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

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ACPM response to proposed revisions to the Instruction Guide for the Preparation of Actuarial Reports for Defined Benefit Pension Plans (the "Draft Guide")

ACPM CONTACT INFORMATION

Mr. Ric Marrero
Chief Executive Officer
Association of Canadian Pension Management
1255 Bay Street, Suite 304
Toronto ON M5R 2A9
Tel: 416-964-1260 ext. 223
Fax: 416-964-0567
Email: ric.marrero@acpm.com
Web: www.acpm.com

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FOREWORD

ACPM (THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT)

ACPM (The Association of Canadian Pension Management) is a national, non-profit organization acting as the informed voice of plan sponsors, administrators and their service providers in advocating for improvement to the Canadian retirement income system. Our membership represents over 400 companies and retirement income plans that cover more than 3 million plan members.

ACPM believes in the following principles as the basis for its policy development in support of an effective and sustainable Canadian retirement income system:

Diversification through Voluntary / Mandatory and Public / Private Options
Canada's retirement income system should be comprised of an appropriate mix of voluntary Third Pillar and mandatory First and Second Pillar components.

Third Pillar Coverage
Third Pillar retirement income plan coverage should be encouraged and play a meaningful ongoing role in Canada's retirement income system.

Adequacy and Security
The components of Canada's retirement income system should collectively enable Canadians to receive adequate and secure retirement incomes.

Affordability
The components of Canada's retirement income system should be affordable for both employers and employees.

Innovation in Plan Design
Canada's retirement income system should encourage and permit innovation in Third Pillar plan design.

Adaptability
Canada's retirement income system should be able to adapt to changing circumstances without the need for comprehensive legislative change.

Harmonization
Canada's pension legislation should be harmonized.

INTRODUCTION

ACPM appreciates the opportunity to comment on the Draft Guide. Given the importance of the Guide on the financing of pension plans subject to OSFI supervision, we encourage OSFI to continue this new practice of issuing the Guide in draft form in the future.

Before addressing the specifics in the Draft Guide, we have two overall comments:

- Even before the COVID-19 pandemic, many DB pension plan sponsors have expressed concerns that the environment of historically low interest rates presented a very challenging time. Solvency funding requirements have become an onerous burden on employers. Many other Canadian pension jurisdictions have recognized this point and have enacted helpful legislation. In the 2019 budget, the Government committed to engage on ways to support the sustainability of defined benefit plans. The Department of Finance has indicated that consultation on solvency reserve accounts and providing more flexibility for ancillary pension benefits is forthcoming, and Innovation, Science and Economic Development Canada held consultations that included solvency reserve accounts as one of the pension options for consideration. Given the foregoing context, we are surprised that OSFI has proposed measures that are expected to increase solvency funding requirements for plans that use the replicating portfolio method. Based on the reaction of our membership, we fear that the changes proposed to the replicating portfolio method will only serve to further pressure those few remaining employers with open defined benefit pension plans to close their plans and implement the only other option available to them at the federal level - defined contribution plans. For obvious reasons, we see this as an undesirable result which can only undermine retirement security for federally regulated employees at our largest Canadian institutions.

  Until the sustainability review is conducted and funding asymmetry addressed, we would strongly encourage deferring any measures that are likely to increase solvency funding, such as the proposed changes to the replicating portfolio method.

  The COVID-19 situation has exacerbated the situation, causing equity markets and interest rates to drop and creating very challenging situations for many federally registered employers. While the situation will continue to evolve over the coming months, now is clearly not the time to strengthen funding rules.

- The Draft Guide is prescriptive in nature, greying the area between the role of the actuary and that of the Superintendent. Under Section 12(3.1) of the PBSA, the actuarial reports must be prepared in accordance with the Standards of Practice ("Standards") adopted by the Canadian Institute of Actuaries (CIA), which require that the actuary opine that the assumptions and methods are appropriate. The Draft Guide, however, states "The Superintendent determines which assumptions or methods are appropriate for the preparation of actuarial reports". The Superintendent may, of course, issue guidance and the actuary must, of course, consider such guidance; however, ACPM believes the Draft Guide is most useful where it acts to clarify treatment of legislative provisions that are not reflected in the Standards (e.g. transfer deficiencies).

