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The Quest for Sustainability in Contingent Pension Plans

As the pension landscape in Canada is transformed by plans that make member benefits contingent on financial performance, "sustainability" has become a watchword in the industry. But what does it mean and how can it be achieved? And what are the implications for regulatory policy?

Barry Gros and Barbara Sanders

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The Study In Brief

The types of pension plans offered to Canadian employees are changing. As membership in traditional defined-benefit pension plans declines, plans in which benefits are contingent on the financial status of the plan are becoming more common. Rather than placing all the risk on sponsors to deliver guaranteed benefits to members, these contingent pension plans require members to take on at least some of the risk that benefits may or may not meet expectations. At the same time, the term "sustainability" has risen to the fore of pension discussions. But what does it mean in the new context for pensions? How can it be achieved? What are the implications for regulatory policy?

We explored these questions in interviews with 30 key experts on the front lines of this pension evolution and provide a summary of their insights in this *Commentary*. We then draw conclusions about how regulatory policy can best adapt to the emerging paradigm.

While the term sustainability has become widely used, many respondents reported using it without having an official definition. When probed for their own definitions and interpretations, their responses varied but usually contained elements such as: long horizon, affordability, and a commitment to members' financial wellness in terms of providing a meaningful benefit. Many view sustainability as a balancing act between the needs of the present and the needs of the future. In fact, there is a strong intergenerational equity component that appears to be tied up in the definition of sustainability, and this is emerging more and more in discussions of contingent pension plans.

When asked about what needs to be in place for a plan to be, or to become, sustainable, respondents surprised us by identifying a wide range of other factors in addition to financial measures, including the design and nature of the plan, governance, and communication with stakeholders.

Contingent pension plans will likely play an increasingly important role in delivering retirement benefits in the future. They offer a different promise than traditional defined-benefit plans and the contract with plan members is different. This needs to be reflected in how they are managed, communicated and regulated. The parties involved in setting pension policy and standards should spend more time understanding in-depth the existing practices of well-managed plans and seriously consider our recommendation that prescriptive standards focus on aspects such as governance and member communication, leaving financing-related standards to be principles-based.

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The Canadian pension landscape is being transformed by a growing number of funded collective pension plans where some or all of the benefits for members depend on the financial position of the plan.

Examples include target-benefit plans, shared-risk plans, multi-employer pension plans and jointly sponsored pension plans with conditional indexing to inflation.[1] We refer to these plans as "contingent pension plans." Along with this development, we have seen "sustainability" added to the pension lexicon. But what does this word mean? What's being done to achieve it? And how is it communicated to plan members? Getting answers to these questions is becoming increasingly relevant as these contingent pension plans may end up dominating the pension landscape given (i) the impending wind-ups of traditional defined-benefit plans that already have been closed to new members since the 1990s and (ii) the trend to plan consolidation. This *Commentary* reports on a study we undertook to explore these questions and its implications for pension regulatory policy.

For this study, we interviewed 30 key individuals with experience in the management of contingent pension plans.[2] We analyzed their responses to our questions, identifying recurrent themes and organizing comments around those themes. We offer here a condensed summary of our findings, followed by a discussion of how considerations of sustainability (as articulated by our respondents) may influence the future direction of regulations for contingent pension plans. For clarity, direct quotes from respondents have been enclosed in quotation marks.

Defining Sustainability in Contingent Pension Plans

Sustainability has become a central concept in the pension world but its origins and exact meaning are more elusive. It is not known when exactly the term sustainability entered the pension lexicon in relation to either funded pension plans generally or contingent pension plans specifically; however, most of our respondents agreed that it has been a relatively recent development. They suggested that interest in sustainability arose in the past 20 years, as part of the shift towards a risk management paradigm for pensions. In fact, it was mentioned that the term itself rose to the fore due to concerns about plans not being sustainable. Since 2008, the term sustainability has been used in multiple government consultation documents relating to contingent pension plans.

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1 Briefly, for non-experts, target-benefit plans have fixed contributions and target benefits; in shared-risk plans, contributions and benefits can change based on plan performance, with both the employer and the plan members sharing the risk; multi-employer plans spread risk across employers and have the ability to reduce accrued benefits; in jointly sponsored plans, the employer(s) and members share responsibility for the plan's governance and funding.

