Canadian Institute of Actuaries
Institut canadien des actuaires

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Re: Bill 57: An Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans – Comments from the Canadian Institute of Actuaries (CIA).

The Canadian Institute of Actuaries (CIA) is the national voice of the actuarial profession. It establishes the Rules of Professional Conduct, guiding principles, and monitoring and discipline processes for qualified actuaries. All members must adhere to the profession's Standards of Practice. The CIA follows its Guiding Principles, including Principle 1, which holds the duty of the profession to the public above the needs of the profession and its members. The CIA also assists the Actuarial Standards Board in developing standards of practice applicable to actuaries working in Canada.

We are pleased to offer the following comments on some provisions included in Bill 57 (Bill). The CIA understands that most of the Bill's content stems from a consensus reached by the Comité consultatif du travail et de la main-d'œuvre (CCTM), and that the main objective of the Bill is to foster sustainability of Defined Benefit (DB) pension plans in the private sector. For ease of reference, our comments are presented for different provisions that are proposed under the Bill, bearing in mind that the most significant provision of the Bill is the elimination of funding requirements under the solvency basis while a plan is in existence.

Introductory remarks

Current perceptions are that DB plan funding on the solvency basis is difficult to maintain as a result of the low interest rate environment and the challenging exercise of matching pension liabilities and underlying assets. These effects often result in contributions levels that are volatile and are seen as unsustainable by plan sponsors and employee groups. In addition, numerous plans already benefit from solvency rules exemptions, and funding relief measures have been implemented more than once over the last 10 years. This translates into inconsistent treatment of pension plans and a realization that the current funding rules were not appropriate to fund the benefit promise in traditional DB pension plans.

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It must be noted that the solvency basis is the ultimate assessment of benefit security at a given point in time, in case of a plan wind-up. A process that removes solvency funding can ultimately result in a deterioration of the solvency position, regardless of the financial status of the going concern basis. It should therefore be understood that with this new reinforced going concern funding approach and the elimination of solvency funding, the risk of having a deficit and the risk of larger deficits will be higher for most plans upon wind-up, therefore increasing the risk of benefit reductions where the plan sponsor is not solvent.

As a professional body looking after public interest first and foremost, the CIA would like to point out that between valuations (regardless of valuation frequency), the financial position of a plan could improve on a going concern basis, while it deteriorates on the solvency basis.

Please find our comments on the Bill below:

1. Plans for which Bill 57 applies

The proposed legislation targets DB plans or plans with DB features, including those with frozen DB service or DB provisions closed to new employees. The CIA acknowledges that the revised funding rules may help such plans; however the legislation would provide assistance to plan sponsors who chose not to provide further DB accruals in their plans. If the legislation were intended to encourage the continuance or creation of DB plans, it might be preferable to offer a less restrictive funding regime to those that provide further DB accruals.

2. Solvency basis funding requirements will be removed. Improved going concern basis will govern funding, with the addition of a Stabilization Provision (SP).

We support the concept of requiring a Provision for Adverse Deviation (PfAD), addressed with the SP in the Bill, if solvency funding requirements are removed. The CIA is doing additional research that will update and enhance the 2013 CIA research paper titled *Provisions for Adverse Deviations (PfAD) in Going Concern Actuarial Valuations of Defined Benefit Pension Plans* (see attached copy), and we are willing to assist in the creation of new regulation. The CIA supports the establishment of an explicit SP, as commented on more fully below.

3. Stabilization Provision level

In the course of its analysis, the CCTM referred to work performed by the CIA in relation to the introduction of a scale in the determination of the SP. Based on the available information, we understand that the scale will be established by regulation, based on the asset mix as per a plan's investment policy. It would serve public interest to communicate the basis of the scale, presumably the 2013 CIA research paper, and in particular, a clear statement on the desired funding objective, such as 85% likelihood of being at least 100% funded in three years (although the CIA research paper presented only results for 75% and 90%).