If OSFI has an issue with the application of the Standards in specific cases, or the Standards themselves, our preference would be that OSFI raise the matter with the actuary directly or the appropriate CIA body, rather than implementing requirements through the Guide.

Further, the Draft Guide frequently uses wording which is similar but not identical to the Standards and other CIA Guidance, creating a risk of conflicts arising between the two interpretations. As noted by OSFI, actuaries are expected to be familiar with CIA Guidance.

We encourage OSFI to rely on the CIA Standards of Practice, and only provide additional guidance where material, leaving matters affecting plan characteristics to the actuary.

Following are our comments on the Draft Guide itself.

1. Replicating Portfolio

ACPM appreciates that OSFI continues to permit replicating portfolio approaches as such scenarios provide the most realistic manner of settling benefits for large plans, particularly where benefits are indexed. Indeed, most solvency liabilities for large plans are determined using a replicating portfolio method. The Draft Guide proposes significant changes from current practices in this area. The proposed requirements appear to be modeled after the Life Insurance Capital Adequacy Testing (LICAT) model. Presumably the intention is to make solvency liabilities under the replicating portfolio approach similar to life insurance reserving requirements and, therefore, provide similar security. However, ACPM has reservations about the applicability of the LICAT model itself, the thresholds within the model that are being applied and the timeframe over which these thresholds are measured.

Applicability of LICAT model

ACPM does not believe that the LICAT model should be applied to the measurement of pension plans' solvency liabilities for the reasons listed below.

- LICAT and pension solvency rules each require reserves in excess of best estimates. However, by definition, experience over time is most likely to be close to the best estimate assumptions, i.e., as expected. For insurance companies, as experience unfolds, the insurance company's required "solvency buffer" is released to the insurer as profit. For pension plans, as experience unfolds, the provisions for adverse deviation are released and a surplus is created. This underscores a fundamental inconsistency in the consequences of applying similar reserving requirements to insurance companies and pension plans. Unlike insurance companies, which recover the released solvency buffer as profit, there is no mechanism for employers to recover the contributions they were required to pay to establish the required solvency provisions, and it becomes trapped.

- For a new block of annuities, the reserves required under LICAT normally exceed the premium received by the insurer, with the insurer using its own capital to make up the difference. Insurers are willing to do so because they expect those reserves to be released back to them over time. If LICAT principles are applied to determine pension plan solvency liabilities, such liabilities would exceed the annuity premium required. This is clearly excessive.

- Life insurance models must accommodate a large variety of products (i.e. life, health and disability insurance, investment products, etc. in addition to annuities) whereas pension obligations are more consistent between plans. Existing replicating portfolio practices would provide a more realistic and appropriate model for valuing obligations and establishing OSFI Guidance.

- Most replicating portfolios currently use a "runoff method", which projects the evolution of the assets and liabilities over the long term under many economic scenarios, with appropriate target probability levels, model parameters, and numbers of scenarios generated. We do not believe that the added complexity inherent in the LICAT models and the Conditional Tail Expectation (CTE) approach adds value versus a well-designed runoff approach.

- It is not reasonable to expect that pension plan administrators and pension actuaries will currently have stochastic models designed for insurance reserving. They will have to build them and it may not be realistic to expect such models to be ready in time for preparing January 1, 2021, actuarial valuations. Such models are extremely complex and will require significant time. Pension plans will incur significant costs.

Replicating portfolio guidance should be based on existing pension practices rather than life insurance models. However, if OSFI does conclude that significant changes to alternative settlement methods for solvency liabilities are required, then they should be deferred until at least 2022 to allow sufficient time to build the required models, and for employers to plan their budgets, especially in the current uncertain markets.

