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

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Bruce Langstroth
Chair, Practice Council
and
Manuel Monteiro
Chair, Committee on Pension Plan Financial Reporting
Canadian Institute of Actuaries
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Dear Mr. Langstroth and Mr. Monteiro:

Re: Indexed Annuity Proxy Rate Guidelines

We are writing to express our concerns on the two following recently released educational notes:

1) Revised Educational Note Supplement dated October 15, 2013 on Guidance for Assumptions for Hypothetical Wind-Up and Solvency Valuations Update – Effective June 30, 2013, and Applicable to Valuations with Effective Dates Between June 30, 2013, and December 30, 2013, and
2) Educational Note dated September 18, 2013 on Alternative Settlement Methods for Hypothetical Wind-Up and Solvency Valuations.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over $1 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 is very concerned about the new guidance introduced in these educational notes regarding the cost of purchasing indexed annuities. While we agree that the status quo is not ideal, PIAC strongly believes it is preferable to the proposed approach. We do not find the proposed approach to be an improvement over the current solvency rules and strongly urge that these changes not be adopted into practice.

We believe that the new guidance will negatively impact pension plans that offer indexing to their members and that are required to fund for solvency purposes (including the cost of indexing). We believe this approach will result in increased funding challenges for indexed defined benefit pension plans and encourage the closure of even more “best-in-class” DB plans. PIAC is very concerned about the steep rate of decline in the number of open defined benefit plans across Canada and the already low pension plan coverage rates.

Our key concerns are as follows:

1) There are only a few quotes for indexed annuities and yet this small market is being proposed to price annuities books much bigger than some of the transactions. PIAC does not believe this provides a robust approach, nor one that sponsors of plans can have confidence in especially given the impact for some plans.

2) We recognize that the additional note on Alternative Settlement Methods for Hypothetical Wind-Up and Solvency Valuations is aimed at providing flexibility; however, this relies heavily on the actuary making assumptions that he/she has no way to validate until the actual wind-up event occurs. Actuaries are assumed to engage the regulator, but the regulator may not provide the necessary guidance. PIAC does not believe this provides a robust approach to base funding levels.

3) The CIA guidance is now building in some allowance for mortality table changes that are likely to be implemented in 2014. At a minimum, PIAC believes the CIA should consider the two recommendations together as the current guidance is in relation to the UP 94 Scale AA mortality assumption.

4) From a practical standpoint, the guidance was provided late in the calendar year and is likely past most organizations’ budget cycles. The timing is likely to frustrate sponsors and contribute to continued discouragement of defined benefit plans.

We believe that more consultation is needed to address the above concerns. Furthermore, rather than moving ahead to adopt new approaches that could have harmful side effects for indexed pension plans in Canada, we believe that the issues around solvency rules deserve fuller consideration.

It is clear to PIAC that the current solvency rules are not working. The rules have not prevented plans from being insufficiently funded for long periods of time or terminating with deficits. Also, numerous temporary solvency funding relief for pension plans have been provided trying to address the challenges created by solvency funding, including the recent proposal for temporary relief for Employer Sponsors of Public Sector Single Employer Pension Plans. A “re-think” on solvency rules has been incorporated into New Brunswick’s shared-risk plan framework and acknowledged in Quebec’s D’Amours Report (2013).

Solvency funding challenges for sponsors are not a short-term problem, as many may have originally thought. We would encourage the CIA to be more proactive, to work collaboratively with policy makers, regulators and plan sponsors to create long-term funding rules that will effectively balance the interest of benefit security and funding reality for plan sponsors. PIAC would be pleased to participate in such collaboration.

We would be pleased to discuss this matter with you at your convenience.

Yours Truly,

Brenda McInnes
Chair

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