The CIA paper outlines the level of PfAD that is expected to leave a plan being fully funded with 75% and 90% probabilities over various horizons, accounting for described asset allocation, degree of plan maturity, valuation techniques and expenses. The CIA would need to examine the actual proposed scale to be able to formulate a clear opinion, however it seems that a simple rule based on the composition of plan assets will be set. The adopted scale should clearly describe what asset classes will define the required SP level, as only two classes seem to

be used (fixed income vs. variable income securities). The breakdown between fixed and variable is too simplistic. Using a unique, asset allocation-only approach for the SP will not capture characteristics specific to each plan (namely regarding maturity and duration) and is actuarially inconsistent with the CIA's research establishing appropriate PfAD levels. If adopted in its current form, it would be beneficial to revise the table in the future.

If the legislation is intended to encourage the continuance or creation of DB plans, consideration could be given toward developing different scales for plans that provide no future DB service or are closed to new employees (e.g., larger SP for plans that are more likely to terminate). It also appears that the scale would not factor in any existing hedging strategies adopted by plans, whereas we believe it would be appropriate for the scale to reflect the plan's own risk.

Given the simplicity and the features of the scale, it should be noted that some plans may take the opportunity to test different asset mix scenarios to assess different funding levels. Therefore the level of risk taken by the plan may not be appropriate; it may rather serve the purpose of comparing required plan contributions under different asset mix scenarios, and therefore result in an incentive to adopt risk approaches that may be inappropriate.

Another comment that we would like to make is that under the current rules, margins for conservativeness are usually combined with the actuary's best estimate assumptions, reflecting the guidance that is published by the Régie. In our opinion, such margins should be determined in accordance with the funding policy that is proposed by the Bill to be required in the future.

4. Stabilization Provision funding for current service

Again, it should be noted that the comments below pertain to the limited information available in the Bill.

It is not clear why contributions should be required to fund the full SP for current service compared to SP minus5% as per proposed Section 132 of the SPPA for past service, as current service benefits become part of past service at the next valuation date. This implies that current service SP contributions may result in quicker funding for all service, as the current service benefits become part of past service benefits at the end of the year. On the other hand, if there was no requirement to include the SP in the current service cost, this SP would become funded along with all past service from the next valuation date.

Increasing CSC by full SP may not encourage the continuance or creation of DB plans, so if one of the objectives is to encourage DB plans for current service, the Government should consider excluding the SP from current service contributions.

5. Amortization of funding deficiencies and Stabilization Provision minus 5% to be over 10 years and transitional rule

The Bill proposes a 10-year period for the amortization of funding deficiencies, replacing the previous 15-year period. We have no opinion on the 10-year period as there are no underlying actuarial principles in support or in opposition of this amortization period, other than considering it as being a reasonable compromise. It may be noted that by consolidating all past deficits at each valuation date means that it takes more than 10 years to fund each new deficit,

so this may be a good justification for reducing the amortization period from 15 to 10 years. The gradual transition from 15 to 10 years can also be considered a useful compromise.

Transitional rules are included in the Bill so that if required contributions under the new funding rules are greater than the required contributions, this excess can be amortized over three years. Such a transitional provision can also be considered a useful compromise.

However, we would like to comment on the proposed application of a "plus or minus 5%" buffer around the proposed PS target level. We wish to point out that the 5% buffer does not bear the same value for all pension plans, and that it is not in line with the findings outlined in the 2013 CIA Research Paper on PfADs. For example, if two different plans with different risk characteristics have a target PS of 7% for the less risky plan and 17% for the more risky plan, it would be more logical if the buffer were smaller for the less risky plan (e.g. 7% +/- 3%) than for the more risky plan (e.g. 17% +/- 7%). Furthermore, the notion that the buffer should be the same size above and below the target PS is not actuarially sound, because the probability is not distributed in a linear fashion (i.e. deducting a 5% buffer from the PS has an impact that is very different from adding a buffer of 5% to the PS). A more realistic approach to the SP threshold could be based on the specified PfAD levels mentioned in the 2013 Research Paper, where SP level and funding would be required for levels between 75% and 90% probabilities rather than a straight 5% offset. For example, the rules could state that contributions are required to fund the lower threshold of 75% while surplus withdrawals are permitted only when the higher threshold of 90% is attained. Such an approach would reflect much better the plan's own risk characteristics. In addition, available information on the single-table approach that we can expect from the regulation suggests that no distinction for SP levels is made based on the nature of the fixed income portion of the asset portfolio. Again this is not in line with the 2013 CIA Research Paper, where different PfAD levels were established for Long vs. Universe Bonds.

