



Pension Investment  
Association of Canada

Association canadienne des  
gestionnaires de caisses de retraite

March 6, 2018

The Honourable Charles Sousa  
Minister of Finance  
Ministry of Finance  
7 Queen's Park Crescent  
5th Floor, Frost Building South  
Toronto, ON M7A 1Y7

Via email: [csousa.mpp.co@liberal.ola.org](mailto:csousa.mpp.co@liberal.ola.org)

Dear Honourable Minister Sousa,

**Re: Pension Benefits Act Reg 909 - Reform of Ontario's Funding Rules for Defined Benefit Pension Plans: Description of New Funding Rules, Description of Annuity Regulations and Pension Benefit Guarantee Fund**

We are pleased to provide comments on the *Proposed Funding Rules and Description of Annuity Regulations* released on December 14, 2017.

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 \$1.8 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.

PIAC first wishes to again commend the Ontario government for tackling the issues related to solvency funding reform. There is important momentum across Canadian jurisdictions to find a more durable balance between defined benefit plan sustainability and security and Ontario's follow-through on the draft regulation will be critical to maintaining that momentum.

## Proposed Funding Rules

PIAC strongly supports the direction of the proposed amendments in terms of moving towards a more stable enhanced going-concern regime for plan funding.

We would make the following observations about the framework for determining the appropriate provision for adverse deviation (PfAD) which seems reasonable at a conceptual level:

- We would encourage Ontario to harmonize its framework with other jurisdictions following this approach (in particular Quebec) to the extent possible in the interests of regulatory consistency.
- While it appears to be the case from the example PfAD calculation in the document, we would emphasize that the Benchmark Discount Rate should be compared to a *best estimate* discount rate without margins so as not to double count provisions for potential adverse plan experience.
- It may be useful in your approach to establishing the PfAD to account for the overall interest-rate coverage of assets relative to liabilities (or duration mismatch) as this can be one of the material drivers of surplus volatility. For example, the PfAD could be set based on the degree of interest rate matching rather than just the allocation to fixed income assets alone.
- The rationale for the distinction between open and closed plans in setting the PfAD is unclear as plan status is not fundamentally a risk factor. The assessment of the PfAD based on the risk profile is more appropriate.
- Finally, there may be some benefits to refining the proposed allocation of all alternative assets as 50% fixed income and 50% non-fixed income. Among the list you provide, for example, we would suggest that resource properties are more appropriately considered 100% non-fixed income while traditional mortgages are more appropriately considered 100% fixed income. PIAC is available to offer assistance with such an exercise.

## Description of Annuity Regulations

PIAC supports providing legal discharge to plan sponsors who purchase an annuity for retired or former plan members. We are generally supportive of the regulatory requirements outlined in your paper, subject to two comments.

It is unclear that there is a policy benefit to requiring sponsors to fund to a predetermined 85% level prior to initiating an annuity. Provided that the solvency level post-annuitization is no lower than it was pre-annuitization, benefit security for non-annuitized members is

unchanged, and has arguably been enhanced to the extent that the sponsor will have made progress in de-risking the plan and reducing the size of the go-forward liability.

We also encourage you to reconsider the proposal to allow members to retain entitlement to plan surpluses in the event of a future wind-up following an annuitization. Fundamentally, we think this provision would exacerbate the asymmetries around ownership of surplus and deficits which have long been problematic for defined benefit plans. Plan members whose pension have been annuitized are receiving full pension entitlement and are no longer exposed to the potential downside risks of an under-funded plan. As such, it is unclear from a policy perspective why they should benefit from future plan surpluses. Any future surpluses would develop relative to the liabilities remaining in the plan post-annuitization and will come about from normal course market/liability movements, which the annuitized members are not exposed to, and/or post-annuitization contributions which are made by remaining plan members and/or the plan sponsor for the account of remaining members. Finally, we believe that this sort of clause would be cumbersome for plan sponsors to administer as it would remain in effect for many years and would no doubt give rise to relatively complex calculations to estimate entitlements, which in many cases would represent small balances.

If the government is concerned about plan sponsors using annuity purchases as a means to appropriate surplus, we believe there are less cumbersome means to mitigate these risks. They could include:

- Apply the provision only in cases where there is a material (e.g. 110% or greater) surplus on a solvency basis in the plan following an annuitization;
- Allow plan sponsors to share any surplus value at the time of annuitization through the annuity economics and thereby eliminate any future surplus entitlement; and/or
- Apply the provision only in cases where a relatively short period of time (e.g. 5 years or less) has passed between the annuitization and the plan wind-up.

### **Pension Benefit Guaranty Fund (PBGF)**

PIAC has historically had concerns that the PBGF provides limited security to the overall pension system given the difficulty of creating a diversified pool of risk in the Ontario defined-benefit landscape and the challenges in effectively pricing the value of the guarantee. To the extent that the government moves ahead with premium increases, we would recommend that plans be able to pay the premiums out of the fund, provided that the plan would remain at least 85% funded on a solvency basis. We would also suggest that confidence in the PBGF regime would be enhanced if there was greater transparency around the fund's financial position and rate-setting mechanisms, including the analysis underlying the proposed changes to the premium structure. The introduction of a charge based on plan liabilities regardless of funding status in particular has raised concerns among a number of our members.

## Solvency Reserve Accounts

Finally, we note that it does not appear that Ontario is allowing for Solvency Reserve Account (SRA) structures in its proposals. PIAC has advocated in favour of SRA's for a number of years as we believe that they can be a useful tool to help manage the inherent procyclical nature of pension funding obligations by encouraging plan sponsors to fund beyond statutory minimums during periods of good economic growth through mitigation of the asymmetries related to trapped surplus. Alberta, British Columbia and Quebec already allow for their use so viable models exist in the Canadian regulatory landscape. We see no downside risk from a policy perspective to an appropriately structured SRA regime, nor do we see a contradiction relative to the movement to an enhanced going-concern funding standard.

We would be pleased to provide any further clarification on our comments at your convenience.

Yours sincerely,



Brenda King  
Chair