2 See Appendix A for more details about our data collection methodology.

Table 1: How Sustainability Has Been Viewed Over Time

Period	Key Characteristics	Sustainability
1950s to 1960s	Prevelance of occupational pensions growing. Most benefits fully guaranteed via deferred annuity contracts with insurers or with government. No risk. Cash accounting.	Not a concern.
1970s	Plans created as trusts, investment in equities permitted. Growth in occupational pension coverage continues. Low recognition of risk in plan management.	Not a concern.
1980s	Significant changes to pension standards introduced in most jurisdictions to strengthen members' rights. Large surpluses emerging in occupational plans. Contribution holidays taken by employers. Plan improvements granted. Incentive is to give employees the best pension possible while meeting broader corporate objectives (e.g., early retirement windows in corporate restructuring). Introduction of solvency funding requirements to protect plan members in the event of bankruptcy of the plan sponsor. Introduction of accrual accounting for pensions.	Not a concern, except perhaps in terms of avoiding runaway surplus. No deliberate allocation of surplus to prudential reserves.
1990s	Significant rewrite of the *Income Tax Act* as it applies to tax-sheltered retirement savings in pension plans and RRSPs. Bank of Canada sets 2 percent inflation target. Steadily declining interest rates result in declining return expectations. Move to mark-to-market accounting for pensions. Plan design focussed on giving members more flexibility. Conversion of defined-benefit plans to defined-contribution picks up speed. Issue of "surplus ownership" takes over pension dialogue.	Not a concern in the private sector; funding challenges seen as temporary. Starts to become a concern in the public sector; introduction of the JSPP model.
Early 2000s	Dot-com crisis. "Perfect storm" of lower/more volatile investment returns and continuing decline in interest rates. Demographic pressures increase as plans are maturing. Awareness of risk increases. Level and volatility of contributions becomes untenable for many, forcing changes. Defined-benefit plan closures and conversions accelerate in private sector. More large public sector plans make effort to address risk by moving to jointly sponsored model with risk-sharing between employers and plan members; some introduce conditional indexation. Large plans develop more sophisticated investment programs, add new asset classes. Many multi-employer plans subject to solvency funding requirements begin to struggle. Several provinces convene expert panels to discuss future of occupational pensions.	Funding challenges significant for many. Viability of traditional DB plans with fully guaranteed benefits brought into question.
Since Global Financial Crisis in 2008	Interest rates declining or stagnant. Multi-employer plans continue to struggle. Solvency funding relief begins. Pension promise is evolving: contingent pension plan designs, including target-benefit plans and New Brunswick's shared-risk plans, emerge. Greater awareness of inter- and intra-generational equity. Going-concern-plus model* for funding emerges to replace solvency funding.	Interest in the sustainability of contributions and benefits develops. Sustainability in the context of contingent pension plans is explicitly mentioned.

*Note: Going-concern-plus refers to a pension funding approach that takes a long-term (i.e., going-concern) rather than short-term (i.e., solvency-based) view of the pension plan and incorporates an explicit provision for adverse deviations (pfad), generally specified by pension standards.

Table 1 provides a brief history of occupational pensions in Canada, with comments on how sustainability has been viewed over time.

While usage of the term has increased since the global financial crisis in 2008, definitions have rarely been provided. A few notable exceptions include Aon Hewitt's definition, provided in the context of target-benefit pension plans:

> A sustainable pension plan […] is one that can consistently deliver, through both favourable and adverse circumstances, an appropriate range of benefits within an acceptable range of costs over the long-term. (Aon Hewitt 2012.)

The only other explicit, public definition of sustainability that we could find was by the Ontario Teachers' Pension Plan (OTPP), communicated in its 2016 Annual Report as the

> ability to meet the needs of the present without compromising the ability of future generations to meet their own needs. (OTPP n.d.)

By comparison, the term sustainability is used frequently outside of pensions. It is often used to convey an expectation of maintaining a certain level of growth (e.g., the economy) or maintaining a certain service level (e.g., medical services). It can also refer to an avoidance of depletion of natural resources to maintain an ecological balance (as in resource management) or to a sense of stewardship for future generations (as in sustainable development).[3] In the domain of public finance, it refers to the ability to continue current spending and revenue policies over the long term without defaulting on (debt) obligations. There are clear parallels between these uses of the term sustainability and its evolving use with respect to pensions.