We understand that simplicity was pursued in the development of the scale defining the SP levels. While it appears that some elements were retained from the 2013 CIA Research Paper, important characteristics such as plan maturity and asset types were not considered, while permitting an arbitrary 5% spread on the SP level. These can result in SP levels that may not be in line with the primary objective of more secure funding, or what they would be believed to accomplish in terms of security.

A more robust approach could still lead to a relatively simple scale (as presented in the appendix of the CIA Research Paper), while preserving sound actuarial principles and better aligning SP levels with sought funding objectives. Please note that the CIA would be glad to provide assistance in establishing a scale based on the desired objective of the Québec government, in order to fine tune the parameters to be prescribed by regulation. So it might be more appropriate for the Bill to refer to prescribed "parameters" instead of prescribed "scale".

For example, if we refer to Appendix B of the 2013 CIA research paper, the lower and upper bounds could be prescribed as follows for a plan that has a 50%-50% split of its liabilities between active members and retirees, with an asset mix that includes either 40% or 60% in the Long Term Bond Index:

Percent invested in Long Term Bond Index	Lower Bound of SP (i.e., 75% probability over 3 years)	Upper Bound of SP (i.e., 90% probability over 3 years)
40%	8%	20%
60%	5%	15%

Furthermore, in situations where annuities were purchased in the past, further consideration should be given to the required SP level. Insured benefits should not be subject to SP requirements as their risk level is practically zero. SP requirements should be determined and applied solely on remaining non-insured plan benefits.

6. Utilization of Excess Surplus

As surplus asymmetry represents an issue for the long-term sustainability of DB pension plans, we recognize that allowing employers to draw from excess surplus is a positive step. As such, the Bill enables a Banker's clause to address to a certain extent the old contentious issue of surplus asymmetry. Namely, the Banker's clause could be used to cover the employer's CSC. The Banker's Clause however fails to address the surplus asymmetry risk upon plan windup, as the Bill does not seem to recognize those amounts in case of windup.

The Banker's clause represents the accumulation of certain employer contributions made to fund a deficiency, and does not include CSC SP. It is not clear what the rationale was for deciding whether or not to include contributions made for both the deficit and for the SP, for past service or for benefit improvements or for current service.

It should be noted that any use of excess surplus inevitably reduces future probabilities of a plan being fully funded. It should be noted that the 2013 CIA Research Paper on PfADs did not include such provisions and therefore the presented PfAD levels did not account for withdrawal of funds. Should the legislation allow excess surplus withdrawals, it might be appropriate to adjust the PfAD levels accordingly in order to reach long term funding objectives.

The Bill also introduces thresholds for use of excess surplus (SP target level plus 5%) that are high relative to the minimum SP funding requirements of SP target level minus 5%. We understand that the 5% interval was set for consensus purposes, however it should be understood that this 5% margin does not bear the same value downward vs. upward, when likelihood of events are factored in. The 5% margin is not in line with sound actuarial principles. It would be preferable to refer to a lower bound and upper bound (such as 75% and 90% probabilities) and not to define a middle level.

Those two thresholds defined by the Bill are used to determine how much excess surplus could be utilized either as withdrawals or for benefit improvements. The Bill restricts such utilization to 20% of the excess surplus in a given year, but this 20% seems to have no actuarial reasoning. It might be preferable to define what the purpose of such a 20% restriction is and then let the Plan's actuary determine what figure corresponds to the objective for a given plan.

