



Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

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Mr. David Marshall
Solvency Funding Review
Pension Initiatives Unit, Pension Policy Branch
Ministry of Finance
7 Queen's Park Crescent
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Toronto, ON M7A 1Y7

Via email: pension.feedback@ontario.ca

Dear Mr. Marshall:

Re: REVIEW OF ONTARIO'S SOLVENCY FUNDING FRAMEWORK FOR DEFINED BENEFIT PENSION PLANS

The purpose of this letter is to provide comments from the Pension Investment Association of Canada (PIAC) on the Review of Ontario's Solvency Funding Framework for Defined Benefit Pension Plans - A Consultation Paper which was released on July 26, 2016.

PIAC has been the national voice for Canadian private and public pension funds since 1977 in matters related to pension investment and governance. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over \$1.5 trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries. PIAC's positions on public policy reflect the fiduciary framework in which member funds operate and its commitment to work in the best interests of plan members.

General Comments

PIAC strongly supports Ontario's review of the regulatory framework for pension funding and transfer values. As stated in our letter to the Ontario government in

September 2015, PIAC believes Canadian governments have the ability to alter the policy underpinnings of the pension regime and thereby alleviate some of the funding and regulatory challenges facing pension plans and the low pension plan coverage in Canada. PIAC is convinced that now is the time for the reform of long-term, minimum funding rules.

We believe Canadian pension jurisdictions need one funding rule, as opposed to one going-concern funding rule and one plan termination (solvency) funding rule. This one funding rule can be properly designed to meet the needs of beneficiaries and plan sponsors to balance the need for benefit security and plan sustainability. It is PIAC's hope that new rules can be developed with jurisdictions across Canada to promote the efficiencies of harmonization.

PIAC's membership has considerable experience with many of the intricacies and challenges associated with these issues, and we would be very pleased to provide assistance on this important initiative.

General Thoughts on Jointly Sponsored Pension Plans (JSPPs)

The Consultation Paper notes that certain existing JSPPs are exempt from solvency funding and have been since 2010. This follows the Ontario Expert Commission Report and is in recognition that the existing going concern funding rules were best suited for such JSPPs given their joint governance, funding responsibility that is shared among members and employers, ability to reduce benefits on plan windup, and the need to ensure inter-generational equity. We would strongly recommend against any changes that add to existing going concern funding rules for such JSPPs. This is because any such changes would only serve to: increase member and employer costs with no corresponding increase in plan sustainability; fail to respect the joint governance structure of those JSPPs, i.e., those that own the risk (members and employers), through their representatives set contributions and other funding assumptions as appropriate for their risk tolerance; and impair inter-generational equity. It may be that the approach chosen through this consultation process would be appropriate for single-employer DB plans that convert to JSPPs in the future.

Specific Comments

The following represents PIAC's views on the specific questions asked throughout the paper. As noted above, we would be happy to go into more detail on our views at the appropriate time.

Approach A - Modifying Solvency Rules

- 1. What are the advantages and disadvantages of maintaining but modifying solvency funding requirements?*

PIAC sees no advantages to maintaining solvency funding requirements under modified form. The costs and complexities in having two different funding regimes are significant and many of the solvency funding options noted in the consultation paper have been tried in the past or in other jurisdictions and have not been successful in solving the pension funding problem. This has directly led to the closing of defined benefit pension plans in Canada. PIAC believes one funding regime with appropriate margins for adverse deviations is in the best interests of both pension plan members and plan sponsors. Pension plans are inherently long-term obligations thus short-term solvency funding policies are not appropriate.

2. *Which option or combination of options would be most effective in balancing the different interests of plan sponsors, unions, members and retirees?*

Average solvency ratios, lengthening amortization periods, consolidation of solvency deficiencies and solvency reserve accounts all have merit and may help mitigate some of the funding challenges. However, some of these techniques have been used in solvency funding relief measures introduced by various provinces and have not proven to be effective in enhancing plan funded ratios in any meaningful way. In addition, they are more complex and costly to manage and the same or similar results could be achieved with one funding model regime with appropriate parameters.

3. *Is there an appropriate solvency funding level below 100% which could be required? For example, should pension plans only be required to fund on a solvency basis to 80%?*

Determining a static funding level below 100% that would be appropriate for all pension plans would be problematic and if combined with an increase to PBGF premiums, the end result may be just as costly for plan sponsors, continue to result in undesirable cash flow volatility and provide no additional benefit to plan members.

4. *If solvency funding requirements are modified, what changes to the PBGF would help maintain benefit security without placing onerous requirements on plan sponsors?*

PIAC believes that the PBGF is not necessary to enhance the security of pension benefits in Ontario. This is not a practice in many other jurisdictions given its high cost and limited coverage. Appropriate funding rules are the best way to balance the security of pension benefits with the interests of plan sponsors.