In our study, many of the respondents reported using the term "sustainability" without having an official definition. When probed for their own definitions and interpretations, their responses varied but usually contained one or more of the elements present in Aon Hewitt's definition: long horizon, affordability, and a commitment to members' financial wellness in terms of providing a meaningful benefit. Some participants also focused on the viability of the pension deal, in the sense of continued support for it from both the sponsor's and the members' perspective. Others added the concept of resilience; that is, remaining strong in the face of adverse experience. Although some respondents put the ability to deliver the promised (or targeted) benefits as a key aspect of sustainability, the definitions of most respondents implied a broader focus than benefit security alone.

It was clear from the responses that, consistent with OTPP's definition, many view sustainability as a balancing act between the needs of the present and the needs of the future. In fact, there is a strong intergenerational equity component that appears to be tied up in the definition of sustainability, and this is emerging more and more in discussions of contingent pension plans. We expect that intergenerational equity could become one of the defining pension issues in the next decade.

When the term "sustainability" is used in official documents, respondents indicated that it would normally be found in the plan's funding policy or the combined funding/benefit policy. Very occasionally, it is included in the Statement of Investment Policies and Procedures (or similar document), to reinforce the importance of investment returns in delivering the promised benefits. It may also occasionally be found in the plan's governance policy document, but almost never in the plan text.

When a plan or an entity does not use the term "sustainable," it may still use related terms, such as "resilient," "viable," or "supportable in the long term." At least one stakeholder reported using "benefit security" as the driver of decisions in

3 It's interesting to note that OTPP's definition above mirrors the quintessential definition of sustainable development first articulated in "Our Common Future," the 1987 report of the World Commission on Environment and Development.

contingent pension plans, rather than the broader concept of sustainability. Some respondents were cautious to use the term sustainability at all, noting that it is "potentially dangerous as it implies a sense of control and certainty that doesn't exist." One respondent suggested that definitions were perhaps not provided in order to avoid blame. The notion of members' reactions (positive or negative) to the term "sustainability" also came up several times.

What seems clear from our interviews is that any plan or entity using the term "sustainability" should proceed with caution. If used, the term needs to represent something tangible that the plan's decision-makers have a consistent understanding of and which they can articulate. If those using the term don't have a clear understanding of what they mean, there is a danger that members will fill the gap with their own interpretations. These may then fuel either complacency or anxiety with respect to the long-term prospects of the plan, neither of which is desirable in the context of contingent pension plans. Even in situations where the term "sustainability" is used as a shorthand for a well-defined set of plan objectives, that connection can be easily lost if not communicated constantly and consistently. In a sense, the plans that have consciously avoided using the term might have an advantage, because the objectives inherent in the messages they communicate about the plan are less likely to lead to misunderstanding.

While the main focus of most respondents was the viability and strength of the pension plan in a financial sense, the situation can be much more subtle, and more complex, especially in the multi-employer space. For a plan based primarily in one industry undergoing tremendous stress, with rapidly declining membership, sustainability can simply mean survival. Where a plan is provided by a union and it is a fundamental component of the union's value proposition to its membership, sustainability can mean ensuring or hoping that conditions will not force changes to the plan in such a manner as to put that value proposition and union membership, if not the union's existence, in jeopardy. Sometimes those conditions are beyond the plan's control, e.g., the overlay of minimum funding rules, such as solvency, for multi-employer pension plans.

Key Contributors to Achieving Sustainability

When we started out, we expected the discussion around sustainability to focus primarily on financial measures and financial management aimed at determining/testing the adequacy of predefined contributions to deliver the targeted benefits. When asked about what needs to be in place for a plan to be, or to become, sustainable, respondents surprised us by identifying a wide range of other factors in addition to financial measures, including the design and nature of the plan, governance, and communication with stakeholders. We comment further on each of these four factors in the remainder of this section.

