June 10, 2021

Financial and Consumer Affairs Authority
Pensions Division
Suite 601, 1919 Saskatchewan Drive
Regina, Saskatchewan
S4P 4H2
pensions@gov.sk.ca

Subject: Consultation: A Review of the Pension Funding Framework for Single Employer Defined Benefit Plans in the Private Sector and Other Complementary Reform Measures Applicable to All Defined Benefit Plans

The Canadian Institute of Actuaries (CIA) welcomes this opportunity to offer its inputs on the aforementioned consultation. Prior to responding to the specific questions laid out in the consultation, we have provided the CIA's overall perspective on pension funding frameworks.

CIA perspective on pension funding frameworks

The CIA is generally supportive of the trend among Canadian provinces away from a solvency funding model towards going-concern plus funding. However, it is critical that the implications are clearly communicated and understood by all stakeholders.

The decision on funding rules for defined benefit pension plans requires balancing interests among many stakeholders. Two primary stakeholders are the employers required to contribute to the cost of benefits and the plan members who receive those benefits. For employers, unpredictable and volatile contribution patterns are a deterrent to sponsoring a defined benefit plan and may in the extreme drive an employer into insolvency if funding relief is not granted. For plan members, many do not have a clear understanding that their pension plan is not always fully funded, and, at times of under-funding, the security of the pension promise is in some part dependent on their employer remaining solvent and/or being able to make contributions.

Going-concern valuations largely focus on delivering a rational and orderly accumulation of assets. These valuations use several techniques to smooth contributions by employers and, as a result, at any particular time, the assets of the plan may be greater or less than the plan's liabilities on a wind-up basis. Adding margins to going-concern funding valuations is not ideally suited to increasing the security of benefits, although to the extent that the addition of the margin requires the plan sponsor to contribute larger amounts and/or continue contributing for longer periods it may help in this regard. Policy makers should consider the purpose of requiring a margin before determining the type and size of the appropriate margin. They should also consider whether the rules for determining the margins create incentives for excessive investment risk-taking.

Solvency/wind-up valuations largely focus on ensuring benefit security. These valuations do not typically include margins but are commonly based on current best-estimate assumptions for a plan to discharge all its obligations. The degree of benefit security provided to a plan member in the short term will in part be driven by what percentage of the wind-up liability a sponsor is required to fund.

Of concern to the CIA is the notion that the volatility of employer contributions can be reduced by reducing solvency funding below 100 per cent, and that at the same time benefit security for members can be enhanced relative to the prior solvency funding regime by increasing margins in going-concern funding. The reality is that going-concern plus funding regimes lower the volatility of contributions compared to solvency funding, but likely reduce the level of benefit security (except in the limited situation where the new rules prevent the insolvency of the employer). We encourage policymakers to be transparent with plan members that these goals are trade-offs.

The lack of uniformity in legislation across jurisdictions has often been cited as a major concern for sponsors of registered pension plans. The current wave of funding reform would be an opportune time to harmonize funding rules; however, it appears that each jurisdiction is choosing to implement different going-concern plus regimes. Given the broad government policy objectives of enhancing retirement security and encouraging the maintenance of defined benefit plans, the CIA strongly encourages Saskatchewan to harmonize legislation as much as possible.

Our responses to the specific questions posed in the document can be found below.

Discussion Questions – Change the Way in Which Solvency Deficiencies Are Funded

1. If the solution is to modify solvency funding, which of the above options or combination of options do you feel provides the right balance between benefit security and affordability?

   We comment below on each of the approaches laid out in the consultation document:

   (i) Lengthen the Amortization Period for Funding Solvency Deficiencies

   A longer amortization period for solvency deficiencies would represent a certain compromise between security and affordability, as contributions could be significantly reduced, but does not remove the basic problem of solvency variability. If a solvency funding regime is maintained, we would suggest lengthening the amortization period to 10 years.

   (ii) Re-Amortization of Solvency Deficiencies

   The consolidation of all past deficits at each valuation date is effectively the approach adopted under the federal solvency regime and would also serve to lengthen the amortization period for solvency deficiencies. The CIA would support this approach if solvency funding was maintained, though the period should be chosen so as to target the desired funding level within a reasonable time frame.

(iii) Solvency Reserve Accounts (SRA)

The CIA strongly supports the concept of a solvency reserve account, which we would more broadly refer to as a flexible funding account (FFA). FFAs should be enabled whether or not the policy decision is made to uphold or remove solvency funding requirements; in fact, we believe that the concept should be extended to the going-concern funding requirement as well.

We note that a number of provinces including Alberta, British Columbia, and Québec (for both solvency and going-concern payments) have adopted SRAs as funding options for plan sponsors.

