February 28, 2019

Jennifer Rook
Director, Pension Policy Branch
Ministry of Finance
7 Queen's Park Crescent
5th Floor, Frost Building South
Toronto, ON M7A 1Y7
Email: pension.feedback@ontario.ca

Re: New Funding Rules for Defined Benefit Pension Plans: PfAD Calculations (Par. 76(12) under the Regulation 909 Pursuant to the Pension Benefits Act)

Dear Ms. Rook:

ACPM (The Association of Canadian Pension Management) 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 more than 3 million plan members.

Overview

The ACPM, ("Association of Canadian Pension Management"), through its National Policy Committee and Ontario Regional Council, is writing to comment on an issue that negatively affects pension plan sponsors and administrators due to specific wording in subsections 11.2(8), 11.2(9) and 76(12) of Regulation 909 under the *Pension Benefits Act*.

Background

The ACPM was pleased to provide the Ontario Ministry of Finance ("Finance") with a submission in response to the January 2018 consultation with respect to DB plan funding rules. Part of those rules require DB pension plans funding to include a buffer over the plan's liabilities using a Provisions for Adverse Deviation ("PfAD").

We agree that the PfAD calculation should be based on the plan's asset mix (or target asset mix), and that a riskier asset mix should naturally require a higher PfAD. Using that logic and an understanding that fixed income investments generally correlate well with pension liabilities, equity investments should require a higher PfAD than fixed income investments.

That being said, the wording in subsections 11.2(8), 11.2(9) and 76(12) is causing what appears to be in unintended result. FSCO is taking the position that this wording causes any non-investment grade fixed income investment to taint all fixed income investments, resulting in their treatment as equity investments.

It is also unclear under which category infrastructure assets should fall into under subsection 76(12). Since they have a number of characteristics that are similar to real estate, it would make sense to treat them similarly for purposes of the PfAD calculation.

We believe that a few minor changes to the wording would clarify what we believe may have been the original intent in the calculation of the Provisions for Adverse Deviation ("PfAD").

The Proposed Solution

Following are the minor wording changes which we believe would clarify the PfAD calculation and remove the potential inadvertent penalty for investing the pension fund's assets in a manner which the administrator might otherwise deem a prudent approach in managing investment risk and diversifying sources of return:

- Paragraph 76(12)6. could be changed to read "Mortgage loans and real estate debentures", as there is little difference between the two.

- Paragraph 76(12)8. could then be changed to read "Infrastructure".

- Paragraph 76(12)15. could be changed to read "Canadian investment grade bonds and debentures other than investments referred to in paragraphs 1 to 12".

- Paragraph 76(12)16. could be changed to read "Non-Canadian investment grade bonds and debentures other than investments referred to in paragraphs 1 to 12".

- A new category for non-investment grade and non-rated bonds may not be needed, as they would end up falling under 76(12)17., allowing for a PfAD that is the average between stocks and bonds. We would argue that this is a reasonable result as the risk associated with a non-investment grade bond or non-rated bond should be less than the equity of the corporation issuing the bond since the bond would still have a higher priority on capital in the event of insolvency of the corporation. In addition, a number of non-rated bonds (private debt) have characteristics and covenants that would provide investors with a similar risk profile as investment grade bonds. This is partly the reason why insurance companies typically invest heavily in private debt.

- Investment grade bonds could be interpreted as bonds or debentures that meet the minimum rating requirement of table 2 under paragraph 11.2. A new definition could be created to clarify this point.

Thank you for taking the time to review our suggested changes to clarify the calculation of the PfAD and remove potential obstacles to prudent management of pension funds. We would be pleased to speak further with Finance about this issue.

As plans are now preparing actuarial valuations under the new funding rules, clarification of this issue as soon as possible would be most welcome.

Yours very truly,

R Marrero

Ric Marrero
Chief Executive Officer
ACPM