Pension Investment Association of Canada
Association canadienne des gestionnaires de caisses de retraite

July 3, 2019

Pension Regulation Division
Nova Scotia Department of Finance and Treasury Board
PO Box 2531
Halifax, Nova Scotia
B3J 3N5

Delivered Via Email: pensionreg@novascotia.ca

Re: Improved Funding Framework for Nova Scotia Pension Plans: The Road Forward

The purpose of this letter is to provide comments from the Pension Investment Association of Canada (PIAC) on the announcements from the Nova Scotia government on the Improved Funding Framework for Nova Scotia Pension Plans: The Road Forward in May 2019.

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 $2 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 commends the Nova Scotia government for moving forward on changes announced in the 2019 budget, including the introduction of solvency reserve accounts (SRA's) and the provision for statutory discharge following an annuity buy-out.

PIAC also supports the framework for enhancing the funding of pension plans through margins added to going concern funding and the reduction in the solvency threshold to 85%.

We note first that the proposal to apply enhanced going concern even in a case where a plan does not elect to move to an 85% solvency standard (or more likely cannot elect to make such a move due to the member approval requirements) will represent an increase in funding requirements which is contrary to the direction that we believe policy-makers should be moving. We recommend that you maintain a status-quo going concern standard for plans that remain on a 100% solvency standard.

PIAC has the following comments on your specific questions:

1. Types of employer contributions that should be permitted to be paid into a reserve account

    - PIAC is in favour of a flexible approach to permitted funding of reserve accounts such that all employer contributions above and beyond current service cost be permitted into a reserve account.

    - We note that Nova Scotia is not proposing that reserve account funds be accessible to the employer as long as a plan is a going concern. We believe this will make them less attractive for sponsors and we encourage you to allow access if a plan meets a prescribed funded threshold as is the case in other jurisdictions. For most employers, plan wind-up is a sufficiently distant event that any funds in a reserve account under the current proposal will likely be viewed as "trapped" from a commercial perspective even if they are not literally trapped from a legal perspective.

    - We also recommend that you permit reserve account funds to be transferred to the plan to meet minimum employer funding requirements to the extent that an employer is current with all statutory funding requirements. A major advantage of a reserve account construct is to permit employers to over-fund during good years and draw on the account in years when cash flow is more constrained. Maximizing the flexibility of reserve accounts will increase usage and therefore improve protection for members.

2. Most appropriate going concern provision for adverse deviation/margin

    a. <u>Preference of option 1 over option 2:</u> PIAC believes that both options 1 & 2 are workable but prefers option 1 as it provides a tighter link to portfolio construction and greater incentives to sponsors to match interest rate risk for any given asset allocation (which is also preferable from a regulatory perspective).

    b. <u>Other options that should be considered:</u> In the context of Nova Scotia's proposal to remove the 15% limit on the use of letters of credit, you may consider whether some link to the level of cash assets in the plan is appropriate for determining the PfAD. While letters of credit provide solvency protection, they do not earn a rate of return or bear market exposure. Basing the PfAD on a dollar-duration (or DV01) ratio of plan fixed income assets to plan liabilities (as an alternative to a duration ratio) would control for this factor, as would measuring variable assets as a percentage of liabilities.

c. <u>Whether there should be a different PfAD for solvency exempt or public sector plans:</u> As noted above, PIAC views an enhanced going concern regime as a reasonable trade-off for eliminating solvency funding. In the case of plans such as public sector and other solvency exempt plans that are considered low enough risk so as not require solvency funding, we recommend that you maintain status quo going-concern funding.

d. <u>Use of an additional PfAD to apply for pension plans using aggressive discount rates</u>: PIAC understands the rationale for introducing a mechanism to link PfAD's to the conservatism of the underlying funding assumptions but we would not recommend that Nova Scotia move in this direction immediately. Our experience is that the actuarial profession converges on a fairly narrow consensus for forward looking returns and best estimate discount rates and that the current challenges facing the vast majority of DB plans are not a result of aggressive discount rates. We suggest that you provide regulators with the appropriate authority to deal with outliers (which may include an additional PfAD or other mechanisms such as a supervisory capability to prescribe maximum rates) but that you wait until you have more experience with sponsor behaviour under the enhanced going concern regime.

e. <u>Definition of variable income securities</u>: PIAC recommends that Nova Scotia harmonize its definition of variable income securities with other jurisdictions which have implemented PfAD regimes to the extent possible. In practice, we believe that core real estate and infrastructure are the most important alternative assets to get right as they are reasonably widely held by Canadian pension plans. Given their lower volatility, bond-like characteristics we recommend a regime that provides some, but not full, credit to such assets as non-variable securities which is in line with the 50/50 approach taken in other jurisdictions. As the use of going-concern plus regimes spreads, this is an area where CAPSA should engage to provide national regulatory guidance.

3. PIAC believes that the proposed three-year transition period for pension plans that must pay increased contributions under the new rules is reasonable.

4. PIAC recommends that Nova Scotia sets the contribution holiday threshold at 105% on a solvency and/or going concern basis. These represent comfortable buffers from a member protection perspective, in particular with the introduction of PfAD's on the going concern measure, and would be more in line with thresholds of other Canadian jurisdictions.

Our final comment is to commend Nova Scotia for adopting the federal permitted investment rules by reference into its regulations. PIAC has long advocated for national regulatory harmonization and this is an important tangible step which will bring incremental efficiency to the system.

We appreciate the opportunity to share our thoughts on these matters, and would be happy to discuss these matters further at your convenience.

Yours sincerely,

Deanne Allen
Chair