Financial Support from Employer

In the Draft Guide's requirements for replicating portfolios, the value of the available financial support from the employer, represented by *Amount E*, may be used to reduce the plan's solvency liabilities, becoming an extremely important factor. *Amount E* is to be based on "an assessment of the financial health of the employer…the actuary should consider not only the immediate factors that affect the employer's business, but also the longer term macroeconomic and regulatory environment in which it operates".

ACPM appreciates OSFI's recognition that plan terminations can entail a continuing employer who is obligated to fund a deficit. Considering the strength of the employer would have the effect of higher solvency obligations for employers with lesser financial means, and lower solvency obligations for financially strong employers. We are not aware of any other Canadian pension jurisdiction where the funding rules differ based on employer financial health.

However, as federally registered plans remain obligated to fund on a solvency basis, this approach provides recognition that being a financially strong employer in and of itself increases the probability that the benefit promises will ultimately be met. This principle is akin to less risky organizations paying lower borrowing costs.

Administrators who have the means to provide continued funding and choose to assume to do so, should be able to avail themselves of lower solvency requirements. However, we have some concerns with OSFI's expectations of how employer financial support is determined and by whom:

- The Draft Guide requires the actuary to make the assessment. Actuaries do not typically have sufficient information about sponsors' financial situation to make such judgments, nor is this work covered by any actuarial standard of practice. In many cases, we expect that actuaries will pass the decision on this assumption to the administrator, stating this clearly in the report; however, the Draft Guide is not clear which party carries the responsibility for this assumption.

- To be meaningful and fair, we would ask OSFI to provide clearer direction on what could constitute acceptable criteria for availability of employer financial support. For example, a company credit rating of investment grade (at least BBB), a corporate structure such as a Crown corporation or a letter from the employer attesting that sufficient funds would be available should provide confidence such additional financial support would be available. Such criteria should be principles based, with not all criteria required, in part as not all are meaningful to every employer. The criteria should not be so onerous as to be unacceptable, as we have seen with the funding workout rules. According to a Moody's study, the probability of a credit loss, over a one-year period, for corporates in the lowest investment grade rating category of BBB is only 0.1%.

- Applying the Draft Guide, we believe that if a satisfactory argument can be made that the employer would have access to cash in the future to fund deficits if necessary, such cash would be at least equal to *Amount D,* the maximum permitted. Therefore, we believe that in most, possibly all, cases, *Amount E* will be determined to be equal to *Amount D* or to zero, with no values in between. In practice, we believe a smoother transition should apply. For example, should the financial strength of an employer decline, a significant one-time increase in its pension funding obligation could be detrimental. The requirement to meet a higher threshold should increase gradually.

- Finally, we are concerned regarding the public reporting, insolvency, and other implications for employers. It is possible that an assessment of the employer's financial wherewithal for this purpose could result in unintended consequences for the employer in its business more generally. The employer in its role of administrator is best positioned to balance the above factors and decide what additional financial support should be considered in the determination of solvency liabilities.

The guidance should allow for the administrator to take responsibility for assumptions which are reliant on the financial health of the employer, with the assessment of employer financial support being simple and relying on existing metrics or on the analysis of qualified independent rating agencies.

Definition of High Probability

The use of a replicating portfolio should ensure a high probability that the benefit promises will ultimately be met. In terms of thresholds, the Draft Guide specifies that full-funding probabilities of 90% and 99.5% be reached for *Amounts C* and *D*, respectively, referencing a CTE of 80% and 99% for this purpose. The 90% threshold would apply where additional financial support is available from the employer while the 99.5% would apply to others.