Financial Management

Contingent pension plans survive through a proper and ongoing balancing of contributions and benefits, and must do so while facing considerable uncertainty in the future. Respondents in our study agreed that it is critical for boards and decision-makers to have robust conversations around risk. The results of those conversations – the plan's objectives and anticipated actions in response to risk – are typically articulated in a funding management policy.[4]

4 Such policies, pioneered by contingent pension plans, have now become more widespread as they are a statutory requirement in most pension jurisdictions.

One of the most significant risks facing contingent pension plans is not realizing the investment returns that are required to keep the contributions and the targeted benefits in balance. This risk has two dimensions: short-term volatility in returns, and the possibility that returns will fall short of expectations over extended periods of time. One respondent noted that, while the former may cause temporary problems in point-in-time assessments of financial health, it is the latter that poses the greater threat to long-term sustainability.

Another respondent pointed out that short- and medium-term volatility is also a critical consideration for contingent pension plans. If the plan assets are not matched to the liabilities, in the sense that market events can lead to changes in the plan's liabilities that are not offset by simultaneous changes in the value of the plan assets, then there is no magical solution that will make the plan sustainable (i.e., balanced in terms of the ratio of plan assets to liabilities) in all scenarios at all times. This is often missing in the conversation. If contingent pension plans insist on investing in assets whose risk characteristics are not aligned with the plan's liabilities then the possibility of benefit reductions cannot be ruled out completely (unless there is an insurer of last resort) because catastrophic shocks[5] are more and more likely to arise as the time horizon increases. This must be understood by all stakeholders.

Respondents described different models (without any prompting from us) for how sponsors/boards might conceptualize the balancing that is required to operate a contingent pension plan. One possible model involves the complete integration of benefit, funding and investment policies, with as many levers as possible in all three. A change to any one of these policies should not be made in isolation and must be evaluated in light of its impact on the other policies (i.e., what must be changed in the others to maintain balance). A slightly different model explicitly brings the idea of intergenerational equity into the balancing exercise, striving to have each cohort of participants (however that may be defined) pay as close as possible to the cost of their own pension. Yet another model keeps benefit security and contribution stability as key balancing elements but also adds adequacy as an important consideration, aiming for no significant disruption financially in people's lives at the time they retire.

We probed respondents about the tools, metrics and time horizons used for their financial analysis. A wide range of tools were mentioned when it came to determining the degree of balance. Most respondents agreed that sustainability testing for contingent pension plans cannot be done without some kind of long-term modelling and that the valuation of assets and liabilities prepared for statutory filing purposes is not the main financial management tool any more. It was also emphasised that the results of any testing need to be translated into decisions, and decisions need to be framed in terms of specific alternatives.

Stochastic and deterministic projections[6] were the primary tools used to assess sustainability, often in tandem, but there were other approaches. One respondent explained a custom risk budget assessment approach to testing whether the characteristics of the assets and liabilities were in balance. Another respondent referenced setting the valuation discount rate (used to calculate the present value of future obligations), excluding

5 For example, a sudden and significant drop in asset values that is not reversed quickly, or persistent poor returns stretching over 3-5 years.

6 Stochastic projection models incorporate risk and randomness by generating a wide range of plausible scenarios that may arise in the future, taking into account the combined effect of different random factors. In deterministic projections, only one future scenario is considered, corresponding to one specific series of future economic and demographic outcomes.

any equity risk premium and then using excess investment returns to fund indexing or other plan improvements. Yet another respondent explained their approach of always having the assets and actuarial liabilities in balance through the setting of the liability discount rate; i.e., the rate would be decreased in better times to build up a margin and increased in times of stress to release the margin.

Respondents were generally in agreement in their assessment of the benefits and shortcomings of stochastic and deterministic projections. Deterministic projections were seen as being more appropriate for stress testing; i.e., testing for events having low likelihood but high financial impact. These projections were also touted as being good for educating pension board members on the nature and impact of specific risks. They were seen as being particularly effective in illustrating what circumstances might have to occur to generate a specific financial result, in a process referred to as "reverse stress testing." Deterministic projections were also presented as the preferred means for illustrating the impact of improvements in longevity and large swings in plan membership. One possible downfall noted was that looking at single risk factors ignores potential interactions between factors.