The CIA has long been an advocate of FFAs, either achieved through a separate account or within the plan; for example, through a “banker’s clause” as in Québec. 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 would be a positive step for them.

Plan sponsors are very concerned that they are required to make large solvency payments. Such a requirement is particularly likely to arise when interest rates are low, as they are currently. A significant increase in interest rates may by itself eliminate current solvency deficits. Under that scenario, those solvency payments would only contribute to a surplus. Often, the use of a surplus is a contentious issue; furthermore, on plan wind-up, it is often subject to litigation.

The CIA has suggested that these payments be accumulated in a special account and that the account be refunded to the entity that has made those payments if all accrued benefits are fully secured. In particular, on plan wind-up, if all accumulated benefits have been settled, the part of the remaining surplus attributable to those payments could be refunded.

(iv) Letters of Credit (LOC)

The CIA supports allowing the use of letters of credit (LOCs) on a temporary basis as a means to manage volatility of contributions. However, we do not believe that LOCs should become an ongoing alternative to the pre-funding of pensions. Therefore, we believe that reasonable limits should be imposed. The limit could be based on the level of volatility in funded status that could be expected under a negative economic scenario. The exact threshold is a government policy decision.

2. Are there other methods of modifying solvency funding which you feel should be considered?

In addition to the approaches discussed in the consultation paper, other Canadian jurisdictions modify solvency funding through the use of average solvency ratios, smoothing of assets (and in some cases, liabilities through averaging of discount rates), and the permitted exclusion of certain benefits in determining solvency liabilities. We do not suggest considering introducing any of these measures because (a) the desired minimum pace of funding can be achieved more directly through adjusting the amortization period and (b) we believe that differences across jurisdictions should be minimized.

Other jurisdictions in Canada have a condition for when more frequent (annual) actuarial reviews are required and is linked to the funded status of the plan. The CIA supports more frequent monitoring of plans that are in poorer financial condition to be able to respond to any further deterioration more promptly.

3. If the period of time for funding solvency deficiencies is lengthened, what is the appropriate new time period?

The CIA recognizes that one of the key objectives of the current reform is to reduce the volatility of funding contributions to pension plans. This is largely achieved through the reduction in solvency funding requirements.

The CIA considers a 10-year period a reasonable compromise between affordability, stability, and security, while noting that the choice of a fixed amortization period is not based on any underlying actuarial principles.

4. If SRAs are allowed, under what circumstances should the employer be allowed to withdraw payments that have been made into the account?

Amounts accumulated in an SRA should be refunded to the entity that has made those payments if all accrued benefits are fully secured. In particular, on plan wind-up, if all accumulated benefits have been settled, the part of the remaining surplus attributable to those payments could be refunded.

It may also be appropriate to allow withdrawals from SRAs for ongoing plans, if the plans are fully funded on a wind-up basis, with some cushion to remain fully funded after an adverse event. The appropriate threshold could be the same as the threshold for permitting contribution holidays. Many other jurisdictions require that the plan remain at least 105% funded on a wind-up basis after any contribution holiday.

From an actuarial perspective, it would be more appropriate to set the threshold based on the risk characteristics of the plan rather than having a fixed threshold apply to all plans. Plans with significant degrees of asset-liability mismatch would have a higher threshold than those whose assets and liabilities are closely matched. However, we recognize that this would add complexity and cost relative to a fixed threshold. Should Saskatchewan wish to develop such an approach, the CIA would be pleased to provide assistance to define such parameters.

5. If LOCs are allowed, should the amount be limited to a certain percentage of liabilities?

The CIA supports allowing the use of letters of credit (LOCs) for temporary periods as a means to manage volatility of contributions. However, we do not believe that LOCs should become an ongoing alternative to the pre-funding of pensions. There is strong rationale for employer-sponsored pension plans to target full funding, and we would be against the extensive use of LOCs which would in effect allow for partial funding models.

Therefore, we believe that reasonable limits should be imposed. The limit could be set based on the potential decline in funded status following a significant adverse economic scenario (such as the 2008/2009 global financial crisis). The exact threshold is a government policy decision.

Discussion Questions – Partial Solvency Funding or No Solvency Funding

1. If the current solvency funding threshold of 100% is reduced to require only partial solvency funding, is a threshold of 85% appropriate?

   The CIA stresses that the level of the trigger is effectively a policy decision. Any level below 100% is a public policy compromise, and not rooted in actuarial principles. In our opinion, a level of 85% could constitute a reasonable compromise between security and affordability.