5. *If solvency funding requirements are maintained in a modified way, what would be an appropriate limit on the use of LOCs?*

LOCs are excellent funding tools and it is common for the LOC to be issued by a financial institution that has a higher credit rating than the plan sponsor. If the plan sponsor can supply a higher amount of an LOC, it is because the banks issuing the LOC believe the plan sponsor has the credit capacity to support the LOC. Conversely, LOCs do not earn a rate of return (either positive or negative) and are therefore not a match to the pension liabilities. A higher LOC limit will not increase the risk to the pension plan but will likely drive higher funding costs over time. PIAC is supportive of a 15% limit similar to those established by other jurisdictions.

Approach B – Eliminate Current Solvency Funding Rules and Strengthen Going Concern Funding Options for Enhanced Going Concern

1. *What are the advantages and disadvantages of eliminating solvency funding requirements and introducing enhanced going concern funding requirements?*

PIAC believes that minimum solvency funding rules are having an ongoing detrimental effect on the viability of defined benefit pension plans. Sponsors of plans not being wound up are struggling with their commitment to their businesses and pension plans, necessitating repeated rounds of temporary regulatory solvency relief. As defined benefit pension plans mature in a low interest rate environment, plan sponsors are still struggling with the large financial burden solvency funding creates; a burden that is clearly worse than expected due to the extraordinary economic circumstances.

PIAC maintains that now is the time to simplify the funding framework in Canada and move to one funding regime which has margins to recognize the possibility of adverse deviations.

2. *Which combination of the options described above would best moderate contribution levels and volatility while providing some degree of benefit security?*

Provisions for adverse deviation and shortened amortization periods are both options that should be considered in setting the appropriate framework for an enhanced going concern funding model. Restrictions on return on investment assumptions should not be necessary if the framework is established with PfADs that are tied to the pension plan's asset mix, the demographic profile of the plan, intergenerational fairness between plan members and level of risk tolerance. An additional solvency trigger adds to the complexity of the enhanced going concern funding approach and adds significant costs in monitoring and reporting. PIAC does not believe a PBGF is necessary in an enhanced going concern funding model.

3. *Are there any other restrictions that could be placed on actuarial assumptions (e.g., salary projection rate for final average plans or mortality assumptions)?*

The actuarial standards that exist today and would be created to further provide standards for funding valuations using an enhanced going concern funding model should be sufficient to ensure appropriate assumptions are used. No further restrictions should be required by regulation. Ultimately, the actuary must confirm that the assumptions used within a funding valuation are independently reasonable and are appropriate in aggregate in accordance with the Canadian Institute of Actuaries (CIA) Standards of Practice.

4. *Are there other measures to enhance going concern requirements that should be considered?*

PIAC is strongly supportive of the introduction of Solvency Reserve Accounts (SRAs) and we agree that restrictions can be placed on SRA withdrawals based on the funded level of the plan. As you identify in your paper, SRAs reduce the risk of excessive funding and trapped surplus in the current era of low interest rates and large contribution requirements for most plan sponsors. Over the longer term, SRAs can also potentially mitigate the inherent pro-cyclical nature of pension contribution requirements by providing sponsors with greater incentive to fund pension plans beyond statutory minimum requirements during periods of stronger economic growth.

5. *Should a plan's funding requirements be linked through a PfAD to their investment strategies to prevent excessive risk taking?*

PIAC supports linking the PfAD to the investment strategies of the pension plan, the demographic profile of the plan, intergenerational fairness between plan members and level of risk tolerance. By their nature, investment strategies that are highly correlated to the pension plan's liabilities will reduce funding risk and consequently should not require a large PfAD. There are both simple and complex ways of accomplishing this. With either approach it will be important that the overall margins built into an enhanced going concern funding valuation are appropriate and that the PfAD does not inadvertently add an additional level of reserve that doesn't reflect the margins already in place. A given PfAD should be supported by the individual pension plan circumstances. PIAC would be happy to help develop the details surrounding the determination of PfAD's at the appropriate time.

Additional Complementary Reform Measures

1. *Which of these measures would be appropriate to help provide balance to a package including one of the two approaches described above? What other measures, if any, could be considered in a balanced reform package?*

There are merits to each of the measures noted in this section.

Annual Valuation Reports: PIAC would support changes to require annual valuation reports while a pension plan is in an unfunded position, with less frequent reports being allowed after a certain level of surplus is achieved. Other jurisdictions have adopted this approach. It would also be appropriate to ensure that simplified valuations are performed (but not filed) on an annual basis to support ongoing contribution holidays in the inter-valuation period.

