May 6, 2016

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Subject: *Regulation to amend the Regulation respecting supplemental pension plans* – Comments by the Canadian Institute of Actuaries (CIA)

The Canadian Institute of Actuaries (CIA) is the national voice of the actuarial profession in Canada. With more than 5,200 members, the Institute puts the public interest ahead of its own, and is dedicated to providing actuarial services and advice of the highest quality.

On April 6, 2016, the Government of Québec published the draft Regulation to amend the Regulation respecting supplemental pension plans. This draft regulation clarifies two requirements introduced by the *Loi modifiant la Loi sur les régimes complémentaires de retraite principalement quant au financement des régimes de retraite à prestations déterminées* (*Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans)*, which came into force on January 1, 2016:

> 1. The information to include with the notice to be sent to Retraite Québec for years where no actuarial valuation is required; and
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> 2. The method for determining the target level for the new stabilization provision (SP) introduced by the *Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans*, replacing solvency funding of pension plans.

We are pleased to offer the following commentary on the draft regulation's provisions.

Section 1

Section 1 amending section 3.1 states that actuaries must provide a notice containing information on the probable financial situation of the plan based on the solvency approach, as well as certification of the plan's degree of solvency on the date of the end of the plan's last fiscal year.

One possible interpretation of the Supplemental Pension Plans Act – as it reads since January 1, 2016 – is that an actuarial valuation not required under section 118 must be complete (i.e., it must include the ongoing basis results), while the notice under section 119.1 must be based on a projection of the last complete actuarial valuation. If this is Retraite Québec's interpretation, the option to calculate the degree of solvency on the basis of unprojected data without having to provide the ongoing basis results would be prohibited. We believe that the public interest would be better served if this option were allowed.

Given that Retraite Québec's interpretation regarding the provisions described above is not known, that the actuary's notice on solvency will not be required until December 31, 2016 and that another regulation is expected this year regarding other aspects of Law 29, the CIA proposes withdrawing this section from the draft regulation and revising this section so that it brings Retraite Québec's objectives adequately into line with the recommendations of the actuarial profession. To that end, the CIA would be pleased to offer its assistance in developing an adapted wording that could be added to the upcoming regulation.

Section 2

Section 60.6

General comment on the concept of duration

We would like to begin by noting that the notion of funding duration is special, because contrary to the duration of solvency liabilities, a 1 percent change in interest rates does not represent an equivalent change in the discount rate. Generally speaking, an interest rate change affects expected yields on fixed-income assets, so it mainly affects a portion of the discount rate, namely that made up of the expected yields of fixed-income assets. Thus, the funding liabilities react in part to an interest rate change. The same dynamic also applies to the duration of assets.

Application of the scale defining the SP

It is possible that the investment policy of certain plans does not define a target or defines the target as being a balanced fund. It is also possible that other plans made changes to their investment policy after January 1, 2016. In these cases, for year one, an interim provision could be adopted to clarify the regulation's application. For example, the entity responsible for the investment policy should decide about the target before the valuation report is finalized, and this update could be retroactively applied to January 1, 2016.

SP level

First we would like to commend the government on adding a second dimension to the scale, in particular to take account of the interest rate risk. The short 30-day comment window precludes the CIA from weighing in on the SP levels prescribed by the regulation. In this regard, the CIA is doing some additional work that will update and improve the CIA's 2013 research paper entitled Provisions for Adverse Deviations in Going Concern Actuarial Valuations of Defined Benefit Pension Plans. We will be pleased to pass along the results to you and help Retraite Québec develop an update of the SP scale, if applicable.

We believe that this scale should be reviewed periodically to ensure its accuracy and its applicability in a different economic environment.

Market risk

We recognize that the proposed scale would link the SP level to the weighting of variable-income assets. We understand that this scale results from a compromise that must not be subject to any changes at the moment. We would be pleased to collaborate with Retraite Québec at a later time to review the scale.

Section 60.7

Definition of certain types of assets

It would be wise to further define the assets mentioned in point 3, "the bond market securities", because these may not consist solely of bonds. For example, a clarification regarding buy-in annuity products would be in order so that they are considered as assets traded on the bond market. The duration of an annuity purchase investment should equal its corresponding liability to reflect the asset-liability matching of this investment. We also suggest specifying the fixed nature of asset-backed securities such as commercial paper and mortgage-backed securities, if applicable.

Assets invested directly in infrastructure or real property

It would be useful to clarify the notion of "direct" investment, because it is unclear whether a plan holding such securities via a common investment fund could consider them as fixed income. Pension funds that invest in infrastructure or real estate generally do so through mutual funds. Therefore, it would be desirable that the consideration or non-consideration of this type of investment (as high as 50 percent) be clearly defined in the regulation.

Section 60.8

Duration of certain types of assets

It is proposed that the duration of each investment be calculated by whoever makes the investment of any portion of the plan asset. It would be useful to specify whether this duration could correspond to an appropriate index in the event that the person making the investment is unable to perform the required calculation for certain types of assets.

In particular, for infrastructure and real estate securities, the concept of duration is not directly applicable and it may be difficult to obtain the required information from managers. The regulation could state that if a duration is not obtained from the one who made the investment, it could be established on the basis of an appropriate index (such as the universe index) or at a fixed value, such as six years. Since 50 percent of these assets can be considered to be fixed income, this strikes us as a reasonable compromise.

Section 60.9

While we understand the need to standardize to some extent the process for calculating the duration of liabilities, the CIA educational note calls for a method based on use of a one-basis-point increase in the discount rate. We recommend using this approach.

Additional remarks

The draft regulation does not deal with other amendments made by Law 29, on such questions as funding policy, purchase of annuities, changes in the surplus asset sections, and the withdrawal of an employer participating in a multi-employer plan. We assume that other draft regulations addressing the other Law 29 amendments will follow shortly.

As always, the CIA remains at your disposal for any assistance in the work ahead.

Thank you for taking the time to consider our comments. If you have any questions, please feel free to contact Joseph Gabriel, CIA staff actuary, education, by telephone at 613-236-8196, ext. 150, or by email at joseph.gabriel@cia-ica.ca.

Yours truly,

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