September 30, 2016

Solvency Funding Review
Pension Initiatives Unit
Pension Policy Branch
Ministry of Finance
7 Queen's Park Crescent
5th Floor, Frost Building South
Toronto, Ontario M7A 1Y7

Via email to: pension.feedback@ontario.ca

Dear Sir or Madam:

Review of Ontario's Solvency Funding Framework for Defined Benefit Pension Plans

The Canadian Life and Health Insurance Association (CLHIA) appreciates the opportunity to participate in the captioned consultation.

Established in 1894, the CLHIA is a voluntary association whose member companies account for 99 percent of Canada's life and health insurance business. The industry provides a wide range of financial security products such as life insurance, annuities (including RRSPs, RRIFs and pensions) and supplementary health insurance to 28 million Canadians. It also holds close to $720 billion of assets in Canada and employs about 155,000 Canadians. In the retirement sphere, CLHIA member companies are major service providers to Canada's defined contribution pensions, and to capital accumulation plans more broadly. Plus, our members provide administrative services and longevity and investment risk mitigation opportunities for defined benefit pensions and other arrangements.

The consumer obligations borne by Canada's life insurance companies are, in many respects, similar to those of defined benefit pension plans; they are long-term, with contracts typically running for several decades, and the ultimate costs of benefits are sensitive to changes in both the investment environment and consumer longevity. Arguably, the funding and reserve requirements in relation to insurers' obligations are more challenging than those of defined benefit pensions, since there is no mechanism by which insurers can increase the price of the benefits promised after the contract is formed, and any guaranteed or potential indexation of benefits must be incorporated in insurance companies' regulatory valuations each year. These valuations and the attendant capital requirements reflect the public policy objective of ensuring, to the greatest extent possible, the ability of insurers to pay promised benefits, and to preserve consumer confidence in a sustainable and reliable insurance system.

By contrast, pension valuation standards, and particularly a going concern standard, appear less robust, in part due to an assumption that employers sponsoring pension plan will remain solvent, such that there is always an opportunity for plan administrators and regulators to require additional funding by sponsors to address asset shortfalls. Unfortunately, history over the last thirty years or more provides too many examples where pension benefits have been significantly impaired by the economic collapse of an employer.

Given the similarity in their obligations, we support policy frameworks that would move required pension plan valuation methods closer to the valuation methods currently required for Canadian life insurance and annuity obligations. This move toward more consistent regulation would recommend the preservation of a solvency funding model, although some adjustment of that model may be warranted, as discussed below.

A key concern identified throughout the consultation document is the potential volatility in employer contributions that arises from current funding and investment strategies. Minimizing funding volatility necessitates robust asset-liability matching. Indeed, efforts to reduce capital contributions have been a key driver of increased equity investment on behalf of pension plans, and the resulting procyclical volatility in funded status. While reliance on long-term fixed yield investments that better match the payment obligations under pension plans may increase contribution requirements during periods of low yields, we do not believe that these are a major contributor to short-term contribution volatility, and would gradually reduce the currently observed procyclical variation in contribution requirements. (We would also suggest that increasing longevity may be as or more material to recent funding pressures than a sustained low investment yield environment, and that enhanced asset-liability matching simplifies and supports enhanced consumer understanding of the pension regime and the operation of defined benefit pension plans.)

We recognize that plan sponsors may argue that such liability-driven investing increases required contributions and reduces employers' ability to invest in expansion and growth of their underlying businesses. However, we believe that strong asset-liability matching is the best measure of the true cost of the secure benefits intended to be provided by defined benefit pension plans. And, we believe that promoting benefit security is the only policy objective of Ontario's *Pension Benefits Act*; that legislation does not, in our view, have an underlying objective of expanding or preserving availability of or participation in defined benefit pension plans based on unrealistically and unsustainably-low contribution requirements.