Another threshold proposed by the Bill for excess surplus utilization is 105% on a solvency basis. Here again, this level seems to represent some sort of compromise but it does not reflect each plan's risk characteristics. From an actuarial perspective, it would be more appropriate to define an objective in terms of a probability level and let the plan's actuary determine the surplus needed to achieve it (e.g. it might be lower or higher than 105%, such as 102% or 108%, depending on the plan's risk characteristics). The CIA would be pleased to provide assistance to define such parameters.

7. Funding of benefit improvements

The Bill proposes that improvements may not be funded with excess surplus beyond 20% per year of the excess surplus defined above. Immediate funding is required if funding ratio is less than 90%, otherwise amortized cost over 5 years. We note that the funding requirements related to benefit improvements deviate from the rules applicable to accrued benefits, resulting in a discrepancy in the funding patterns. Such a "cliff" rule would result in inequities, as plans showing funding ratios just below 90% will be subject to immediate funding, while plans at 90% will be allowed to apply amortization.

Although this approach may support a specific legislator's objective, a more appropriate approach, in order to ensure uniform funding, would consist of applying a uniform rule consistent with current legislation, that requires immediate funding of the portion of the improvement that is short of the 90% threshold, and allow the amortization of the portion of the improvement when the plan has a funded ratio over 90%.

Also, from an actuarial standpoint, the SP applicable on the funding of plan improvement should be consistent with the level required on accrued liabilities (e.g. SP - 5%) to preserve consistency in the funding pattern as well as intergenerational equity as it relates to benefit security. It should be realized that the legislation already provides that these benefit improvements would be subject to reduction or removal on plan wind-up, if such wind-up is declared within 5 years.

8. Valuation Frequency

The current provisions of the Bill would prescribe full valuations at least every three years with an estimate of the Solvency Ratio (SR) reported on an annual basis. In addition, a SR of less than 85% would result in a requirement for a full valuation.

The CIA supports triennial valuations and annual assessments of the solvency position, with the solvency position being disclosed to plan members. However, we would like to bring your attention toward the inconsistency in setting the SR as the trigger for establishing valuation frequency of an enhanced going concern funding model, as no link exists between the solvency and going concern bases. Using the solvency basis as the criterion for valuation frequency is difficult to justify in a context where solvency deficits are no longer funded, and may result in lower funding contributions, thereby defeating the purpose. For example, this could have been the result for many plans in 2015, following a decrease in solvency discount rates and relatively high investment returns.

As the Bill establishes enhanced going concern as the funding basis, a valuation trigger linked to the going concern basis seems more appropriate. In addition, unusual circumstances such as financial market crisis or massive early retirement by plan members could also trigger a valuation as a result of a reduced funding ratio.

9. Benefits on Termination of Active Membership

The Bill proposes to pay a terminating member an amount equal to the CIA Commuted Value (CV) times the Solvency Ratio (SR), unless a member has no other option such as a deferred or an immediate pension. Also, it appears to us that Section 23 of the Bill (modifying Section 143 of the Act) is ambiguous. Is it meant to say that a plan may be more generous if desired? In other words, either pay 100% even if SR is below 100% or apply a ratio above 100% if SR is above 100%.

The actuarial profession has developed standards of practice to determine the “fair value” of a pension benefit. With the proposed change, terminating plan members would have the option to receive immediately a value that could be lower than the fair value. If such members do not agree with this approach, the deferred pension option remains available to them, albeit not fully funded on a solvency basis. It is our opinion that the possibility to offer a reduced Commuted Value (CV) option (in lieu of fair value) is a Government policy decision: the decision of paying a benefit that is less than the “fair value” based on CIA Standards rests with the legislators. Consequently, clear information on the implications of this option should be provided to terminating members. In the interest of increased transparency, members should also be informed about this impact.

