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CIA Finalizes Standards for Pension Commuted Values

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Authors

Dominic Bourbonnais, FCIA, FSA

Karen DeBortoli, BA, LLB

Tom Mudrinic, FCIA, FSA

This *FYI* provides information on the recently finalized changes to the Canadian Institute of Actuaries' standards for calculating pension commuted values, and what regulators and plan sponsors must do to prepare for the changes to take effect.

New commuted value standards

On January 24, 2020, the Canadian Institute of Actuaries (CIA) published its *Final Standards – Amendments to Section 3500 of the Practice-Specific Standards for Pension Plans – Pension Commuted Values* (Standards). Effective August 1, 2020, the Standards will make a number of changes to how defined benefit pension plans calculate commuted values (CVs).

The impact of the changes will vary depending on the type of pension plan, plan terms and prevailing bond yields.

Key changes

Interest rate assumption

- CVs will still be based on two sets of interest rates; one for the first 10 years, and another following the 10-year mark. When calculating the rates, the liquidity spread will change from a fixed +0.90% spread to two-thirds of the provincial bond spread plus one-third of the corporate bond spread (for medium and long-term bonds). The spread cannot be less than 0% or more than 1.50%.
- While interest rates will still be rounded to the nearest 0.10%, rounding has been introduced for indexation. Two options are provided for indexation rounding.
- The interest rate assumption for indexation must be reported separately.
- A statement must be provided indicating that the CV may provide more or less retirement income than the deferred pension foregone.

The impact of the above changes will vary according to bond yields. Based on recent rates, CVs determined under the Standards will be similar to or slightly lower than current CVs.

Commencement age assumption for commuted values

The new Standards assumes a 50% probability that retirement will occur at the age that maximizes the CV and a 50% probability that retirement will occur at the age that provides an unreduced pension (previously it was assumed a member would retire at the age that maximizes his or her CV). This is subject to a number of exceptions:

- If a member's age is greater or equal to the age at which an unreduced pension is payable, that payment date is assumed to be the retirement date, with any retroactive payments incorporated based on applicable legislation.
- If there are different early retirement reductions for different periods of service, the assumed retirement age is the age that maximizes the CV for each different period.
- If a member's pension is impacted by income tax limits, the unreduced pension age to be used is the one at which the largest lifetime pension is payable.

Where the new retirement age assumptions are not considered reasonable for the circumstances, the Standards permit use of an alternative assumption.

The impact of the above changes will generally lower CVs, particularly for those members who are entitled to generous early retirement subsidies. The impact will be less for members who are not eligible for significant subsidies, and for those who retire near or after NRD. The CVs calculated under the Standards at a specific interest rate will not be higher than the CV for the same rate calculated under the existing rules.

Recomputation period

A plan's benefit recomputation period is currently determined by its actuary, in light of the terms of the plan and applicable legislation. The Standards provide that this period will now be determined by the plan's administrator, or by the terms of the plan or applicable legislation. The default recomputation period is nine months.

Target benefit provision

New section 3570 applies to target benefit plans, including some multi-employer pension plans. These plans are generally subject to section 3500, however concern assumptions are used to determine the members' CVs. If permitted by the terms of the plan and applicable legislation, plans can also use their funded status to adjust CVs. Early adoption of the Standards is permitted for such plans.

In addition to requiring significant administration changes, the effect of the Standards will be to significantly lower the CVs paid out from target benefit plans.

Legislative environment

Pension standards legislation in most jurisdictions references the Standards as amended from time to time, meaning that no regulatory or legislative is amendment is required to adopt the latest changes. The following jurisdictions take a different approach:

- **Manitoba:** CVs are to be determined in accordance with both the Standards, as amended from time to time, and in accordance with any additional directions from the Superintendent;
- **Newfoundland and Labrador:** CVs are to be determined in accordance with the Standards, as amended, or another method as determined or approved by the Superintendent;
- **Nova Scotia:** Except in specific circumstances, CVs cannot be less than the value determined in accordance with Standards; and
- **Quebec:** CVs are to be determined in accordance with the Standards, with mandatory usage of the CIA mortality tables effective October 1, 2015.

As a result of these requirements, regulatory amendments or guidance may be required from the Manitoba, Newfoundland and Labrador, Nova Scotia and/or Quebec on the use of the Standards. Guidance will be particularly useful on the availability of early adoption for eligible plans.

Action required

Administrators and sponsors of defined benefit pension plans need to prepare for the Standards by:

- Reviewing current assumptions used for administration purposes;
- Updating administration systems to reflect the new assumptions, which may entail significant changes in some cases;
- Verifying whether a plan’s terms define the recomputation period (or give the administrator the power to define it), and making any necessary plan amendments;
- Determining the financial impact of the new assumptions for both member CVs and plan funding costs – these impacts will be felt by both registered pension plans and Supplemental Executive Retirement Plans (SERPs); and
- Reviewing and updating any member communication materials impacted by the changes in the Standards.

For more information on the Standards and what your plan must do to prepare for them, talk to your Buck consultant or contact the Compliance Consulting Practice at talktocanada@buck.com or +1 866 355 6647.

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