We believe that employers' concern re lack of access to "trapped surplus" is a significant challenge to the existing defined benefit regime. Increased funding of defined benefit pension plans is analogous to insurer's capital requirements, and we support such enhanced funding as a way to enhance benefit security. To allay employer concerns that such amounts may not be recoverable by the employer if not needed to protect benefit security, CLHIA supports the adoption of refundable "solvency reserve accounts" as a means of encouraging robust funding while preserving the desired flexibility and access to surplus for employers.

CLHIA acknowledges that an increasing focus on solvency funding and liability-driven investment practices may require substantial escalation of funding levels in the near term for some plans, and that balancing such escalations against employers' cash flows should be recognized in the development of appropriate amortization periods for solvency deficiencies. Some relaxation of the amortization period of funding deficiencies may be warranted, although we are somewhat concerned that consolidation of solvency deficiencies may delay the adoption of more robust funding levels.

Similarly, the adoption of average solvency ratios would appear to be at odds with the adoption of stronger asset-liability matching. It is not clear that adopting average solvency ratios, with a short period over which such averages are determined, would provide material relief in a regime with stronger asset-liability matching, since variation in asset and liability levels should be diminished.

Targeting a reduced funding level clearly conflicts with the objective of optimizing benefit security, and CLHIA does not support such a weakened target. Nor do we support restricting full solvency funding to only specified parts of the promised benefit.

We strongly oppose any measures that would reduce reliance on solvency funding in favour of either the current or a modified approach to going concern funding.

With respect to complementary reform measures, it may be reasonable to decrease the frequency of required valuations as liability-driven investments become more widespread. In the near term, we would not propose altering the current filing schedule for actuarial valuations.

The potential for gaps between an employer's pension funding policy and the plan administrator's investment policies has been recognized for several years. While robust governance likely includes access to a funding policy and monitoring of contributions against that funding policy, it is unclear that regulatory filing of funding and governance policies would add material value to the regulatory process. It would, however, be reasonable that regulators have access to such policies and supporting documentation as necessary.

CLHIA supports adjustment of commuted values to reflect an underfunded status in a pension plan, at least with respect to plan members who are closely connected to the management and control of a defined benefit pension plan. This is addressed more fully below in the discussion of annuity buyouts. Further consideration should be given to the adjustment of commuted values where a plan has a solvency funded status in excess of 100 percent.

CLHIA also supports restriction on contribution holidays and benefit improvements as outlined in the consultation document.

CLHIA has previously indicated our support for a full discharge of any plan administrator liability where pension obligations are assumed by a third party via an annuity buyout. We believe that this option is a prudent risk management strategy, and that the security of benefits provided by Canada's life insurance companies exceeds that available under the regime applicable to pension plans. We acknowledge that, where a plan member who is closely connected to a pension plan in terms of its management and control elects to have his or her benefits annuitized, there is a risk under the current regime that that individual's retirement benefits would be fully protected under the proposed discharge, to the potential detriment of plan members whose benefits are determined to be underfunded at that time. We believe that a more robust solvency funding standard would serve to minimize such a risk. In addition, it may be appropriate to limit individual annuitization options for such closely connected individuals, perhaps by reducing the commuted value of their entitlements to mirror any funding deficiency in the plan as a whole at the time of annuitization.

We believe that any expansion of coverage under the Pension Benefit Guarantee Fund, including targeted enhancements with risk-based assessments to specified pension plan sponsors, raises significant risk of moral hazard and an inappropriate subsidization of plan specific risks by the broader population. CLHIA therefore opposes such an expansion.

Canada's life insurance companies greatly appreciate the ongoing opportunity to engage with the government as it considers this matter. Should you or other officials have any questions regarding the concerns identified above, we would be pleased to discuss these matters in more detail. Please feel free to contact me at your convenience in this regard, by telephone at 416-359-2021 or by email at rsanderson@clhia.ca.

Yours sincerely,

(Original signed by)

Ron Sanderson
Director, Policyholder Taxation and Pensions