Most respondents believed there is a difference between "sustainability testing" and "stress testing," and favoured stochastic modelling for the former. The most-often-mentioned advantage of stochastic models was their ability to easily present a wide range of scenarios over a much longer term, together with illustrating potential future patterns of benefit costs, plan liquidity and plan maturity. Another often-mentioned advantage was in educating board members on the interaction between assets, liabilities and sustainability metrics. Several respondents implied that the reputation of stochastic models has been hurt by poor delivery, inundating boards with seemingly endless numbers and charts. As a remedy, they suggested taking a more focused approach to using the projections, such as looking primarily at the lowest decile of potential outcomes and concentrating on the factors that would generate such scenarios. Several respondents pointed to the tendency of lay decision-makers to look at stochastic models as predictive models, and stressed the importance of educating them about how to properly interpret probabilistic outcomes. Respondents also cautioned that stochastic models are usually calibrated using historical experience (e.g., when setting the correlations between the projected returns on different asset classes) and that it can be difficult to incorporate emerging risks, which may very well affect broad economic outcomes but which are difficult to quantify just yet (e.g., geopolitical, cyber, or environmental risks).

Respondents reported using a wide range of metrics to assess sustainability, including the following:

- Current going concern funding ratio, possibly with a specific targeted level.
- Projected going concern funding ratio, generally on an open group basis (that is, taking into account new members who may join the plan in the future to replace members expected to retire and terminate employment in the future).
- Aggregate funding ratio that includes contributions and benefit service costs projected to arise over the remaining working life of current plan members.
- Current or projected solvency ratio (especially for plans under federal pension standards).
- Probability of "failure" in the future, however that is defined. For some plans failure means hitting a threshold for decision-making or engaging a funding lever.

Several respondents preferred to use more than one metric, choosing a suite of metrics that were directly related to how they defined sustainability and how they conceived of the balancing exercise within their plan specifically.

The time horizons used for deterministic projections were generally shorter than those used for stochastic models. The period for stochastic analysis was consistently in the 20-25 year range although longer was suggested by at least one respondent. There did not seem to be any particular rationale given for the period chosen, other than the desire for it to be "sufficiently long."

The Design and Nature of the Plan

Based on the interviews, it is clear that design is critical to maximizing opportunities for sustainability. Furthermore, design works directly in concert with financial management in determining the balance previously referred to. In terms of the design and nature of the plan, the respondents consistently provided the following advice:

- Keep it simple, by focussing on meaningful basic benefits. Ancillary benefits that advantage certain categories of members over others (e.g., based on their future elections or family status) should be limited.
- Make it relevant, by incorporating features that are important to members (e.g., early retirement provisions for members involved in physically demanding work).
- Keep contributions within acceptable levels, whether either a fixed contribution rate or a possible range of contributions, by ensuring they meet the parties' ability and willingness to pay (recognizing these thresholds can change over time).
- Create scale to ensure plans can afford the critical resources needed to proactively manage risk in the 21st century. There is also emotional strength that comes with size, as it gives a sense that the promise is more likely to be delivered.
- Build in resilience by maximizing the ability of the plan to withstand adverse experience. This can be achieved in two ways: by incorporating as many levers (i.e., conditional provisions) as possible, or by building explicit margins into the funding to improve the likelihood of delivering the targeted benefit.

There was disagreement among respondents about the appropriate size and mechanism of margins. Under the shared-risk plan model in New Brunswick, contributions have a built-in buffer and this appears to be accepted by practitioners as necessary for delivering the benefit with high probability. By contrast, respondents with target-benefit plans registered in BC, who are subject to the new going-concern-plus framework (i.e., that takes a long-term approach to funding and requires explicit contingency buffers), lamented the fact that contributions must now include a volatile and an often high provision for adverse deviations, even if the plan had a surplus in respect of accrued benefits. Several respondents pointed out that margins only enhance sustainability if they can be built up in times of favourable experience and released in times of adverse experience; margins that are fixed or must increase in times of financial stress can actually be detrimental to the plan.

Respondents also identified two fundamentally different approaches to articulating the "target" or "ambition": one is to establish a lower base benefit and provide enhancements, including cost-of-living adjustments, relatively often (i.e., under-promise and over-deliver) and the other is to aim for a higher benefit but occasionally fall short, sometimes by a large margin. It appears to us that these two approaches would not only elicit very different psychological responses from plan members but would also require different approaches to plan management and communications, and thus should be considered carefully.