Both the thresholds and the methods specified in the Draft Guide for defining the probability of full funding are unworkable for several reasons including the following:

- The Draft Guide refers repeatedly to the CTE measure, presumably due to its use in life insurance reserving requirements. It is our understanding that insurers can use a CTE between 60% and 80%, while the Draft Guide expects alignment with the upper end of this range. In addition, life insurers are able to diversify their annuity business risk across multiple transactions for the purpose of meeting their capital requirements, rather than testing each transaction in isolation, as is analogous to the Draft Guide's approach. For both of these reasons, the measures required by the Draft Guide may be more stringent than those that apply to insurers.

The definition of CTE for this purpose, and how it is to be applied and interpreted, is not clear in the Draft Guide. We believe this should be removed.

Timeframe for Measurement

In addition to the threshold, the probability for full funding depends on the timeframe for measurement and the treatment of experience gains and losses:

- It is not clear whether, for *Amount C*, the objective is a 90% probability of full funding in one year, or over the long term, or both. A one-year period in our view is inappropriately short. As the current environment illustrates, significant volatility can occur which may not affect long-term outcomes; and

- The draft Guide mentions that "the model should not assume that adverse experience in earlier time periods can be offset by positive experience in later time periods". The pension obligations under the replicating portfolio are determined over the long-term and we believe so should the recognition of experience**.** Otherwise, security margins built into the models to achieve particular thresholds each year will result in much higher probabilities over the long term than indicated by those threshold levels, either under a CTE or another measure.

Given the long-term nature of the pension promises, a longer-term view is rational. ACPM believes that the probabilities of being fully funded should be determined over the expected liquidation period of the plan, or at least 10-15 years, and be inclusive of any margins.

2. Replicating Portfolio – Summary

ACPM questions whether the significant changes to the replicating portfolio guidance are necessary or desirable. Reasons cited for the changes include benefit security, parity with small plans and consistency across plans. However:

- From a benefit security perspective, pension insolvencies at the federal level are uncommon, as noted during previous pension consultations, indicating that a high probability that benefit promises will ultimately be met already exists.

- While replicating portfolios are not available to smaller plans, the objective of the PBSA should be security of benefits, not equity across plans. While it is true that smaller plans are more expensive to operate due to economies of scale for fees and expenses, increasing the burden on larger plans will not improve benefit security or cost effectiveness for smaller plans.

Consistency across plans is the most pertinent justification for change. Consistency will not be achieved by shifting to a LICAT model with extremely high thresholds due to differences within the models themselves. Furthermore, the measures proposed will have an extremely adverse impact on plans, the degree of which is not quantifiable due to the lack of clarity in the requirements.

Consistency across plans would be better addressed in an evolutionary manner by leveraging existing replicating portfolio methods and defining the appropriate level of security. OSFI should continue to consult with the industry to ensure methods are reasonable and impacts on contributions are appropriate.

3. Going concern discount rate assumption

OSFI has imposed a limit on the going concern discount rate assumption for many years. The Draft Guide makes two significant changes to this limit:

- The maximum has decreased, from 6.00% to 5.75%; and
- The maximum is to be applied before deduction of margins for adverse deviations.

It would be useful to better understand how this maximum is set. Rather than setting the maximum discount rate explicitly in the Guide, it may be better to prescribe a formula for the maximum, based on observable economic data. As no one can forecast future asset returns with certainty, various models employed by actuaries will result in a range of expectations. Any limit imposed by OSFI should make allowance for a reasonable range, as well as recognizing the risk/return characteristics of less traditional asset classes. Given how infrequently the limit is updated, care must be taken not to set too low a limit, as it may not be consistent with future changes in market conditions. Indeed, the current crisis illustrates how quickly things can change, and OSFI's analysis may no longer be valid.

The Draft Guide mentions that "the maximum rate should be adjusted by the actuary for a plan using an asset mix expected to generate a lower return than that obtained by using a 50% fixed-income allocation". To make that adjustment and disclose it, the actuary must calculate the expected return on a 50% fixed-income allocation asset mix, which may be higher or lower than the maximum rate of 5.75% proposed by OSFI. It is unclear how the maximum discount rate should be adjusted if it is unclear how the maximum itself is derived.

