Canadian Institute of Actuaries / Institut canadien des actuaires

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Subject: Bill 29 – Regulation to amend the Regulation respecting supplemental pension plans – Comments by the Canadian Institute of Actuaries (CIA)

The Canadian Institute of Actuaries (CIA) is the national voice of the actuarial profession in Canada. With more than 5,200 members, the Institute puts the public interest ahead of its own, and is dedicated to providing actuarial services and advice of the highest quality. The CIA 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 also assists the Actuarial Standards Board in developing standards of practice applicable to actuaries working in Canada.

On July 20, 2016, the Government of Québec published the draft Regulation to amend the Regulation respecting supplemental pension plans ("draft regulation").This draft regulation clarifies changes to the Québec regulations in the following areas:

1. The information to include in actuarial valuation reports;
2. The reduction of letter of credit amounts where there are surplus assets;
3. The variable benefits in defined contribution plans;
4. The calculation of benefits in the event of marriage breakdown; and
5. The information that must be disclosed to members.

We are pleased to offer the following commentary on the draft regulation's provisions.

Section 4 of the draft regulation

The final paragraph of subsection 11.1 reads: ". . . with a certification of the actuary certifying that a complete actuarial valuation of the plan carried out at the valuation date would have established amounts equal to or less than the amounts indicated." A partial evaluation is an extrapolation of a previous complete valuation. The only way to confirm with certainty that a new complete valuation would produce amounts equal to or less than those of an extrapolation would be to conduct a complete valuation, which goes against the spirit of allowing partial valuations. Still, with an extrapolation conducted on a conservative estimate basis, there is a high likelihood that the contributions produced by an extrapolation would exceed those

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produced by a complete actuarial valuation. The requirement that now says “. . . with a certification of the actuary certifying that a complete actuarial valuation of the plan carried out at the valuation date would have established amounts equal to or less than the amounts indicated” should be eliminated and replaced with a requirement that the partial valuation be calculated based on a conservative estimate basis.

The following subsection 11.2, introduces the concept of a conservative estimate made by the actuary. This concept is not clearly defined in the legislation and could be subject to several interpretations as to, among other things, use of margins for adverse deviations. Under paragraph 3230.01 of the CIA’s Standards of Practice, it is not necessary to include margins; an actuary is required to select either best estimate assumptions or best estimate assumptions modified to incorporate margins for adverse deviations if necessitated by the terms of engagement. A complete valuation or an extrapolation containing margins could be considered conservative. For the purposes of subsection 11.2, it should be sufficient to produce a conservative estimate for the extrapolation period only. To that end, the CIA would be pleased to cooperate with Retraite Québec to establish benchmarks for conservative estimate calculations.

In our opinion, the following elements from subsection 7 pertaining to the content of the actuarial report should be adjusted to reflect the latest changes in the method for calculating the stabilization provision. These elements consist of administrative changes:

- Subsection 7(2): “the list of investments provided for in the investment policy . . .” could be replaced by “the categories or classes of investment provided for in the investment policy . . .”. This change will be more consistent with the manner in which investment policies are written, and it will provide Retraite Québec with key information.
- Subsection 7(5): The CIA recommends that the duration that should appear in the report should be that of the benchmark index for each investment considered as fixed income for the purposes of calculating the stabilization provision.
- Subsection 7(9): “the proportion of assets of the plan allocated to each investment provided for in the investment policy” should be more general and refer to the categories or classes of investment provided for in the investment policy (as per our recommendation for 7(2).
- Subsection 10(4): The paragraph reading “The report must also indicate the effect of the amendment, where applicable, on each item of information required under sections 5 to 9” should be adjusted to be more specific and to refer to specific factors. In our opinion, the report should only indicate the effect of the change on the funding liabilities, solvency liabilities, funding level, solvency level, current service contribution, and stabilization provision.
- Subsection 11.3: The draft regulation should be clarified to indicate that the information provided for in the special measures should be required only if it affects the required contributions.

Section 7 of the draft regulation (letter of credit)

The draft regulation seems to penalize plan sponsors which will be using letters of credit in the future, in addition to negatively affecting businesses which used letters of credit prior to January 1, 2016 in accordance with the previous financing rules. Such an intent would come as a surprise to the CIA.

In the *Supplemental Pension Plans Act* (SPPA) in effect as at January 1, 2016, the rules regarding the appropriation of surplus assets were clarified. A banking clause was also created with respect to technical amortization payments, stabilization amortization payments, and contributions paid in excess of the minimum required (section 42.2 of the SPPA).

Letters of credit put in place prior to January 1, 2016

Prior to January 1, 2016, the risk concerning appropriation of surplus assets was very significant. To manage that risk, some businesses chose to use letters of credit. The existing rules prior to January 1, 2016 allowed businesses to reduce the amount of their letter of credit via an additional contribution or if the plan reached a certain level of surplus assets.

