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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

August 30, 2019

Financial and Corporate Sector Policy Branch
Ministry of Finance
PO Box 9418 Stn Prov Govt
Victoria, BC V8W 9V1

Via email: PBSA.SolvencyReview@gov.bc.ca

To Whom It May Concern:

Re: Our Comments on the Review of the Solvency Funding Framework under the *Pension Benefits Standards Act:* Report on Stakeholder Committee Process

ACPM is the leading advocate for plan sponsors and administrators in the pursuit of a balanced, effective and sustainable retirement income system in Canada. We represent plan sponsors, administrators, trustees and service providers and our membership represents over 400 companies and retirement income plans that cover millions of plan members.

We thank you for the opportunity to provide these comments on the proposed changes to the solvency Funding Framework for British Columbia registered defined benefit pension plans.

GENERAL COMMENTS

As noted in our previous response to funding reform, we are supportive of the review of solvency funding with the goal of pursuing the dual goal of sustainability (heavily influenced by contribution stability) and benefit security (as measured by the funded status on a wind-up basis). Previous funding frameworks focused primarily on the latter measure which we believe has led to a decline in the number of defined benefit plans in Canada.

Our comments below reflect our thoughts and views about the relationship between assets, liabilities, and sensitivities of each in addressing a plan specific Provision for Adverse Deviation. We recognize that the draft regulation is attempting to provide a very simplified approach to defining minimum funding standards. Given the governance framework (written funding policies and governance assessments), these comments might be useful instead in crafting a regulatory guideline on the assessment of plan specific adjustments to the minimum prescribed PfAD.

Finally, we would encourage the government to proceed with the recommended revision to the Reserve Account as soon as practicable after the adoption of the new funding framework.

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COMMENTS ON THE GUIDING PRINCIPLES IN THE REPORT

While we agree with many of the comments and sentiments in this section, there are a few on which we wish to offer a different perspective:

- The nature of the PfAD: While we agree that the level of a PfAD should be supportive in mitigating contribution stability, we fundamentally believe the level of the PfAD should be linked to the amount of risk attributed to the expected variability in the going-concern financial position and in contributions required to fund deficiencies. The variability in the going-concern financial position is directly related to how the assets are expected to move in relation to the liabilities. The expected variability of the financial position is primarily driven by interest rate risk (which varies between assets and liabilities) and by asset volatility due to factors other than interest rate changes. The Canadian Institute of Actuaries has conducted extensive research in this area and has developed very reasonable guidelines on development of PfADs. Indeed, the PfADs defined in the Québec legislation reflect this research and were designed specifically to reflect these two primary risk factors.
- Linkage between PfAD and investment policy makes inherent sense. A statement in the Committee Report was made that "…basing PfAD requirements on investment mix inappropriately influences investment decisions, raising fiduciary issues." We fundamentally disagree with this sentiment. In the work headed by Barbara Sanders (Simon Fraser) on the Canadian Institute of Actuaries Task Force on Target Benefit Plans, it was noted quite strongly that funding policy, investment policy and benefit policy need to be developed in concert in order to best manage the risks to a pension scheme. Indeed, even the guidelines prepared by CAPSA on funding policy development make the point that investment policy should be taken into account when considering appropriate PfADs. In our view, the lack of a linkage in regulations between PfADs and the investment policy could encourage additional risk taking which would be counterproductive in the goal of this regulatory reform. Therefore, we would recommend that regulatory guidelines promote more diligent application of prudent funding policies by strengthening requirements beyond the minimum prescribed PfADs, where appropriate, reflecting plan specific risks.
- Benefit security is also important: We agree that benefit security is an important element in designing a funding regime and believe that the 85% solvency funding floor seems to be a reasonable compromise between the dual objectives of a pension funding framework. That being said, this solvency funding level may justify a relatively low level of PfAD to achieve the aims of the new funding framework.

COMMENTS ON TECHNICAL DETAILS SECTION IN THE REPORT

- We agree with the comments and suggestions made in sections 1 and 2 in the Report.