The Draft Guide requires that a downward adjustment be made to the maximum discount rate for less risky asset mixes, but we believe upward adjustments should also be allowed for riskier asset mixes. Otherwise, OSFI is creating a funding asymmetry. OSFI should provide greater flexibility to actuaries to reflect the actual plan asset mix and risk profile.

Should the proposed changes remain in the final guide, changing both the level of the limit and its meaning results in a very large effective change in a single update of the Guide.

We suggest that these two changes be phased in gradually, perhaps by applying a 5.75% maximum, but before expenses only, and, at a later date, changing the definition to apply before margins.

Applying the maximum before margins imposes an upper limit directly on the actuary's best estimate (compared to the approach in the current Guide, which tests the best estimate and the chosen level of conservatism in combination). However, this could create difficulties and additional margins in cases where the actuary's best estimate exceeds the maximum.

To illustrate this, consider the following example: Assume the actuary's best estimate is 5.85%, and the administrator has selected a margin of 0.40% (for simplicity, we will assume expenses are provided for explicitly, rather than through a reduction in the discount rate). Under the current Guide, the discount rate is 5.45% per year (5.85% - 0.40%), and the margin is clearly specified. Under the Draft Guide, it seems there would be two types of "margin": 0.10% to bring the best estimate in line with the maximum, plus the administrator's margin of 0.40%. What margin does OSFI expect to be disclosed, and how should the effect of the maximum be reported?

The Draft Guide (page 19) also seems somewhat inconsistent on the relationship between the maximum and selected margins: "While margins for adverse deviations may be included in the discount rate for some plans because of this approach [application of maximum rate], the intention is not necessarily that it provides the only source of margins included in the valuation." This sentence seems to imply that the application of the maximum may, on its own, give rise to a margin.

ACPM welcomes the ability provided by the Draft Guide to reflect de-risking strategies that may result in different discount rates for some categories of members. Such an approach is consistent with buy-in strategies and will encourage plan sponsors to review the option of de-risking their plan within their own fund.

4. Treatment of alternative asset management fees

With respect to investment management expenses for alternative asset classes, we are very surprised that OSFI would expect all such expenses to be treated as passive management expenses, and consequently require them to be subtracted from the imposed maximum discount rate. We believe this does not appropriately reflect the characteristics of alternative asset classes that distinguish them from public market assets.

Alternative asset classes, the use of which has increased dramatically over the past two decades, can have low correlations to public markets, so portfolios holding them are more diversified than those that do not. This diversification effect is expected to increase portfolio returns, provided that the alternative assets are expected to achieve net returns at least equal to the expected net returns from the portfolio's public market investments. There are many advantages that alternative investments offer to achieve superior returns over public market investments, including the following:

- They provide illiquidity premiums that public market investments can't provide;
- They can provide exposure to sectors and return streams that are hard to obtain in public markets;
- Their returns can be significantly enhanced through judicious use of leverage;
- They are not constrained to long-only positions, which greatly increases their opportunities for obtaining risk efficient returns; and
- They source unique deals that are not available to most investors and create value by negotiating the terms of their deals, rather than being price takers of plain vanilla public market securities.

For these reasons, alternative assets are expected to generate excess returns over public market investments which more than offset their investment management expenses. Otherwise, they would not be attractive as pension fund investments.

We are concerned that the proposed treatment of investment management expenses for alternative asset classes could have unintended consequences. Pension plans that seek superior risk-adjusted returns through allocations to alternative assets will be penalized, because they will be forced to use lower going concern discount rates relative to pension plans that only invest in public market investments and will be forced to contribute more as a result. Pension plans may react by significantly reducing their exposure to alternative assets to avoid an unnecessary increase in contributions, causing considerable negative impact on benefit security for members and further increasing the cost of DB pension plans for both members and plan sponsors. This would obviously be an undesirable result.

