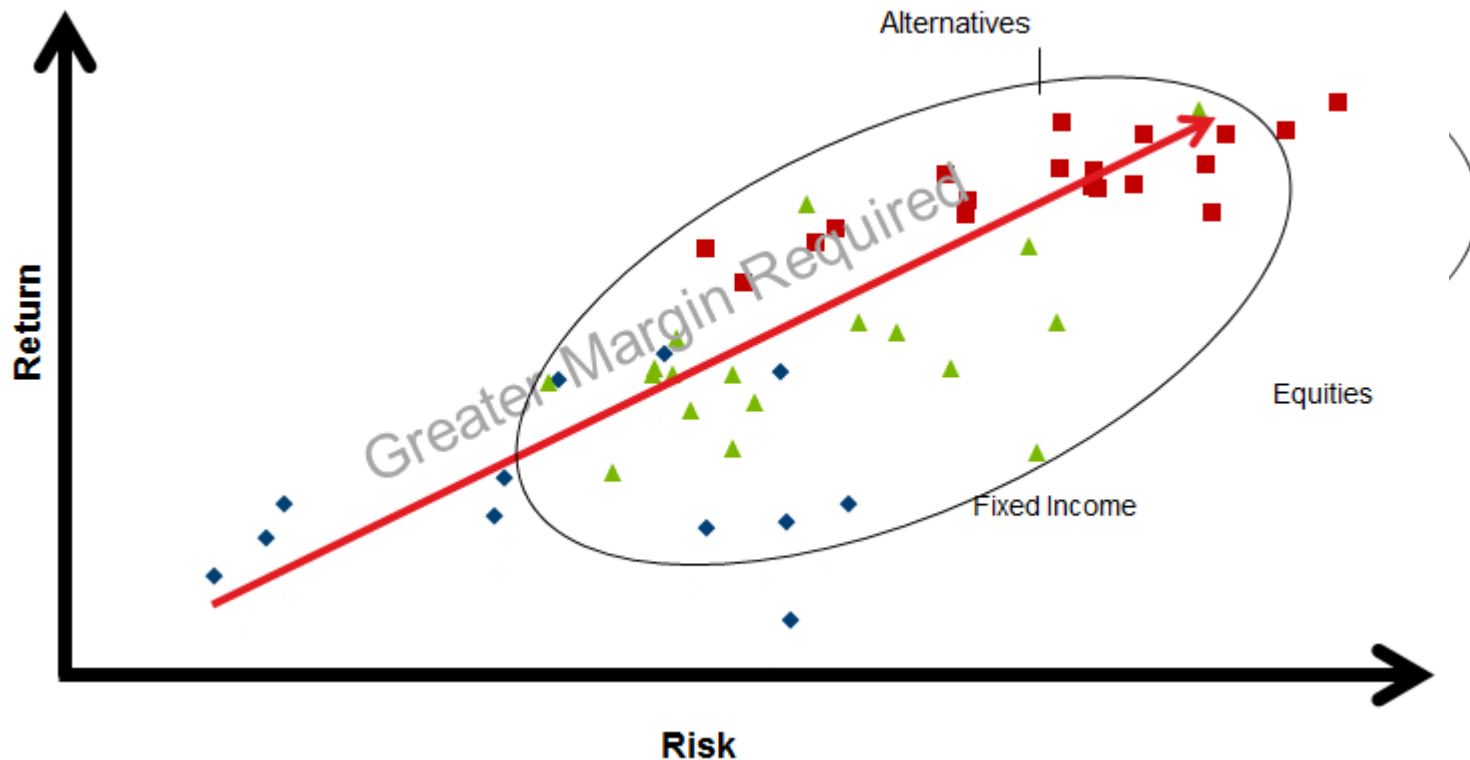
- The greater the allocation to equities the larger the PfAD

- **Variable part of PfAD:**

- Increases PfAD when a market based discount rate is greater than the valuation discount rate

PfAD—Asset Allocation Portion

- Based on the principle: the riskier the investments, the larger margin you must hold:



PfAD—Variable Portion

- Using an aggressive discount rate you should hold more margin. Compares:

Valuation Discount Rate
(Set by plan & actuary)

VS

Benchmark Discount Rate
(Prescribed by PBSA)

Based on expected long term returns.