Under the proposed rule, there would be inconsistency between members who terminate before a plan winds up (they lose the unfunded portion of their CV) and the plan members at the time of wind Up and where the employer is solvent (such members would receive their full CV). This would create a potential for disputes.

As an additional comment, if the policy decision is made to of pay termination benefits less than the CV, Quebec plan members may receive lower lump sum termination benefits than other members who would be subject to other jurisdictions in some cases. This raises an equity issue on the treatment of pension entitlements of Quebec pension plan members in comparison to pension plan members of other provinces.

In the event that part of the CV based on the SR would be payable as a lump sum on termination, the SR should be established as per the most recent information (e.g. current monthly SR estimate) rather than the SR at the previous valuation (or annual update). Using the SR estimate from last valuation or from last plan year-end would not depict an accurate picture of the circumstances of the plan at the time of termination given the volatility in market conditions on a monthly basis. Moreover, the legislation should clearly allow the plan to pay the full CV if the plan sponsor makes an additional contribution covering the unfunded portion of the CV.

Please note that the CIA and the Actuarial Standards Board are preparing to reconsider in the near future the appropriateness of the current CV calculation.

10. Annuity purchases

As per the proposed Bill, it will now be possible to settle a member's retirement benefits (thus cutting all ties with the plan, subject to a possible right to the allocation of surplus assets for three years following such a payment) by purchasing an annuity from an insurer, if the plan establishes an annuity purchasing policy that meets the requirements prescribed by regulations.

The CIA supports this option as long as the funded position of the remaining plan is not reduced. Should annuity purchases occur in times of solvency deficit, accrued benefits for remaining members should be protected, in terms of remaining solvency level being preserved either by additional contributions or purchasing annuities according to the SR at the time the annuities are purchased.

One of the main issues surrounding annuity purchases is the definition of the related policy. The regulations should be clear on who would be empowered to define the annuity purchase policy. It is important to mention that annuity purchases may have sizeable impacts on a plan sponsor's financial results, combined with additional employer contributions. These significant implications suggest that the entity empowered to decide on annuity purchase conditions should be the entity responsible for the funding of the plan, namely the plan sponsor in most cases. The choice of the annuity issuer and the administration of the process could be made in conjunction with the Pension Committee, or its delegate, provided they possess the required knowledge to carry the tasks forward.

Clear directions on responsibilities should also be set as annuity contracts are currently considered as plan assets and may fall under the fiduciary liability of the Pension Committee. The CIA believes that these rules should also permit the conversion of current annuity contracts into fully settled buy-out contracts in the future, provided the annuity purchase policy is respected.

Where annuity purchase were completed in the past, the power to convert these existing annuity contracts into full settlement should remain with the entity responsible for the funding of the plan and be addressed in the annuity purchase policy.

Further consideration should be given to instances where a buyout would take place when the plan is underfunded. As an example, say a plan shows a 80% SR and the sponsor elects to annuitize 80% of the benefits with available assets from the plan, leaving no assets for the remaining 20% of benefits in the plan. Such a situation should not be allowed; therefore immediate top-up solvency funding should be required in a context of an annuity purchase occurring in times of deficits, in order to preserve existing solvency levels and eliminate intergenerational asset transfers.

Also several scenarios of annuity purchases can occur: as an example, a plan may elect to stagger an annuity purchase covering retiree pensions in two stages covering each 50% of the benefits. In such a case, clarification on the timing of the deemed completion should be established, namely it would be preferable to deem any insured portion via buyouts to be settled and free of any ties.

Complex administration issues may arise for plans subject to more than one jurisdiction, as rules governing the purchase of annuities differ by province.

Given the wide variety of ancillary benefits provided by pension plans such as full, partial or formula-based indexing, insurance companies may not offer annuity products with identical features, or provide them at the cost of a significant risk premium, given the level of risks inherent in this type of promise. Consideration should be given to allowing conversion of a plan's indexing provision to another feature, deemed to be of equivalent value, in order to enable a plan to fully annuitize accrued pension benefits, and not only in the case of a plan wind-up or for a solvency valuation.