Governance

Governance was consistently mentioned as being an important factor in achieving sustainability. Comments relating to governance focused on competence and expertise, continuity, respect for the fiduciary role, and education, as well as conflicts of interest in situations where trustees are also involved in negotiating contributions and/or benefits. It is worth noting that virtually all of the contingent pension plans included in our research involve joint governance by sponsors and members in one form or another, which has implications on how these plans should be regulated.

Some respondents focused on structure and process, suggesting that pension boards should have many of the same characteristics as corporate boards, including a skills matrix, board training, and self-assessments. Given the potentially frequent turnover among members of representative boards, these respondents noted the importance of having clear policies around the plan's objectives, priorities, and decision processes; a good record of following those policies; and education to ensure that the trustees understand the rationale behind the policies. It was mentioned that clear policies can also help decision-makers focus their attention on a limited menu of alternatives, and avoid paying large fees to external service providers for endless analyses of unlimited options.

Others suggested that it is not the governance structure itself that protects plans from potential pitfalls, but the specific people in the structure, noting that a good governance structure with the wrong people does not work, whereas a less robust governance structure with the right people can actually be okay.

There was also an interesting comment made regarding the focus of the board, noting that it is more difficult to have robust conversations around risk (and, by extension, sustainability) with boards that are more administrative and operational – as opposed to strategic – in nature.

Communication with Stakeholders

All respondents agreed that members' general understanding of their plan is terrible, except perhaps those near retirement. Respondents generally agreed it is unrealistic to expect younger members to have an in-depth understanding of the plan, or even have an interest in obtaining one. Some comments that stood out are paraphrased and summarized below:

- Sadly, the concept of sustainability is usually raised in the context of negative actions, primarily contribution increases and benefit reductions/suspensions. The term is used to support action being taken or, more positively, in reinforcing the conditional nature of benefits and in reinforcing why buffers are built into the contributions, in addition to discussing why members might not receive what was intended.
- It can be hard for members to understand what sustainability means. There's a perception bias, meaning that the term causes members to wonder if you're not going to sustain the plan.
- Members can have an intense reaction to the word "sustainability": a worry that makes it as important to elaborate on why you're using that term as disclosing the nature of the plan.
- Some entities believe the less they say the better off they are. They're afraid to say too much. In some cases, they want to reduce the chance of getting sued by reducing how much is in the public domain. Others believe the opposite: the more you say the better off you are. There was no consensus on style of communication.
- It is hard to make the transition from no communication or reassuring communications to discussing the realities of variable pension financials and the impact on benefits. Members become suspicious as to why they are either getting more communication, or a sudden change in communication.
- One way to connect members to the plan is to focus communications on the value proposition of the plan, and the spirit and intent behind the commitment. Focus on the goal: a healthy pension plan, supplemental to members' personal circumstances, that contributes to their retirement security by providing income for life.
- Keep repeating your messages so that members can become confident in the plan. Confidence is important, whereas knowing the actual details of the risk factors is less so.
- It's a long-term process, not a one-time exercise. In the words of one of the respondents: "Ignorance is a renewable resource. You might think, oh well, we told them two years ago about how this works. Well, there've been new members and even the ones who understood you two years ago likely have forgotten."

One observation we had part way through the interviews was that successful communication often involved members trusting that the plan is being managed properly. While this term wasn't mentioned by the earlier respondents, we began to probe the importance of trust thereafter. Subsequent respondents overwhelming agreed that establishing and maintaining the trust of members is critical. But it also became clear that plan situations vary and that one set of rules/advice for establishing trust would not necessarily work in all situations.

Furthermore, on a generally universal basis, plans are undertaking no formal activities to understand their members' understanding of the plan, their concerns and their misconceptions. True communication involves a feedback loop and this feedback loop is universally missing. Also, many plans lacked clarity on their communication strategy and key messages. Perhaps this last observation reflects the fact that, except for the largest plans covered, communication professionals are rarely involved in the processes of developing and executing communication strategies.