Typical approach:

Long term inflation

Plus, real return on assets

Plus, rebalancing impact

Less expenses



Not directly linked to market conditions

Blend of calculated equity and non-equity return:

Equity return:

Long term government bond plus 4%

Non-Equity return:

AA Corporate bonds
(30-year spot rate)



Driven by market conditions

PfAD Variation—What this Means

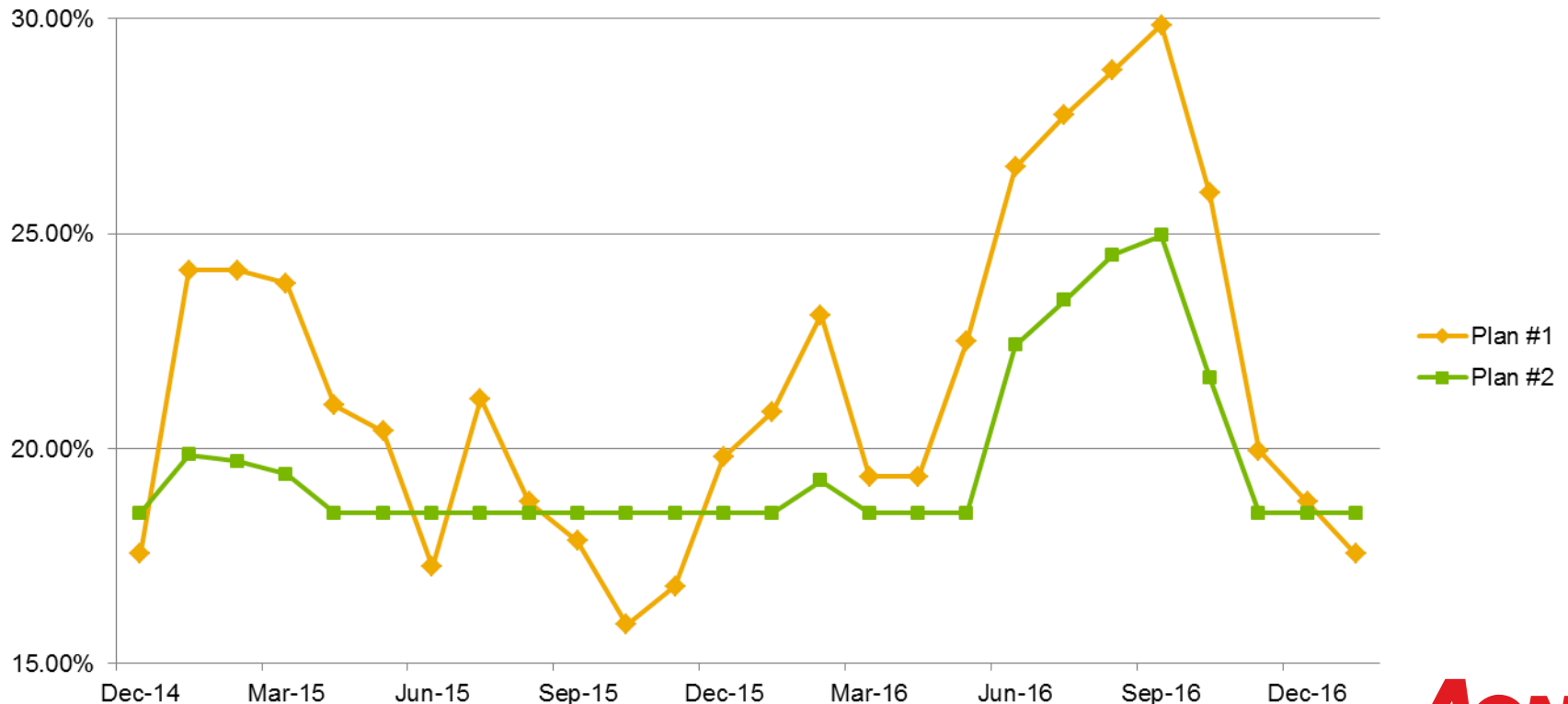
How the PfAD is flawed:

Plan #1

Heavily diversified with alternatives
45% equity investment
Discount Rate: 5.75%

Plan #2

Heavy equity allocation
(70%), little diversification
Discount Rate: 5.75%



How Does BC Compare to Other Provinces

	British Columbia	New Brunswick
Rules Based vs. Principles Based	Rules Based	Principles Based
Nature of Test	Closed group, single point in time, single set of assumption	Include open group projection and stochastic testing
Benefit Reduction	Immediate action to be taken if fail tests	Action if tests failed for more than 2 years in a row
Benefit adjustments	No explicit rules for how adjustments are made	Explicit rules must be set out in advance

Does the PBSA Help or Hinder the Target Benefit Principles

- **Principle #1**—The plan has stable benefit levels with limited chance of benefit reduction
- **Principle #2**—The benefit earned is fair relative to the contributions made
- **Principle #3**—There is intergenerational equity within the plan

Key Takeaways

- Within the current **rules based** framework:
 - The Contribution Adequacy test's ability to draw on accessible going concern excess is inconsistent with a rules based approach as it is not clear as to what is considered acceptable (esp. when this is set out in considerable detail for other situations).
 - We need a definition of equities/non-equities that follows a principle based approach rather than a rules based approach
- Longer term—look to a **principles based** funding mechanism, that:
 - Less driven by single day market conditions
 - Looks at a holistic view of the plan over the long term, for current and future membership (i.e. looks at open populations)
 - Allow for investment strategy that is best for the plan, and does not encourage short term behaviours

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