We take the opportunity to outline to the Régie that similar conversion should be permitted to accrued benefits payable from the plan, in order to simplify complex indexing provisions provided by some plans. Conversion could be made conditional to a plan member consultation process with similar rules to the current surplus allocation process upon plan windup (less than 30% opposition).

11. Funding Policy

The CIA praises the Government for addressing this item. Under the proposed legislation, the funding policy will be the responsibility of the entity capable on changing plan provisions, generally the plan sponsor (generally not the pension committee). We agree with this position.

However it should be mentioned that if the investment policy and the funding policy are the responsibility of different entities (e.g. employer for funding policy and pension committee for investment policy) then some divergence in objectives sought by each entity may emerge (e.g. minimum required contributions vs. benefit security).

The required items to be covered in the funding policy should be set by the Régie, in order to obtain uniformity of content across plans and to provide guidance to the entities responsible for establishing policies. In order to foster uniformity with other jurisdictions, it would be recommended to refer to guidelines issued by CAPSA (Canadian Association of Pension Supervisory Authorities, which includes the Régie). Items to be included in the funding policy could be disclosure of any margins in the assumptions (which should no longer be based on guidelines that were published by the Régie), as well as the objectives for the long term funded position of the plan (e.g. funding policy's objective is to achieve a probability of X% for the plan to be fully funded over N years). As a general view, the funding policy could include: a Plan overview, the desired funding objectives and targets, the risks faced by the plan and how they are managed, the factors influencing the volatility of contributions, a description of any cost sharing provisions, the conditions under which surplus can be used, actuarial valuation frequency, applicable legislation and funding provisions on plan wind-up.

Communication to participants about the Funding policy could be beneficial, and some information should be included on the members' annual statements, namely on how the funding policy may impact the benefit security over time.

12. Deficit on Plan wind-up

We agree that the entity responsible for plan funding should remain responsible for funding on plan wind-up.

The CIA wishes to emphasize that as solvency funding requirements are removed while the plan is in existence, deficits may occur on plan wind-up as the commuted values are calculated based on CIA Standards. Though we recognize that removing solvency funding represents a compromise between benefit affordability and security, it must be understood that security can be at risk on wind-up in the absence of solvency funding while the plan is in operation.

13. Other remarks

The Bill does not address benefit restructuring for past service, as it was the case recently for plans in the municipal sector in Quebec. In order to ensure the future of some plans, CIA believes that it might be in the public interest to allow, upon parties' request and consent, a certain flexibility to restructure past service benefits.

The CIA encourages the Quebec Government to consider the concept of prepaid contributions as in other jurisdictions. These are contributions in excess of the minimum required contributions set out in prior valuation reports. These contributions could be later applied to reduce certain employer contributions or payments otherwise payable. This would further help with the objective of stabilizing contributions.

The Bill allows the use of Letters of Credit (LOC) to replace past service SP contributions. As such, it recognizes existing LOC up to 15 % of plan going concern liability. Previous legislation recognized LOC for solvency purposes and up to 15 % of plan solvency liability. Existing LOCs should be fully recognized in the value of assets, on both the going concern and solvency basis, as they would be fully available to support payment of benefits in the event of default of the sponsor.

LOCs could be used to a larger extent, such as for SP amortization payments. As investment returns are not generated on LOC balances, expected investment return on LOC balances could be considered in the funding requirements. The CIA supports allowing the use of LOCs.

Ending Remarks

We understand that Regulations will be published to clarify certain technical details relating to the application of Bill 57, including the scale to be used for the SP in accordance with the asset mix and the contents of the funding and annuity purchase policies. As stated earlier, please note that the CIA would be pleased to provide assistance with the establishment of these items.

Thank you for taking the time to review our submission. If you have any questions, please do not hesitate to contact Joseph Gabriel, CIA Staff Actuary, Education at 613-236-8196 ext. 150 or at joseph.gabriel@cia-ica.ca.

Sincerely,

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