   However, if such a threshold is maintained, it would be important to permit amortization of solvency amounts over a reasonable period rather than requiring lump sum contributions to get above that threshold.

2. What is the main risk(s) that a PfAD should mitigate?

   A move to a going-concern plus regime means that funding requirements will be primarily driven by the going-concern valuation. The most important assumption in going-concern valuations is the discount rate, which is generally determined based on the expected long-term rate of return on plan assets. Consequently, all else being equal, plans which adopt investment strategies with higher expected returns (which generally also involve higher risk) would have lower funding requirements than plans which adopt more conservative investment strategies.

   From a public policy perspective, the CIA believes it is important to avoid creating incentives for plan sponsors to establish inappropriate investment or funding policies. The PfAD structure, in isolation, should not have the potential of encouraging plan sponsors to increase the equity component of the pension fund so that they may benefit from a decrease in required contributions. The PfAD structures in some other jurisdictions have created these incentives.

   The PfAD can and should be designed to mitigate such incentives. The PfAD should reflect the inherent risk being taken by the plan by being linked to the degree of asset-liability mismatch. This can be accomplished using a two-dimensional grid based on the level of non-liability matching assets and the portion of interest rate risk being hedged.

   The objective should be to find a simple but appropriate proxy for the risks in order to establish the PfAD. The calculation of the PfAD should not significantly increase the cost of actuarial valuations.

   We would like to draw your attention to Québec legislation, as well as the current regulations for Limited Liability Plans registered in Saskatchewan, which both follow a form of the above approach.

3. What do you feel is the best method of determining the level of PfAD?

   We believe that the best approach is that the PfAD be based on the level of risk being taken by the plan, which is primarily driven by the degree of asset-liability mismatch. This can be accomplished by using a two-dimensional grid based on the level of non-liability matching assets and the portion of interest rate risk being hedged.

   The objective should be to find a simple but appropriate proxy for the risks in order to establish the PfAD. The calculation of the PfAD should not significantly increase the cost of actuarial valuations. A two-dimensional approach represents a good compromise between simplicity and theoretical appropriateness.

   We would like to draw your attention to Québec legislation, as well as the current regulations for Limited Liability Plans registered in Saskatchewan which both follow a form of the above approach.

   We also recommend that you conduct analysis to determine the appropriate levels of PfAD. The CIA would be pleased to assist in this regard, building on analysis that we have done in the past.

4. Should the method of determining PfAD be different if there is no solvency funding required than if there is a certain level of solvency funding required?

   We do not believe that the PfAD is an optimal tool to provide for benefit security.

   If Saskatchewan wishes to establish a certain minimum level of benefit security, it would be more effective to directly establish a solvency funding target (e.g., 85%) rather than trying to accomplish the same thing indirectly through higher PfADs.

5. Should the PfAD have to be funded on current service contributions, even if the plan is in a going concern surplus?

   Yes. Current service costs become liabilities at the end of each year. If it is deemed appropriate to prefund a PfAD on liabilities, we do not see a strong rationale not to prefund a PfAD on current service costs. A failure to do so would create actuarial losses at each year end.

6. If the period of time for amortizing going concern deficiencies is shortened, what is the appropriate period?

   The CIA recognizes that one of the key objectives of the current reform is to reduce the volatility of funding contributions to pension plans. This is largely achieved through the movement away from solvency funding regimes.

   The CIA considers a 10-year period a reasonable compromise between affordability, stability, and security, while noting that the choice of a fixed amortization period is not based on any underlying actuarial principles.

7. Are there other methods of enhancing going concern funding which should be considered?

   As noted previously, a move to a going-concern plus model increases the importance of the assumptions used in the going-concern valuation, particularly the discount rate. From a policy perspective, it will be important to ensure that the assumptions are appropriate.

   There are different ways to accomplish this from a regulatory perspective.

   Ontario has included a mechanism within the PfAD calculation to counter the impact of aggressive assumptions. OSFI has imposed maximum discount rates for federal plans in their Instruction Guide.

   Our preference is to allow for a flexible approach rather than a formulaic approach or one-size-fits-all limit. The actuary should remain responsible for setting the assumptions based on the particular circumstances of the plan. However, the regulator should be fully empowered to challenge the valuation assumptions if they feel they are inappropriate.

8. Are there any other features to the funding rules which should be considered, such as consolidation of unfunded liabilities?

   If an enhanced going-concern model is adopted, then it may be appropriate to revisit the calculation of transfer values. As pension plans may no longer be expected to be fully funded on a solvency basis in a five-year time horizon, it may not be logical to provide a commuted value assuming a 100% solvency ratio. A potential solution would be to pay the commuted value multiplied by the most recently determined solvency ratio (and not to provide the unfunded portion of the commuted value in five years). In most cases, terminated members have the option of selecting a deferred pension, and potentially could be offered the commuted value option periodically, say every five years, as the solvency ratio might improve in future years.

