Submission to the Government of Saskatchewan on the Consultation on 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

Canadian Life and Health Insurance Association
June 2021

The Canadian Life and Health Insurance Association (CLHIA) is a voluntary association with member companies which account for 99 per cent of Canada's life and health insurance business. The life and health insurance industry is a significant economic and social contributor in Canada.

$63 million in provincial tax contributions

$11 million in corporate income tax

$5 million in payroll and other taxes

$47 million in premium tax

Investing in Saskatchewanians

$25 billion in total invested assets

98% held in long-term investments

The industry also plays a key role in providing a social safety net to the people of Saskatchewan.

Protecting 910,000 Saskatchewanians

730,000 with drug, dental and other health benefits

630,000 with life insurance averaging $256,000 per insured

340,000 with disability income protection

$3 billion in payments to Saskatchewanians

$1.7 billion in annuities

$0.9 billion in health and disability claims

$0.4 billion in life insurance policies

Our industry is pleased to provide its comments on the province's consultation in respect of amendments to the *Pensions Benefits Act, 1992* ("PBA") regarding 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. Our industry greatly appreciates the opportunity to provide input on these matters.

Technical Comments:

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?

The CLHIA commends the Government of Saskatchewan (Saskatchewan) for its actions in examining issues related to solvency funding. Furthermore, the CLHIA acknowledges the financial situation in Saskatchewan resulting from the COVID-19 pandemic. Pension funding rules need to balance plan member benefit security with plan sponsor solvency and sustainability. However, the historical volatility in solvency funding ratios (and the resulting advocacy for solvency funding relief) is contributed to by plan sponsors mismatching their assets in relation to underlying pension liabilities. Softening solvency funding rules could lead to plan sponsors taking more risk by continuing to make calls on interest rates and equity markets, and potentially even considering re-risking their pension plans. Further, contribution volatility and procyclical contributions requirements are less significant issues in comparison to assets that are not mismatched with liabilities.

The insurance industry has a deep understanding of the capital and risk management principles required to make and deliver on a pension promise. Members of defined benefit (DB) pension plans count on their benefits as an important source of retirement income and incorporate them into their financial and retirement planning. They have a reasonable expectation that sponsors will fund plans in a manner that will ensure benefit security.

As such, we believe that any additional relief should be provided by the first main approach – changing the way in which solvency deficiencies are funded. We strongly believe that the measures under this approach are more effective at providing the right balance between benefit security and affordability than the second main approach – partial solvency funding or no solvency funding, with enhanced going concern.

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

The CLHIA believes that the following principles are essential to a robust funding regime:

- Plan sponsors should be required to fund deficits in a timely manner and should be able to withdraw surpluses.

- Sound risk management, including liability driven investment (LDI) and pension risk transfer strategies, e.g., annuity purchases, should be encouraged since they benefit both plan sponsors and plan members.

- Undue costs should not be placed on plan sponsors. For example, triennial valuations should be available for pension plans that meet solvency thresholds.

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

No comment.

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

We support the adoption of SRAs. We believe it is reasonable for the employer to be allowed to withdraw payments that have been made into the account if the plan is funded at 100% solvency ratio or 100% solvency ratio with a Provision for Adverse Deviation (PfAD).

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

We support the adoption of LOCs with the amount limited to a certain percentage of liabilities. We recommend Saskatchewan explore the approaches that other jurisdictions have taken with respect to imposing limits.

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?

We believe that requiring plans to fund at 100% solvency ratio protects members' benefits and the long-term sustainability of DB plans. Solvency funding adds rigour to pension plan financing through its funding calculation, and through clear, unbiased rules for the methods and assumptions used by plan sponsors. Any new solvency funding rules that do not require plan sponsors to make special payment contributions to fund the pension plan to a 100% solvency ratio will result in additional risk for plan members in the event of a plan sponsor insolvency.

A strong funding ratio is the best assurance of benefit security. The recent Sears Canada Inc. DB pension plan insolvency highlights the risk of solvency underfunding. Terminal funding is only needed when a pension plan ceases to be a going concern (usually as a result of its plan sponsor becoming insolvent), but at that time, it is unlikely that the plan sponsor will be able to top-up a solvency deficit. The result is a shortfall in assets when they are needed the most – leading to a reduction in plan members' promised benefits.

Moving away from a solvency funding regime discourages plan sponsors from prudently managing risk and could jeopardize members' benefit security. The volatility that plan sponsors are struggling with under the current solvency funding regime can be effectively managed using LDI strategies.

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

We believe that the main goal of a funding buffer or a PfAD should be to help preserve member benefit security. A properly constructed PfAD is a powerful tool to educate plan sponsors on good risk management and to encourage them to take actions in their plans that strike the right balance between seeking excess returns and maintaining members' benefit security.

The calculation and design of the PfAD should encourage plan sponsors to manage risk appropriately and prudently. We believe this means considering more than just interest rate risk, such as, equity risk, inflation risk, credit mismatch, and longevity risk. Furthermore, consideration should be given to how assets and liabilities interact. The Ontario and Quebec regulators have established varying approaches to manage risk in these areas. This, in turn, will lead to increased benefit security for plan members without jeopardizing plan sustainability.

We believe that all financial service regulators should have a mandate to improve accountability and oversight, with an aim to protecting consumers, or in this case pension plan members. Given the impact of plan sponsors' investment strategies on members' benefits – and ultimately their retirement security, we encourage Saskatchewan to leverage the PfAD as an effective way to influence good risk management by rewarding good investment strategies.