The Implications for Regulatory Policy

All pension plans are governed by the *Income Tax Act* (ITA) and by provincial or federal pension standards. The focus of the ITA is to provide a tax-deferral framework for pension plans, whereas the primary focus of the various pension standards across the country has always been protecting members' rights. This latter focus was particularly important when the single employer pension plan model dominated, with employers simultaneously acting as both sponsor and fiduciary. As noted previously, this is not the case with contingent pension plans, which generally have a joint form of governance with meaningful involvement of plan members. The inclusion of plan members in the governance structure is highly relevant to the nature of the regulatory framework; i.e., there is less need for prescriptive rules and more scope for principles-based regulation.

From the 1980s until recently, a key element of the protection provided under provincial pension standards was solvency funding: attempting to ensure that the plan had sufficient assets to settle members' accrued benefits immediately in the event of the sponsoring employer's (hypothetical) insolvency. Solvency funding was particularly ill-suited to contingent pension plans for two reasons: these plans did not have the same kinds of guarantees attached to accrued benefits that traditional DB plans did, and most contingent pension plans involved multi-employer situations where the financial risk to the plan in case of the failure of a single employer would be minimal. Over the past 20 years, declining interest rates have made solvency funding onerous for all plans, in some cases threatening the survival of the plan itself on account of increased solvency contribution requirements. For this reason, temporary solvency funding relief was enacted by many jurisdictions. Today, the trend is to move away from full solvency funding altogether, not only for contingent pension plans but also for traditional DB plans.

A logical question in this post-solvency world is then: what should be the focus of the new regulations? We contend that, in the context of contingent pension plans, pension standards should aim to support long-term sustainability by taking into account key risk factors and the dynamic nature of the plan's benefits and contributions. While easy to state, this objective is extremely difficult to achieve. As demonstrated by our study, contingent pension plans are a heterogeneous group: plans with different designs and sponsorship structures operating in different sectors and business environments can have vastly different definitions of "sustainability" and, even when their definitions are similar, they may operationalize it very differently, leading to diverse financial management approaches. As a result, it is incredibly difficult to come up with a single prescriptive regulatory framework that does not "get in the way" of the plan's specific objectives.

New Brunswick managed to avoid this conundrum altogether by legislating the financial management framework itself (i.e., by specifying the tools, metrics and time horizons to be used) thereby indirectly defining what sustainability means for all shared-risk plans in the province. While there is some flexibility in how these plans achieve resilience (i.e., choice of triggers and actions, margins, etc.), there is considerable homogeneity in design and especially management. In this sense, all shared-risk plans registered in New Brunswick are fundamentally the same.

By contrast, the going-concern-plus funding regimes applicable to (most) contingent pension plans in BC, Alberta, and Ontario did not lay out a prescriptive operational definition of sustainability: plans are (seemingly) free to develop their own definitions and management philosophy. Unfortunately, such plan-specific definitions and objectives can easily come in conflict with the new rules regarding minimum provisions for adverse deviations. In this way, policymakers in these provinces are indirectly telling some contingent pension plans that their choices with respect to long-term sustainability are not considered to be appropriate. Neither we, nor the participants in our study, consider this to be an effective approach. We suggest that policymakers either:

- allow real discretion so plans can actually run their affairs in a way that is consistent with their own clearly articulated goals, or
- have the legislation clearly articulate what the acceptable long-term sustainability goals are and then lay out the rules that specifically support achieving those goals.

We understand that history matters: the jurisdictions embracing the going-concern-plus framework already had a large number of heterogeneous contingent pension plans (in the form of negotiated-cost multi-employer pension plans) so they were not in a position to start with a blank slate as New Brunswick did. In fact, the latter option above would likely be met with significant opposition.

Pursuing the former option, which essentially advocates for principles-based regulation of the financial aspects of contingent pension plans, would be no less challenging. As a first step, regulators would need to work on building capacity. Additional investment in personnel may be required. Larger regulatory bodies with significant experience in principles-based oversight of complex financial institutions (e.g., the federal Office of the Superintendent of Financial Institutions) may be able to provide leadership, spreading best practices not only across provinces, but also across practice groups (e.g., from insurance regulators to pension regulators). Provinces with more resources and experience in this type of oversight could second or share staff with other provinces. To be clear, we understand that harmonization of the legislation applicable to contingent pension plans is unlikely at this point; however, opportunities for innovative cross-jurisdictional oversight may still exist.