To illustrate, consider a pension plan's decision between a 30% allocation to alternatives with 1% investment management expense, versus a 30% allocation to public market investments with 0.1% passive investment management expense. The required reduction from the imposed 5.75% maximum discount rate is 0.30% if the plan chooses alternatives, compared to 0.03% if the plan chooses public market investments. The plan sponsor may view the impact on contributions from the 0.27% differential in the resulting discount rate as outweighing the benefits to the plan of investing in alternative assets.

Finally, the proposed requirements assume that the pension plan administrator has clear and timely access to detailed investment management expense information. However, this is not necessarily the case for many alternative assets. This underscores the fact that pension funds invest in alternative assets based on expectations for net returns relative to the expected net returns of other asset classes. The proposed requirements to disclose investment management expenses for alternative assets, and to adjust the going concern discount rate for these expenses, may be difficult for plan administrators and actuaries. Furthermore, we question the usefulness and appropriateness of these requirements.

We recommend that returns on alternative assets be considered on a net-of-fees basis in the development of the going concern discount rate, such that no investment management expenses related to alternative assets should be deducted from any imposed maximum discount rate. For consistency, investment management expenses related to alternative assets should not be included in the investment management expense assumption.

5. Risk Assessments - Going Concern Valuation

The Draft Guide largely mirrors the CIA Standards of Practice and thus is an example of where referencing the Standards should be sufficient and would avoid conflicts between the guidance and Standards. However, there are two areas of note.

- The Draft Guide refers to "a description and the impact of any compensating adjustments available to be utilized by the administrator that were reflected in the scenario". ACPM suggests that "to be utilized by the administrator" be deleted. The example in the Standards makes reference to a reduction in margin, which is an administrator responsibility. However, other compensating adjustments may not be.

- Under the Draft Guide, the actuarial report should include a description of any effects of risks in combination, while under the Standards, the actuary may assess the impact of the risks in combination but would not be required to do so. ACPM believes that assessing risks in combination should be discretionary. Most large plans measure risks using assessments outside of the usual actuarial reporting process, such as asset liability modeling and stress testing. Including additional plausible scenarios in the actuarial report would increase costs of actuarial reporting and may not provide any added value.

6. Disclosure

Membership data

ACPM agrees with OSFI that additional disclosure on membership data may be helpful for the reader. However, the actuary should be able to use their judgment as to whether or not it is relevant to split some category of members (e.g. members subject to different pension legislations – may not impact how liabilities are valued if the plan provisions are more generous than the minimum requirements).

Often, summarizing sub-groups of data is costly to produce and provides little insight to interpreting results. A key criterion would be whether the actuary believes that summaries of sub-groups may be material to another user when assessing the results. In many cases, only disclosing the number of members in a particular sub-group would provide sufficient detail.

Stochastic modeling for indexation

The disclosure requirements in the Draft Guide are based on those applicable for stochastic modeling intended for stochastic modeling for the purpose of funding advice, such as a New Brunswick-style shared-risk plan, not for the development of one assumption within a larger valuation when they would be excessive. Justifying an indexation assumption established through stochastic modelling should be similar to other assumptions, for example a retirement assumption based on an experience study.

Alternative settlement methods

ACPM agrees with OSFI that additional disclosure can help OSFI to better evaluate the level of margins taken by the plan under specific situations. The Replicating Portfolio Information Summary (RPIS) already covers the most informative disclosure requirements. So as not to create overly cumbersome disclosure requirements, an interim solution might be to increase the level of disclosure requirements for the most pertinent elements only, analyze the outcome for a few years and arrive with a final recommendation after the analysis has been finalized by OSFI.