- Under 3., we do not think that the level of variability in the going-concern funded position (and thus contribution variability) is directly linked to the actual level of the long-term bond yields. While one might be able argue there are market forces which will often nudge current long bond yields to some historical relationship with long-term expected nominal GDP, it is hard to predict the timing of this "normalization".

- Based on the work of several organizations, including the Canadian Institute of Actuaries, it has been shown that the primary levers which drive the majority of the variation in the going-concern funded position can be broken down into two important factors that affects the probability of maintaining a fully funded state in unfavourable scenarios, namely:

    - <u>The variability of assets that do not correlate with the liabilities:</u> Generally speaking, this may include equities, real assets and other alternative investment strategies. That being said, in some cases, namely real assets, there can be moderate correlation with liabilities, due to the greater dependence on the discounting of fairly predictable cash flows (rent, tolls, and other income from such real assets). Accordingly, the PfAD required on these special types of variable assets might be reduced to reflect the expectation of lower variability and moderate correlations with the liabilities.

    - <u>The change in liabilities due to a change in the discount rate</u>: Investments in bonds and other fixed income investments will often correlate highly with the liabilities. For example, if a Plan invested 100% of its assets in fixed income assets that closely mirrored the characteristics of the liabilities, you might expect very little deviation in funded status between valuations. The suggested approach using the ratio of the duration of assets to the duration of liabilities is a simple and reasonable approach to defining that aspect of a prescribed PfAD.

  Overall, we believe a simple two-dimensional table can be used to calculate the PfAD which would be expected to mitigate going-concern funded status volatility and thus manage contribution stability. The table in question would have, in one-dimension, the degree to which the assets are expected to correlate or not with the going-concern liability (*e.g.* the ratio of the duration of assets over the duration of liabilities) and, in the other dimension, the percentage of assets invested in variable assets which are not expected to correlate with liabilities (*e.g. equities)*. For example, we believe the table in the Québec regulation provides a simple and effective approach to calculate, administer and regulate the PfAD. As an alternative, if a sponsor wanted to use a different PfAD than the one prescribed, we believe it should be permitted to apply for an exemption from the regulated PfAD by conducting its own stochastic study to demonstrate a stated stability goal (*e.g.* that there is at least an 85% chance that a Plan with a fully funded PfAD, would continue to have a ratio above 100% in three years' time).

- The 85% minimum solvency funding floor and the contribution holiday rules described in the report likely justify a reduced level of PfAD in comparison with the table in the Québec legislation. Option#1 proposed by Nova Scotia would appear to be a reasonable compromise of balancing all these factors (see below):

Option 1: The PfAD is determined by the two-dimensional grid below which considers the ratio of the duration of assets to the duration of liabilities, a measure of interest rate risk, and the percentage of a plan's assets invested in variable income securities, a measure of market risk:

% Assets in Variable Securities	Asset/Liability Duration Ratio: 0%	25%	50%	75%	100%
0%	7	5	3	1	0
20%	9	7	5	3	1
40%	11	9	7	5	3
50%	12	10	8	6	4
60%	14	12	10	8	6
70%	17	15	13	11	9
80%	19	17	15	13	11
100%	22	20	18	16	15

- With respect to the other elements of the Technical Details, we largely agree with them.
- We welcome the proposal to vary the PfAD for derisked plans, i.e. those having more than 70% of assets invested in fixed income categories. This reflects our comment above to the effect that it is better to gauge the interest rate risk by focusing on the combination of assets and liabilities.
- The proposal to revise the calculation of deficiency payments by disregarding interest amortization and simply dividing by 60 or 120 surprised us; we do not consider it complicated at all to properly reflect interest and we question the appropriateness of such proposed simplification.

Thank you once again for inviting our comments. We would welcome the opportunity to meet with you and discuss any questions you may have on our feedback. Please feel free to contact us if we can be of further assistance.

Sincerely,

Ric Marrero
Chief Executive Officer
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