As indicated in the draft regulation, in the event of surplus assets, the appropriation of surplus assets to reduce the amount of the letter of credit would reduce the banking clause which, in most cases, will be created by amortization payments made after January 1, 2016. Such treatment, namely the reduction of the banking clause, creates an additional asymmetrical risk of additional surplus assets for businesses that have managed this risk, according to the rules in effect prior to 2016, by means of a letter of credit. The banking clause is meant to be a surplus assets risk managing tool, while the draft regulations would create problems for plans with surplus assets. The CIA does not believe that this is the intent of the proposed regulation. There are two possible solutions:

1. The reduction in the amount of the letters of credit put in place before January 1, 2016, does not affect the banking clause, and the letter of credit reduction trumps the provisions of the plan that apply in the case of surplus assets if the employer opts for a reduction in the amount of the letter of credit for a contribution holiday; or
2. Letters of credit put in place prior to January 1, 2016 are included in the banking clause as at January 1, 2016; in as much as they have not been accounted for previously.

Letters of credit put in place as of January 1, 2016

An employer may only make stabilization amortization payments by letter of credit. Use of a letter of credit is not in addition to the banking clause.

According to discussions with Retraite Québec, additional contributions paid by the employer to reduce the amount of an existing letter of credit does not constitute payment in excess of the minimum and may not be included in the banking clause. Such treatment creates incompatibility in the treatment of stabilization amortization payments. An employer that makes stabilization amortization payments is credited the balance of its banking clause, whereas an employer opting to repay the balance of its letter of credit receives no credit in its banking clause. In both cases, the employer makes amortization payments to the fund; it’s just

that the dates differ. This inconsistent treatment also applies to letters of credit put in place prior to January 1, 2016 that an employer chooses to repay.

The same problem with letters of credit put in place prior to January 1, 2016 applies as well, i.e., reduction of the banking clause when the amount of the letter of credit is reduced under an appropriation of surplus assets. Reducing the amount of the letter of credit by using surplus assets should have no effect on the banking clause, since the stabilization provision is intended as an additional target forcing the provision over 100 percent.

Draft regulation section on partition of benefits

The CIA notes that the amendments proposed in the draft regulation change how a negative pension is calculated and do away with the principle of neutrality for the pension fund, which will create gains for members with shared benefits. These gains will come at the expense of the employer or of the other members in the case of shared-cost plans.

The new method for calculating a negative pension according to section 54 of the draft regulation ignores that part of the benefits transferred to the spouse come from surplus contributions and the value of the bridging benefit. The draft regulation could be adjusted to provide for a negative bridging benefit in these situations, as in the Ontario legislation.

We also note that from now on, a negative pension will have to be adjusted to take plan changes into account. To eliminate administrative problems, the draft regulation should provide that all negative pensions determined prior to December 31, 2015 should not be adjusted for changes made prior to that date. In many cases, the information required to make the adjustments may no longer be available. The CIA suggests that, in the final version of the draft regulation, relatively specific interim rules be included to provide for a smooth transition from the current to the proposed rules.

Draft regulation section on variable benefits

Some words seem to be missing when we analyze the various insertions proposed in some sections. What is more, a few insertions seem to create inconsistencies. It would perhaps be preferable to completely replace the sections affected by the required changes to take into account pension plans that will offer variable benefits.

For example, section 15 of the draft regulation: Section 22.2 of the Regulation is amended by adding "from a supplemental pension plan that offers the variable benefits referred to in Division II.3" after "from a life income fund"." Section 22.2 of the current regulation contains two references to a life income fund, and we believe that the addition of the comma should be replaced by the word "or".

In addition, a correction is required in the English version of section 15 of the draft regulation. It should read as follows:

> 15. Section 22.2 of the Regulation is amended by inserting "from a supplemental pension plan that offers the variable benefits referred to in Division II.3" after "from a life income fund of a given purchaser".

Interaction with regulations applying to university and municipal pension plans

The draft regulation eliminates certain sections that remain necessary for university and municipal pension plans, particularly sections relating to the provision for adverse deviations. We understand that these provisions still exist for these plans. To make it easier to understand the rules, we would suggest to repeat the sections that are eliminated from the SPPA in the regulations applicable to university and municipal plans.

Also, the new rules concerning partition of benefits between spouses do not seem to apply to members of university and municipal plans. This discrepancy should be corrected.

As always, the CIA stands ready to assist in the work ahead.

Thank you for taking the time to consider our comments. If you have any questions, please feel free to contact Joseph Gabriel, CIA staff actuary, education, by telephone at 613-236-8196 ext. 150, or by e-mail at joseph.gabriel@cia-ica.ca.

Yours truly,

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