New paper calls for linking DB pension solvency minimums to plan member age

By: Gideon Scanlon | September 28, 2021 | 10:15

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A new white paper published by the Canadian Institute of Actuaries is proposing new rules during defined benefit plan windups, requiring higher solvency ratios for members who are retired and lower ones for those at earlier stages in their careers.

"This paper suggests that retiree pensions would be better protected if the solvency funding regime framework and the benefit reduction rules on windup recognized the premise that younger workers can tolerate greater risk and have more opportunities to recover from pension losses," wrote co-authors Joe Nunes, executive chairman of Actuarial Solutions Inc., and Serge Charbonneau, president of Pro-Pension Inc. "As workers age and, in particular, after workers retire, they can tolerate less risk since there is much less time and many fewer options available to remedy the negative impact of lost pensions."

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According to existing rules for winding up underfunded DB plans, the pension's funds are divided among all plan beneficiaries on a pro-rata basis. In a situation where a plan has only 90 per cent of its promised funding, all beneficiaries would see an even 10 per cent reduction in their pension.

While this may be, on an actuarial basis, the fairest way of handling a difficult situation, the white paper's authors aren't convinced it's the best way. "If someone is already retired, cutting their pension by just $50 to $100 could cause things to not balance out," says Nunes. "An 80-year-old who loses $300 per month has very few options to self-correct."

According to the paper, solvency funding rules could be redefined targets for members categorized by age, rather than requiring DB plans to fund all solvency liabilities to the 85 per cent level.

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"Instead of a one-size-fits-all approach, this could involve differentiations based on certain eventual benefit reductions that could be mitigated by the members continuing to take some investment risk for the remainder of their life," noted the white paper.

Under one set of proposed rule changes, solvency funding minimums for plan members under the age of 45 would be reduced to 75 per cent and for those between 45 and 54, it would be reduced to 80 per cent. For those aged 65 to 74 and 75 to 84, the rules propose raising the minimum solvency to 90 per cent and 95 per cent, respectively. And a 100 per cent solvency minimum would be required for members over the age of 85.

"This is about harm reduction, although it isn't a term actuaries tend to use. We think of it as protecting the most vulnerable," says Nunes, adding the paper's position isn't meant to represent the official position of the CIA.

"Serge and I had both been discussing the issue for a while with our fellow actuaries. The CIA encouraged us to work together to produce the paper. We treated it as a thought experiment designed to get a conversation going."

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