Canadian Institute of Actuaries | Institut canadien des actuaires

June 28, 2019

Finance and Treasury Board
Pension Regulation Division
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Subject: Improved Funding Framework for Nova Scotia Pension Plans: The Road Forward

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Our members are dedicated to providing actuarial services and advice of the highest quality. The Institute holds the duty of the profession to the public above the needs of the profession and its members.

We are pleased to offer the following comments on the consultation paper. The topic of solvency funding reform has been raised in recent consultations in other provinces, including Ontario, Québec, Manitoba, and British Columbia, and the CIA responded in length to those proposals.

The CIA advocates for consistency whenever possible across Canada, and this is an opportunity to achieve greater uniformity in provincial legislation. Therefore, we would like to refer you to a submission we issued in 2016 in response to Ontario's consultation on a solvency funding framework. Many of our comments at that time are relevant to the issues that Nova Scotia is currently examining.

Responses to Nova Scotia consultation

Please find below our responses to the specific issues raised in your consultation:

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

   We propose that any contributions above the current service cost should be permitted to be paid into a reserve account. We understand that the intention is not to propose a provision for adverse deviation (PfAD) for the current service cost. If that were to change, the PfAD could be included in this reserve account.

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2) *Most appropriate going concern provision for adverse deviation/margin*

    a. *Preference of option 1 over option 2*

    Our recommendation is for option 1. The two-dimensional approach recognizes that interest rate risk is also a major risk that affects pension plans (in addition to investment risk arising from variable security investments). Option 2 does not recognize the fact that plans that structure their fixed income portfolio to better match liabilities (generally through the use of longer-term bonds) are less risky than those that do not. We do not believe that the flat 5% in option 2 would adequately reflect those risks. A two-dimensional approach represents a good compromise between simplicity and theoretical appropriateness.

    We also recommend that you conduct further analysis on the levels of PfAD to better understand whether the new rules will create incentives for plan sponsors to take excessive investment risk in their pension plans.

    b. *Other options that should be considered*

    We suggest that the regulations define a specific objective and allow actuaries to determine a proper PfAD for a given plan if they wish to deviate from the prescribed grid.

    c. *Whether there should be a different PfAD for solvency exempt or public sector plans*

    We understand that the primary purpose of the PfAD is to enhance benefit security. Consequently, to the extent that benefit security is not a concern or a lower concern for certain plans, a strong argument can be made that they should not be forced to reflect a PfAD.

    We also note that certain risk-shared plans vary their level of margin in order to manage contribution/benefit volatility. Mandating a minimum PfAD may constrain their ability to meet their objectives. We note that the named jointly sponsored pension plans in Ontario were exempted from the PfAD requirements for this reason.

    If our recommendation in 2b is adopted, then each plan could calculate its own PfAD, and different rules would not be necessary.

    d. *Use of an additional PfAD to apply for pension plans using aggressive discount rates*

    As actuaries, our first duty is to the public – something that our members take very seriously. Consequently, we believe that the regulator should be able to rely on the actuary's certification of best estimate assumption. Of course, the regulator should be equipped to challenge the actuary's assumption if they believe it is too aggressive.

Prescribing a maximum discount rate in legislation is fraught with difficulties. In particular, it does not recognize that market conditions that influence future return expectations can change rapidly, and it may not be robust enough to handle new investment strategies and innovations.

e. *Definition of variable income securities*

Given the wide array of current investment strategies, and the certainty of continued innovation, the government needs to adopt a flexible and principle-based approach rather than adopting a very prescriptive approach.

The best approach would be for the legislation to provide high-level principles of the characteristics of variable income securities, and then leave it to the regulator to adopt guidelines that could evolve over time.

We believe that the approach implemented in Ontario fails to recognize the characteristics of certain types of securities. This approach also introduced certain unintended consequences (e.g., having a small percentage of non-investment grade fixed income in a pooled fund would taint the entire pooled fund investment).

3) *Proposed three-year transition period for pension plans that must pay increased contributions under the new rules*

We support a period of three years, akin to what was implemented in Québec and other jurisdictions. In addition, we recommend that the amortization period be phased in from 15 to 10 years, over a period of five years. We would also support a simpler framework, whereby fresh starts are always allowed, as opposed to continually maintaining historical amortization schedules.

4) *Proposed contribution holiday threshold (110% funded on both going concern and solvency bases)*

There should be some threshold above 100%, below which contribution holidays are not permitted. However, we suggest that 105% is reasonable and will help establish a consistent and harmonized approach across jurisdictions.

However, we also recommend that the threshold should apply to wind-up liabilities and not solvency liabilities, given the ability to exclude certain liabilities (particularly in respect of indexation) from solvency liabilities. It would seem inappropriate for an indexed plan which is not fully funded on a wind-up basis to be taking contribution holidays.

Other comments

We note that there is a proposal to allow an 85% solvency standard, provided that there is member consent. We do not support this proposal, as the introduction of a PfAD is meant to be a substitution for solvency funding. As well, we anticipate that obtaining member consent for this would be practically difficult.

We appreciate the opportunity to engage on this important issue, and welcome further discussion with you throughout this process.

If you have any questions, please contact Chris Fievoli, CIA Staff Actuary, Communications and Public Affairs, at 613-656-1927.

Sincerely,

[original signature on file]

John Dark, FCIA
President, Canadian Institute of Actuaries