Pension Investment
Association of Canada
Association canadienne des
gestionnaires de caisses de retraite

June 8, 2021

Saskatchewan Financial and Consumer Affairs Authority
Via pensions@gov.sk.ca

Re: Solvency Funding Review

PIAC appreciates the opportunity to comment on Saskatchewan's Review of the Pension Funding Framework for Single Employer Defined Benefit Plans in the Private Sector.

PIAC has been the voice for Canadian pension funds since 1977 in matters related to pension investment and governance. PIAC's members manage over $2.2 trillion of assets on behalf of millions of Canadians. Our mission is to promote sound investment practices and good governance for the benefit of plan sponsors and beneficiaries.

General Comments

PIAC strongly supports the review of the regulatory framework for pension funding. PIAC believes Canadian governments have the ability to alter the policy underpinnings of the pension regime and thereby alleviate some of the funding and regulatory challenges facing pension plans. PIAC is convinced that now is the time for the reform of long-term, minimum funding rules. We believe Canadian pension jurisdictions need one funding rule, as opposed to one going-concern funding rule and one plan termination (solvency) funding rule. This one funding rule can be properly designed to meet the needs of beneficiaries and plan sponsors to balance the need for benefit security and plan sustainability. It is PIAC's hope these rules can be developed consistently with jurisdictions across Canada to promote the efficiencies of regulatory harmonization. PIAC's membership has considerable experience with many of the intricacies and challenges associated with these issues, and we would be very pleased to provide assistance on this important initiative.

Specific Comments

The following represents PIAC's views on the specific questions posed in the paper. As noted above, we would be happy to go into more detail on our views at the appropriate time.

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?

PIAC does not see maintaining solvency funding requirements under a modified form as the solution. The costs and complexities in having two different funding regimes are significant and many of the solvency funding options noted have been tried in the past or in other jurisdictions and have not been successful in solving the pension funding problem in Canada. This has directly led to the closing of defined benefit pension plans in Canada. PIAC believes one funding regime with appropriate margins for adverse deviations is in the best interests of both pension plan members and plan sponsors. Pension plans are inherently long-term obligations such that short-term solvency funding policies are not appropriate.

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

Average solvency ratios, lengthening amortization periods, consolidation of solvency deficiencies all have merit and may help mitigate some of the funding challenges. However, some of these techniques have been used in solvency funding relief measures introduced by various provinces and have not proven to be durable or effective in enhancing plan funded ratios in any meaningful way. In addition, they are more complex and costly to manage, while the same or similar results could be achieved with one funding model regime with appropriate parameters.

Solvency reserve accounts (SRAs) can be a useful tool to solve issues related to trapped capital and can serve as an incentive for employers to fund benefits despite risks related to revenue and Covid-19. SRAs are an important design feature but are not a substitute for funding reform.

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

As mentioned above, while lengthening the amortization period for solvency deficiencies may have merit and may help mitigate funding challenges faced by plans, better outcomes could be achieved with one enhanced going concern funding model with proper measures in place.

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

SRAs are a useful tool to manage the inherent procyclical nature of pension funding obligations by encouraging plan sponsors to fund beyond statutory minimums during periods of good economic growth through mitigation of the asymmetries related to trapped surplus. We see no downside risk from a policy perspective to an appropriately structured SRA regime. PIAC supports a requirement that a 105% solvency and going concern threshold be met following a withdrawal from an SRA. We also support a five-year period over which the eligible surplus can be withdrawn. To ensure that SRA withdrawals are not based on stale information, we support a requirement that withdrawals only occur in the calendar year following an actuarial valuation as well as a requirement that the plan sponsor does not have any reason to believe that the plan funded position would fall below the minimum 105% thresholds following a withdrawal. We note that the requirement that any eligible surplus can only be withdrawn over five years mitigates much of the risk related to the timing of any single withdrawal. Finally, PIAC believes that flexible reserve account structures, which allow for access if certain funding thresholds are met, will best encourage sponsors to make use of such accounts and that broad take-up is well aligned with regulatory objectives.

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

Letters of Credit (LOCs) are an excellent funding tool, and it is common for the LOC to be issued by a financial institution with a higher credit rating than the plan sponsor. If the plan sponsor can supply a higher amount of an LOC, it is because the banks issuing the LOC believe that the plan sponsor has the credit capacity to support the LOC. Conversely, LOCs do not earn a rate of return (either positive or negative) and are therefore not a match to the pension liabilities. A higher LOC limit will not increase the risk to the pension plan but will likely drive higher funding costs over time. PIAC is supportive of a 15% limit similar to those established by other jurisdictions.

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?

PIAC supports funding being based on a going-concern “plus” model and eliminating solvency requirements except for an 85% plan-wind-up-funding ratio floor. With other jurisdictions, including Ontario and British Columbia, PIAC has strongly supported moves to enhanced going concern funding combined with modified solvency funding of an 85% threshold.

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

PfADs should mitigate against several risks including the potential that the plan would take an action, such as improving benefits, that weakens the plan’s funded position and diminishes benefit security. PfADs should also be established to mitigate against market/investment risks, such as interest rate and equity risks. These points are expanded upon in our response to the next question on the best method of structuring a PfAD.

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

PIAC believes that PfAD determination should have a tight link to plan asset allocation, as is done in Ontario and Quebec. A standardized PfAD based mainly on long-term bond yields at the valuation date may prove to be too conservative for substantially de-risked plans in some scenarios (i.e., in higher interest rate environments) and conversely less conservative for plans with a higher allocation to “risky assets” in other scenarios (i.e., very low interest rate environments). A tighter link to asset allocation will make the regime more robust to plans with a broader range of asset allocations and may make it more robust to extremely low interest rate scenarios, which have developed in a number of advanced economies in recent years. This approach would moreover be consistent with the general approach to regulatory capital in the broader financial sector which typically discriminates based on overall balance sheet risk.

