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BY E-MAIL

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Subjet: Adjustment and predictability of the maximum interest rate assumption on a going-concern basis

Mr. Gamache,

Association of Canadian Pension Management ("**ACPM**") is the leading advocacy organization for a balanced, effective and sustainable retirement income system in Canada. Our membership manages retirement plans for millions of plan members.

We are writing to express the concerns of some of our members and to provide you with comments regarding the process for adjusting the maximum interest rate assumption on a going-concern basis for actuarial valuations dated after December 30, 2021.

In April of this year Retraite Québec released its instructions for setting the maximum interest rate assumption to be applied for all actuarial valuations after December 30, 2021 (including the effects of rebalancing and diversification). For example, for an investment policy that provides for 50% of plan investments to be fixed-income investments, Retraite Québec expects that the interest rate assumption will be established using a best estimate of the rate of return on investments that does not exceed 5.75%.

For a different investment policy, the actuary should consider this limit as well as the Canadian Institute of Actuaries' educational note to establish a reasonable level of risk premium for the different asset classes.

Historically the maximum interest rate assumption has not changed significantly from year to year, going for example from 6.00% to 5.75% from December 31, 2017 to December 31, 2021. We note that it has been quite rare for a pension plan to meet the limit at a given actuarial valuation and then not meet the limit at the next actuarial valuation due to the adjustment to the maximum interest rate assumption.

We recognize that the current rate adjustment process was quite acceptable in the environment of continued economic growth following the 2008 financial markets crisis. However, in times of economic shock such as we are currently experiencing, more frequent adjustment and/or greater predictability of the maximum interest rate assumption would be desirable.

We understand that as part of its usual process, Retraite Quebec will review its instructions only in early 2023 and will consider the interest rate assumptions used in the December 31, 2021 actuarial valuation reports as well as the most recent forecast of returns for the coming years. While we have no doubt about the thoroughness of this analysis, greater transparency regarding the forecasted returns in future years would be appreciated to facilitate the predictability of the adjustments.

An increase in the maximum interest rate assumption that does not accurately reflect the increase in expected returns could significantly worsen the financial position of some plans, given that returns on assets are strongly negative to date in 2022. On the other hand, a reasonable increase in the maximum interest rate assumption would better reflect future return expectations and in large part maintain the financial position of plans. More than ever, this assumption will be critical in determining the required contributions for the year 2023 for those plans required to file an actuarial valuation as at December 31, 2022. Plan sponsors are concerned about this issue as they prepare their budgets for next year.

We also note that most economic models are already suggesting significant increases in long-term return expectations as of June 30, 2022. For several plans these increases can reach more than 1.00% on the long-term expected rate of return. A significant portion of this increase is due to higher rates of return on fixed income investments and the situation is unlikely to reverse itself before the end of the year. An interim update of instructions may be necessary for those wishing to file an actuarial valuation during 2022.

Proposals

We understand that by regulating the selection of the interest rate assumption, Retraite Québec wants to protect the rights of plan members by reducing the risk of underfunding pension plans due to the use of an unduly high interest rate. However, the current maximum interest rate assumption is too low to account for the new economic environment. We therefore invite Retraite Québec to quickly review its instructions for actuarial valuations dated in 2022. Such an initiative would provide a good indication of the maximum interest rate assumption that could apply at the end of the year and would alleviate the concerns of plan sponsors who must file an actuarial valuation as at December 31, 2022.

We also hope that Retraite Québec will communicate its new instructions for actuarial valuations after December 30, 2022 as soon as possible in early 2023.

We encourage Retraite Québec to disclose additional information on the models inherent in the return forecasts for the next few years in the next update of its instructions for the maximum interest rate assumption. This would make it easier for plan sponsors and administrators to anticipate in-year changes.

Retraite Québec could also consider alternative approaches that would allow for an automatic adjustment of the maximum interest rate assumptions based on economic conditions prevailing at the time of the actuarial valuation.

As always, we would be pleased to discuss our comments and suggestions at your convenience.

Sincerely,

Tina Hobday
Chair of the Québec Regional Council
ACPM

Ric Marrero
Chief Executive Officer
ACPM

cc. Ms. Claudia Giguère, Retraite Québec