   The CIA agrees with an approach of consolidating unfunded liabilities. We support this approach as it is simple and it is being used in other jurisdictions. However, the implications of this measure entail that the funding of deficiencies is always being pushed forward with new 10-year amortization periods, and in the absence of experience gains, funding deficiencies or any targeted funding level is unlikely to be achieved within 10 years.

9. Are there any options from the previous section (**Change the Way in Which Solvency Deficiencies Are Funded**) which should be incorporated if only partial solvency funding is required, or if it is eliminated completely? In particular, would solvency reserve accounts and letters of credit be useful mechanisms if a solvency deficiency has to be funded only to a certain level?

   The CIA would support extending the application of solvency reserve accounts for going-concern deficiency payments, in order to avoid discouraging plan sponsors from funding more than the minimum requirements. We do not support the extension of letters of credit to cover going-concern special payments, as this would result in the drift away from a full funding model.

Discussion Questions – Full Funding on Plan Termination

1. Assuming the solvency funding framework is changed, are there any types of SEPPPs for which an employer should not have to fully fund a deficit if the plan is voluntarily terminated? For example, if members are required to contribute towards a solvency deficit, the framework could be structured so that only a portion of the deficit has to be funded by the employer if the plan is wound up.

   We believe it is appropriate for the employer to fully fund deficits if a SEPPP is voluntarily terminated. We cannot think of any situation where this would not be appropriate.

2. Are there any options presented in "Two Main Approaches" which should not require the full funding condition, if the Regulations are amended to include only that option? For example, if the only change made to the Act or Regulations is to allow a longer period of time for amortizing a solvency deficiency, should full funding on plan termination still be a condition for electing the option?

   No.

Discussion Questions – Restrictions on Contribution Holidays

1. Should contribution holidays be restricted further than they are currently? If so, which method best protects member benefits?

   Contribution holidays should only be permitted if the plan is fully funded on both a going-concern and solvency basis, and would maintain some level of buffer throughout the contribution holiday. Contribution holidays should cease if the buffer has been eliminated.

2. If a plan is required to be funded at a higher level than 100% on a solvency basis and/or a going concern basis before taking a contribution holiday, what is the appropriate level?

   There should be some threshold above 100%, below which contribution holidays are not permitted. However, we suggest that 105% (applied to the greater of going-concern and solvency liabilities) is reasonable and will help establish a consistent and harmonized approach across jurisdictions.

   From an actuarial perspective, it would be more appropriate to set the threshold based on the risk characteristics of the plan rather than having a fixed threshold apply to all plans. Plans with significant degrees of asset-liability mismatch would have a higher threshold than those whose assets and liabilities are closely matched. However, we recognize that this would add complexity and cost relative to a fixed threshold. Should Saskatchewan wish to develop such an approach, the CIA would be pleased to provide assistance to define such parameters.

3. Should the ability to take a contribution holiday be determined on an annual basis, whereby a cost certificate would have to be filed each year to determine whether the plan remains in a surplus position?

   Yes – we agree that an annual cost certificate filing would be appropriate. Furthermore, FCAA could consider following the lead of FSRA, which requires plans to review their funded status at least quarterly, and to cease contribution holidays if they have reason to believe that the surplus has declined below the defined thresholds.

Discussion Questions – Annuity Discharge

1. If annuity discharge provisions are added to the Act, what are the appropriate conditions that a plan should have to meet in order to be eligible to qualify?

   The solvency position of the residual portion of the plan should not decline following the annuity transaction. Plan sponsors should be required to make additional contributions to maintain the solvency ratio at the same level as it was prior to the transaction.

   The plan sponsor should be required to certify that:

   - the choice of the annuity issuer considered the creditworthiness and administrative capabilities of the insurer; and
   - the entitlements of all plan members included in the transaction have been preserved to the extent possible. There may be cases where certain provisions, such as inflation-linked indexation, make it impossible or impractical to purchase in the annuity market. In such cases, it may be appropriate to substitute an alternative provision, such as a fixed annual percentage increase for pensions in pay. Any such modifications to the plan provisions should be subject to regulatory approval.

The CIA appreciates the opportunity to provide feedback on these issues, and we would 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 or chris.fievoli@cia-ica.ca.

Sincerely,

[Original signature on file]

Michel St-Germain, FCIA
President, Canadian Institute of Actuaries

The Canadian Institute of Actuaries 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.