PIAC supports linking the PfAD to the investment strategies of the pension plan, the demographic profile of the plan, intergenerational fairness among plan members and level of risk tolerance. By their nature, investment strategies that are highly correlated to the pension plan’s liabilities will reduce funding risk and consequently should not require a large PfAD. There are both simple and complex ways of accomplishing this. With either approach it will be important that the overall margins built into an enhanced going concern funding valuation are appropriate and that the PfAD does not inadvertently add an additional level of reserve that does not reflect the margins already in place. A given PfAD should be supported by the individual pension plan circumstances. PfAD requirements must be carefully set out, particularly as they are set in relation to investment policy mix and overall investment risk (and not over-shooting the level of required PfAD).

It may be useful in establishing the PfAD to account for the overall interest-rate coverage of assets relative to liabilities (or duration mismatch) as this can be one of the material drivers of surplus volatility. For example, the PfAD could be set based on the degree of interest rate matching rather than just the allocation to fixed income assets alone.

PIAC believes that CAPSA is well placed to review the various PfAD regimes which have developed in recent years with a view to harmonizing various provincial approaches and would encourage such an initiative to be added to CAPSA’s agenda.

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?

PIAC views an enhanced going concern regime as a reasonable trade-off for eliminating solvency funding. In the case of plans such as public sector and other solvency exempt plans that are considered low enough risk so as not to require solvency funding, we recommend that status quo going-concern funding is maintained.

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

It is PIAC's position that while a plan has a going concern surplus of a specified size (eg. 105%), current service contributions should be funded on a "best estimate" basis without factoring in servicing a PfAD.

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

PIAC supports shortening amortization to 10 years. Shortening the amortization period is an option that should be considered in setting the appropriate framework for an enhanced going concern funding model. A shorter maximum funding period would increase benefit security in the context of an overall move away from solvency funding toward an enhanced going-concern regime.

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

PIAC is strongly supportive of the introduction of Solvency Reserve Accounts (SRAs) and we believe that restrictions can be placed on SRA withdrawals based on the funded level of the plan as explained in the answer to question four of the previous section. SRAs reduce the risk of excessive funding and trapped surplus in the current era of low interest rates and large contribution requirements for most plan sponsors. Over the longer term, SRAs can potentially mitigate the inherent pro-cyclical nature of pension contribution requirements by providing sponsors with greater incentive to fund pension plans beyond statutory minimum requirements during periods of stronger economic growth.

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

Consolidation of solvency deficiencies is a reasonable design element to create an appropriately robust going concern regime.

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?

If only partial solvency funding is required or if it is eliminated completely, PIAC supports the introduction of solvency reserve accounts (detailed in the answer to question 7) and letters of credit. Solvency reserve accounts and letters of credit would still be useful mechanisms even if a solvency deficiency only has to be funded to a certain level. SRA rules should be integrated with the rules permitting the use of letters of credit such that the latter continue to operate effectively.

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.

PIAC has no comments to share in response to this question.

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?

PIAC has no comments to share in response to this question.

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?

PIAC supports linking the ability to take contribution holidays with the funded position of the pension plan. Under an enhanced going concern funding model, contribution holidays should continue to only be permitted when a pension plan is fully funded. As the enhanced going concern funding model is to include a PfAD, contribution holidays up to the amount by which the pension plan's funded position exceeds 100% would be appropriate and still provide benefit protection. Benefit improvements can also be tied to the funded position of the pension plan with additional immediate funding required to bring the pension plan back to the minimum funded level. In this situation, the current amortization period could be maintained.

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?

PIAC recommends that a contribution holiday threshold be set at 105% on a solvency and/or going concern basis. These represent comfortable buffers from a member protection perspective, in particular with the introduction of PfAD's on the going concern measure and would be more in line with the thresholds of other Canadian jurisdictions.

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?

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Annual valuations provide an excellent tool to ensure that changes to the capital markets are being appropriately reflected in a pension plan's funded position and action can be taken to ensure funding levels are adjusted appropriately. PIAC believes that it is appropriate to ensure that simplified valuations are performed (but not necessarily filed) on an annual basis to support ongoing contribution holidays in the inter-valuation period.

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?

PIAC strongly supports statutory discharge of liability for pension plans where annuity buy-outs occur. Annuity discharges should be allowed for all plan members as all plan members should be treated equally. We believe there are a small number of reasonable conditions that a plan should have to meet in order to be eligible to qualify to achieve full discharge:

- Annuities should be purchased from a qualified provider (i.e., regulated insurance company)
- The funded position of the plan should not be worse off after the buy-out than before
- The purchased annuities should substantially replicate the terms of the pensions being discharged and rules around such buyouts should be consistent with the Government of Canada's Newsletter 20-1, Registered Pension Plan Annuity Contracts ("Newsletter").

Additionally, the regulator should be advised of annuity discharges and receive a certification that the annuity discharge complies with legislation. Members must also be advised that an annuity has been purchased, from who the annuity was purchased, and who to contact. Following this, the insurance company will be tasked with providing all disclosures. Member consent should not be required.

Importantly, we note that PIAC does not support the approach taken by Ontario which requires members to retain entitlement to plan surpluses in the event of a future wind-up following an annuitization. We believe this approach creates asymmetries in the allocation of risk, is administratively complex and serve as a disincentive for plan sponsors to pursue annuitizations which are fundamentally well aligned with regulatory objectives. We encourage Saskatchewan to not take that route.

We would be pleased to provide any further information, should you request it.

Yours sincerely,

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