Written Policies: PIAC believes that having governance and funding policies are part of good governance practices for pension plans as recommended by CAPSA. PIAC would recommend an approach whereby the plan sponsor certifies that the policies exist and are reviewed on an annual basis, perhaps through the annual information return.

Commuted Values: PIAC agrees with the comments in this section and highly recommends that CV's be calculated using interest rates that more appropriately reflect the underlying risk associated with the pension benefit. PIAC also recommends taking the funded position of the pension plan into consideration when paying out a CV. Pension plans are there to provide life-time retirement income at retirement and not to provide CV transfer rights that effectively try to replicate, for an individual in the retail-market-place, what an institutional pool of assets can achieve over the very long term. Plan members are currently incented to take out their CV on termination under the existing rules, which often results in less benefit security for plan members. Furthermore, unduly high CVs can lead to ongoing plan members subsidizing the costs of benefits provided to those leaving the plan. By making the above changes, plan members will appropriately weigh the CV decision more carefully.

Restrictions on Contribution Holidays and Benefit Improvements: PIAC supports linking the ability to take contribution holidays with the funded position of the pension plan. Under an enhanced going concern funding model, which would replace both the current going concern and solvency funding models, contribution holidays should continue to only be permitted when a pension plan is fully funded. As the enhanced going concern funding model includes a PfAD, contribution holidays up to the amount by which the pension plan's funded position exceeds 100% would be appropriate and still provide benefit protection. Benefit improvements can also be tied to the funded position of the pension plan with additional immediate funding required to bring the pension plan back to the minimum funded level. In this situation, the current amortization period could be maintained. As mentioned above, it would also be appropriate to ensure that simplified valuations are performed (but not necessarily filed) on an annual basis to support ongoing contribution holidays in the inter-valuation period.

Administrator Discharge for Annuity Buyouts: PIAC strongly supports the inclusion of annuity buy-outs with full discharge of liability. PIAC has been

advocating for legal discharge in all jurisdictions in Canada to recognize that by shifting the risk of default of payments from a single corporate sponsor to an organization like an insurance company, risks are being assumed by a highly regulated, highly rated and heavily capitalized part of the financial system. This ensures ongoing security for plan members and regulatory oversight.

2. *To what extent would annual valuations, and funding and governance policies help to protect benefits if solvency funding requirements are modified or removed?*

As previously noted, funding and governance policies are part of a pension plan's good governance practises. All pension plans should have these policies and review them annually. Annual valuations provide an excellent tool to ensure that changes to the capital markets are being appropriately reflected in a pension plan's funded position and action can be taken to ensure funding levels are adjusted appropriately. This provides an important level of security to plan members that fits well with an enhanced going concern funding model.

3. *Should restrictions be placed on annuity buyouts that result in a discharge to the administrator? For example, before a discharge is given should a certain funded level be attained? Should buyouts be for retirees and/or former members only?*

Annuity buyouts should not be restricted other than to ensure that the funded ratio of the pension plan remains at or above the funded ratio just prior to the transfer. This can be achieved by allowing the plan sponsor to fund the pension plan, immediately prior to the transfer to the insurance company, for the amount required to 'pay' the difference between assets available in the pension plan and the amount required for the annuity buyout.

4. *Should recipients of buyout annuities retain their membership status for the purpose of sharing a surplus from a future wind-up?*

PIAC does not believe a full discharge can be achieved if the plan member is still entitled to any benefits under the pension plan including any surplus distribution on a future wind-up.

5. *What changes to the PBGF would be needed if solvency funding is replaced by enhanced going concern requirements?*

PIAC does not support changes to the PBGF (such as an increase in assessments or an expansion of coverage) as a condition of moving to a modified going concern funding framework. It is difficult to price pension insurance on an economic basis in the context of the PBGF, as Ontario faces a relatively small and concentrated group of employers with large defined benefit plans, and the current trend toward closing defined benefit plans will only exacerbate this situation in the future. In practice, then, the PBGF effectively acts as an additional cost for plan sponsors with little ability on its own to materially enhance the security of the overall system.

6. *Would employers be willing to pay higher PBGF assessments for lower funding requirements?*

PIAC does not believe employers would be willing to pay higher PBGF assessments. There are many challenges with the PBGF for employers – particularly for those who sponsor multi-jurisdictional plans whereby some members are covered by the PBGF and others are not. In addition, the risk of the sponsoring employer becoming bankrupt is not taken into consideration in determining the assessment resulting in solvent companies subsidizing those who are less solvent. Finally, given underfunded plans are required to pay PBGF assessments directly by the employer (vs. from the pension fund), PIAC believes that employers would prefer any additional contributions to be directed to the pension plan itself vs. the PBGF.

We would be happy to meet with you to further discuss our comments in this letter at your discretion. Thank you again for including PIAC in the consultation process.

Yours sincerely,



Lisa Jankov
Chair