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

The CLHIA supports requiring the PfAD that is based on the plan's investment policy, matching of assets and liabilities, discount rate assumptions and, ideally, the financial strength of plan sponsors.

The CLHIA has the following comments on the design of a PfAD, based on our observations of Quebec's stabilization provision and Ontario's PfAD:

- Duration of plan liabilities: The CLHIA strongly recommend that a PfAD include a component related to the duration match between plan assets and liabilities. We note the Quebec stabilization provision is significantly higher (approximately 8% on average) for plans with no asset liability duration matching than for plans with full asset liability duration matching. We believe this would encourage plan sponsors to follow good risk management practices by using investment strategies such as LDI. We also recommend considering the use of alternative investments, such as private placements, real estate assets, and any duration exposure resulting from the use of leveraged bond strategies, when reasonably appropriate.

  Under Ontario's rules, a plan with a high liability duration that is 100% invested in cash has the same PfAD as a plan with full asset liability duration matching, which does not reflect the additional risk of being 100% invested in cash.

  Not including a PfAD component related to duration matching could discourage plan sponsors from better matching their assets and liabilities, making the funded ratio of their plans more vulnerable to market downturns.

- Characteristics of fixed income: The CLHIA recommends that when developing the details on characteristics of bonds that would constitute fixed income, consideration be given to both bonds rated by an external rating agency, as well as bonds rated using an internal credit rating model that is designed to be consistent with the ratings of external rating agencies. This would appropriately reflect the benefits of investing in private fixed income assets (such as infrastructure debt) to achieve both interest rate risk mitigation and better diversification.

- Non-fixed income assets: The CLHIA recommends a sharper increase in the PfAD component for plans with increasingly larger allocations to non-fixed income assets than what has been enacted in both Ontario and Quebec. The CLHIA believes that an inappropriate PfAD could encourage some plan sponsors to take more risk because the penalty for taking risk is lower than the potential reward. In fact, several pension consulting firms have publicly commented on this issue and encouraged their clients to consider taking additional risk in their pension plans.

  One data point that may be helpful is the capital that an insurance company needs to hold for a higher risk asset mix. The capital requirements set by OSFI is analogous to the PfAD concept for pension plans. The insurance company capital requirement for a 60% equity / 40% fixed income asset mix is in the range of 30% to 40%. This is much higher than the PfAD amounts implemented by both Quebec and Ontario.

  If the insurance company capital represents a reasonable risk and reward trade-off, it is easy to understand why Quebec's stabilization provision and Ontario's PfAD may encourage some plan sponsors to take additional risk in their plans.

- Closed plans: The CLHIA believes that all plan members should be equally protected, irrespective of whether their pension plan is open or closed. A plan sponsor of an open plan is not necessarily better able to fund a solvency deficit in the event of insolvency than a plan sponsor of a closed plan.

  If different PfAD levels are required for open and closed pension plans, we suggest that the definition of a closed plan be clarified. Some scenarios to consider include whether a plan is closed to new entrants or to all future benefit accruals; as well as a plan of 1,000 members that only accepts three new entrants a year.

- Benchmark Discount Rate (BDR): S&P 500 data shows there was an average premium of 3.6% between 1955 and 2017, and 3.9% between 1997 and 2017. An equity risk premium higher than these historical premiums could encourage plan sponsors to take more risk to achieve a higher going concern discount rate and lower funding requirements – therefore reducing the benefit security of plan members.

A properly constructed PfAD is a powerful tool to educate plan sponsors on good risk management and to encourage them to take actions in their plans that strike the right balance between seeking excess returns and maintaining plan members' benefit security.

Therefore, the CLHIA recommends that Saskatchewan takes into consideration the above concerns when reviewing the various approaches taken by other jurisdictions.

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?

No comment.

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

No comment

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

No comment.

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

No comment

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

We support the consolidation of unfunded liabilities.

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?

No comment

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.

No comment.

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 comments.

Restrictions on Contribution Holidays

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

No comment.

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?

No comment.

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?

No comment.

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 CLHIA encourages a harmonized approach with that of other provincial and territorial pension authorities, such as Ontario, B.C., and Quebec.

The CLHIA recommends that annuity discharges be allowed for all individuals tied to the pension plan. Allowing annuity discharges for only members and permitting the liability to remain for their spouses or beneficiaries who have less of a nexus to the plan or employer would result in additional red tape and complexity for pension plan administrators.

A few years ago, the Ontario government excluded spouses and beneficiaries. However, the government promptly amended this provision and allowed annuity discharges for all individuals.

In the spirit of avoiding unnecessary red tape for pension plan administrators, the CLHIA believes that it should be sufficient to require a certification from the pension plan administrator that they have purchased annuities in compliance with the Pension Benefits Act, 1992 and the Pension Benefits Regulations, 1993 requirements.

To encourage transparency, the CLHIA supports requiring disclosure to affected plan members. However, the CLHIA believes plan member consent should not be required as there is minimal value in requiring consent from retirees who terminated long ago and are unlikely to respond. This measure would also introduce additional red tape for pension plan administrators. In addition, assuming the annuity covers the same benefits that the pension plan provides, the only change is the provider of the benefit.

Conclusion

Thank you for your consideration of our comments noted above. We would be pleased to expand on these concerns should you wish to discuss any of the issues identified in our comments. Please feel free to contact me at 416-359-2047 or by email at nsimon@clhia.ca.