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Subject: Revised Section 2.7.4 of the Instruction Guide for the Preparation of Actuarial Reports for Defined Benefit Pension Plans – Draft

The Canadian Institute of Actuaries (CIA) thanks OSFI for the opportunity to comment on the revised Section 2.7.4 of the aforementioned draft. We note that several concerns that were raised in our earlier communications have been addressed. We believe that the revised draft Section 2.7.4 is much more practical than the prior version.

We would like to offer further comments on the following points:

- The *Economic Risks* section requires that the provision for adverse deviations be set based on the probability of the pension promise being met from the plan assets, without financial support from the employer. The section requires a higher probability of the pension promise being met from plan assets for employers with lower credit ratings than those with higher credit ratings, presumably to reflect the higher likelihood that employers with higher credit ratings will be solvent and able to provide financial support if needed. We believe that this concept is appropriate.

  The section requires a probability of 85% for employers with credit ratings for subordinated debt higher than A, ranging up to 99.5% for employers with credit ratings below B. We are concerned that the 99.5% confidence level for employers with subordinated debt credit ratings lower than a B grade will result in wide ranges of results due to model differences in the extreme tails of probability distributions. We would instead recommend a range from, for example, 80% for higher than A to 95% for lower than B, instead of 85% to 99.5%, which should narrow the range of results.

- We recommend that there should be some flexibility to determine the appropriate credit rating to apply for the purpose of this section, as not all entities have a credit rating for subordinated debt.

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- The *Non-Economic Risks* section requires that a provision for adverse longevity experience include an allowance for both a decrease in the current base mortality rates as well as an increase in the expected rate of longevity improvement. We expect that most plans that are large enough to employ a replicating portfolio approach would have credible mortality experience. Consequently, there should not be much uncertainty about the appropriateness of the base mortality table. In cases, where the mortality table is based on credible plan experience, we suggest that the provision for mortality should only be in respect of an adjustment to the improvement scale.

- The *Correlation* section requires that the correlation between economic and non-economic risks be set to 50%. We recommend that the correlation between economic and non-economic risks be left to the actuary, as the prescribed level of at least 50% does not seem to have any justification. If OSFI would prefer that a consistent assumption be applied across plans, it seems more appropriate to assume a correlation of 0%, since we would expect these risks are largely independent.

- OSFI expects that the replicating portfolio approach only be used by plans which are not able to settle liabilities through annuity purchases over 5 years or less. Footnote 6 states that "Thresholds specified in CIA Guidance should be used as a reference. Current liability thresholds above which a plan may have difficulty in effecting a series of group annuity purchases are $3.75B (5 x $750M) for non-indexed annuities and $1.25B (5 x $250M) for indexed annuities." We note that the referenced educational note also indicates that plans with certain benefit provisions may have difficulty purchasing annuities at the 1X current threshold. As well, the alternative settlement methods outlined in the educational note indicate that "For plans with liabilities that are less than five times the capacity thresholds noted above, it may be reasonable to assume that the liabilities would be settled through a series of annuity purchases over a period of five years or less." We believe that OSFI may have taken these words out of context in order to apply a limit on the use of replicating portfolios, which may not be appropriate for plans with complicated provisions. We suggest that there should be clear flexibility for the actuary to apply judgment in determining whether settlement through annuity purchases over a 5-year period is possible for a particular plan, and therefore whether a replicating portfolio approach is appropriate.

- We understand OSFI's position that the replicating portfolio assets plus the assumed financial support from the employer should provide a similar level of security as a group annuity purchase. However, we note that insurance companies, in general, have access to surplus that a pension plan sponsor would not, and that the concern of over-funding remains. A phased approach to allow time for solvency reserve accounts (SRAs) to be established would alleviate some of these concerns. We acknowledge that SRAs would require action by the Department of Finance.

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
Immediate Past President, Canadian Institute of Actuaries

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