Earlier in the *Commentary* we listed other factors besides financial management that contribute to the long-term sustainability of contingent pension plans, and these also have relevance to regulatory policy. Respondents generally welcomed the increased member communication requirements that were introduced in BC for target-benefit plans, but several indicated they believed the regulations do not go far enough. Respondents generally believed that governance plays a very significant role in sustainability – plans being able to make tough decisions at the right times – but there is little regulation in this area. It seems to us that pension regulation could be made more effective in these two areas – communication and governance – if it was more prescriptive in what is required to provide the outcomes desired.

Conclusions

Contingent pension plans will likely play an increasingly important role in delivering retirement benefits in the future. They offer a different promise than traditional defined-benefit plans and the contract with plan members is different, especially for target-benefit plans. This needs to be reflected in how they are managed, communicated and regulated. The concept of sustainability will also likely be with us for some time, especially in the context of contingent pension plans. The respondents in our research indicated several factors that contribute to sustainability and that sustainability testing requires long-term modeling. We believe we can benefit significantly from further research in this area, particularly in tracking how existing practice evolves, what is working and what can be improved.

We also believe we need pension standards that will assist in the goal of achieving sustainable contingent pension plans, not impede it. Based on input from our respondents it is unclear that the direction currently set for pension standards will support that. Designing a meaningful, sensible and effective regulatory environment for members of contingent pension plans requires balancing a number of factors, which include:

- Benefits in contingent pension plans are not guaranteed.
- Not all contingent pension plans have the same benefit risk profile. Plans with more benefit levers, such as the ability to adjust ancillary benefits (e.g., post-retirement indexing for inflation and early retirement reduction factors) before having to consider reducing accrued or future benefits, are more resilient to adverse plan experience than plans with few or no levers.
- Economic conditions can change dramatically over time from those in place when regulations are adopted (e.g., interest rates).
- Actuarial professional standards are limited and still evolving for some sub-types of contingent pension plans (e.g., target-benefit plans).
- Pension regulatory authorities generally do not have extensive depth of actuarial expertise in their staff.

Coming up with effective pension regulations is challenging. Pensions are technically complex, generally only understandable to professionals working in that field. They are seldom an election issue, so getting the attention of politicians is not easy. This means that the opportunity to make changes to pension legislation is infrequent and it is incredibly difficult to fix poorly written legislation once it's in place. We ask that parties involved in setting pension policy and standards spend more time understanding in depth the existing practices of well-managed plans and seriously consider our recommendation that prescriptive standards focus on aspects such as governance and member communication, leaving financing-related standards to be principles-based.

Appendix A: Data Collection Methodology

We conducted 30 confidential interviews with key individuals across Canada involved in the management of contingent pension plans. The interviewees were chosen from four groups:

- high-level plan employees (i.e., members of the executive team, or direct reports thereof) of contingent pension plans ("Plan Representatives"),
- pension consultants (all Fellows of the Canadian Institute of Actuaries) with substantial experience dealing with contingent pension plans of any size ("Consultants"),
- senior legal professionals practicing in the area of pensions and benefits ("Lawyers"), and
- other senior members of the Canadian actuarial community who are not currently providing consulting services to contingent pension plans, but are generally seen as thought leaders within the industry, with significant experience providing advice on occupational pension plan design, funding, and management ("Other Experts").

Interviewees were recruited by email. Summary data regarding the participants is presented in Table 2.

Table 2: Participant Data

	Number
Plan Representatives	10
Consultants	10
Lawyers	3
Other Experts	7

The interview process consisted of open-ended questions relating to how participants and their organizations/clients think about pension plan sustainability, the metrics they use (if any) to track it, and how they or their clients communicate it. The interviews were semi-structured: our questions loosely adhered to a script, probing deeper to clarify concepts and techniques where appropriate, and changing the order of the questions as needed to fit the direction indicated by each interviewee's responses.

The interviews took place during the period from October 2018 to February 2019. Most interviews were conducted either in person (16) or by videoconference (12). Two of the interviews were conducted by telephone. All interviews were recorded and transcribed. Most interviews were 90 minutes long, for a total of approximately 45 hours of recorded time.

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