Approximations

The Draft Guide states, "The actuary should detail in the actuarial report any approximations and provide a rationale for why their use does not materially affect the results of the valuation." This requirement is highly impractical and is in direct conflict with Section 1410 of the CIA Standards of Practice, being the Section referenced in the footnote. Relevant subsections in Section 1410 are:

- .04, acknowledging that "approximation pervades virtually all work"
- .08, citing examples of approximations, such as mid-year deaths
- .13, discouraging reporting of appropriate approximations to avoid unintended reservations, citing that complete reporting would be impractical due to their pervasiveness

Also relevant is Section 1240 on materiality, and specifically 1240.04, which provides that the actuary would not report an immaterial deviation from guidance except if doing so assists a user to decide whether the standard of materiality is appropriate for the user, the user's decision-making or the user's reasonable expectations. Disclosure should be restricted to elements that materially impact the results, and not create additional work and costs for which there is no value added.

We suggest this requirement be limited to approximations which may be construed as assumptions and, in the actuary's judgement, potentially have a material effect on the results of the valuation.

7. Mortality

The Draft Guide states "OSFI expects the CPM2014 mortality table (and appropriate projection scale) to be used for going concern valuations, unless the actuary explains in the actuarial report why the use of the CPM2014 mortality table would not be appropriate" and requires justification where another base mortality table is chosen or where adjustments are made. Though this wording has not changed substantially since the 2017 Guide, ACPM is concerned that OSFI's preference for the CPM2014 mortality table is contrary to the principles established in the CIA Educational Note – *Second Revision: Selection of Mortality Assumptions for Pension Plan Actuarial Valuations*. Specifically, the Educational Note states "There is no one standard mortality assumption that would apply to all plans. The actuary would apply judgment in selecting a best estimate mortality assumption for the plan under review."

While the actuary should provide a rationale for the assumptions selected, considering the plan's experience and characteristics, such rationale should be restricted to justifying the selected table. Providing a detailed justification for not selecting another table (i.e. the CPM2014 combined table, if it was not selected), could inappropriately raise doubt, suggesting such table merits consideration when, in practice, it may not be a best estimate for a given plan.

For example, ACPM thinks that it is reasonable for a private sector plan to use CPM2014Priv, all other things being equal (public sector plan could use CPM2014Publ), without a detailed justification for not using the Combined table. Unlike the industry adjustment, the study which created the CPM tables found a significant, credible difference in mortality experience between the public and private sectors.

The ACPM believes that the Draft Guide should defer to the CIA Educational Note.

8. Smoothing of Assets

In the Draft Guide, an example is given of an asset smoothing method, in which the difference between actual and expected investment income is spread over a number of years, where the expected investment income is determined based on an assumed rate of return, for the total portfolio or a class of assets, as the case may be. The Draft Guide goes on to limit this assumed rate of return to the discount rate used in the going concern valuation.

Such a limit may be reasonable for a method where actual vs. expected returns for the total portfolio are spread over time, but it is not clear how it would work for a method where returns on only a portion of the portfolio or certain classes of assets are smoothed. For example, if equity returns are smoothed over time, but fixed income returns are not, any limit on the expected return used for this purpose should be related only to the equity component of the portfolio, which may be higher than the going-concern assumption. Using the going concern discount rate in this case would likely create bias in the asset smoothing method, and, as a result, is inconsistent with the CIA's guidance.

We propose that OSFI not prescribe any particular limit on the expected return used in an asset smoothing method. It should be sufficient to rely on the actuary's adherence to CIA guidance on asset valuation methods, and the Draft Guide's requirement that a method "does not produce asset values that are systematically greater than the market value of the total portfolio".

CONCLUSION

Thank you for inviting our comments. With the COVID-19 pandemic, the economic environment has clearly changed since the Draft Guide was published. We encourage OSFI to consider whether the Draft Guide or its implementation should be modified as a consequence.

Nonetheless, we would welcome the opportunity to meet with OSFI and discuss any questions you may have on this feedback either at the next scheduled semi-annual meeting or a special meeting. In the meantime, please feel free to contact us if we can be of further assistance.