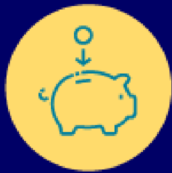
FSRA Financial Services Regulatory Authority of Ontario

ARSF Autorité ontarienne de réglementation des services financiers

www.fsrao.ca



Quarterly update on

Estimated Solvency Funded Status of Defined Benefit Pension Plans in Ontario

June 30, 2020

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Introduction

Each quarter, FSRA monitors the solvency funding position, and publishes the estimated solvency ratios of Ontario Defined Benefit (DB) pension plans that are subject to solvency funding. This is one of the supervisory tools FSRA utilizes to improve outcomes for pension plan beneficiaries and to proactively engage in a dialogue with plan sponsors where there may be a concern over the security of the pension benefits.

It should also be useful for plan fiduciaries who must adhere to a high standard of care in administering their pension plans and investing the plan assets. Having an effective governance framework in place with a good understanding of the key risks facing the plan, their impact and risk mitigation strategies are key to ensuring the desired outcomes and the ability to weather a number of stress events. For example, having due consideration to the plan's ability to absorb fluctuations in funding costs and the probability of delivering the promised benefits under a range of possible outcomes that may result from the funding and investment strategy are important elements of a plan administrator's duty as a fiduciary.

Projected Solvency Position as at June 30, 2020

As capital markets rallied over the quarter ending June 30, 2020, the median projected solvency ratio increased to 90%.

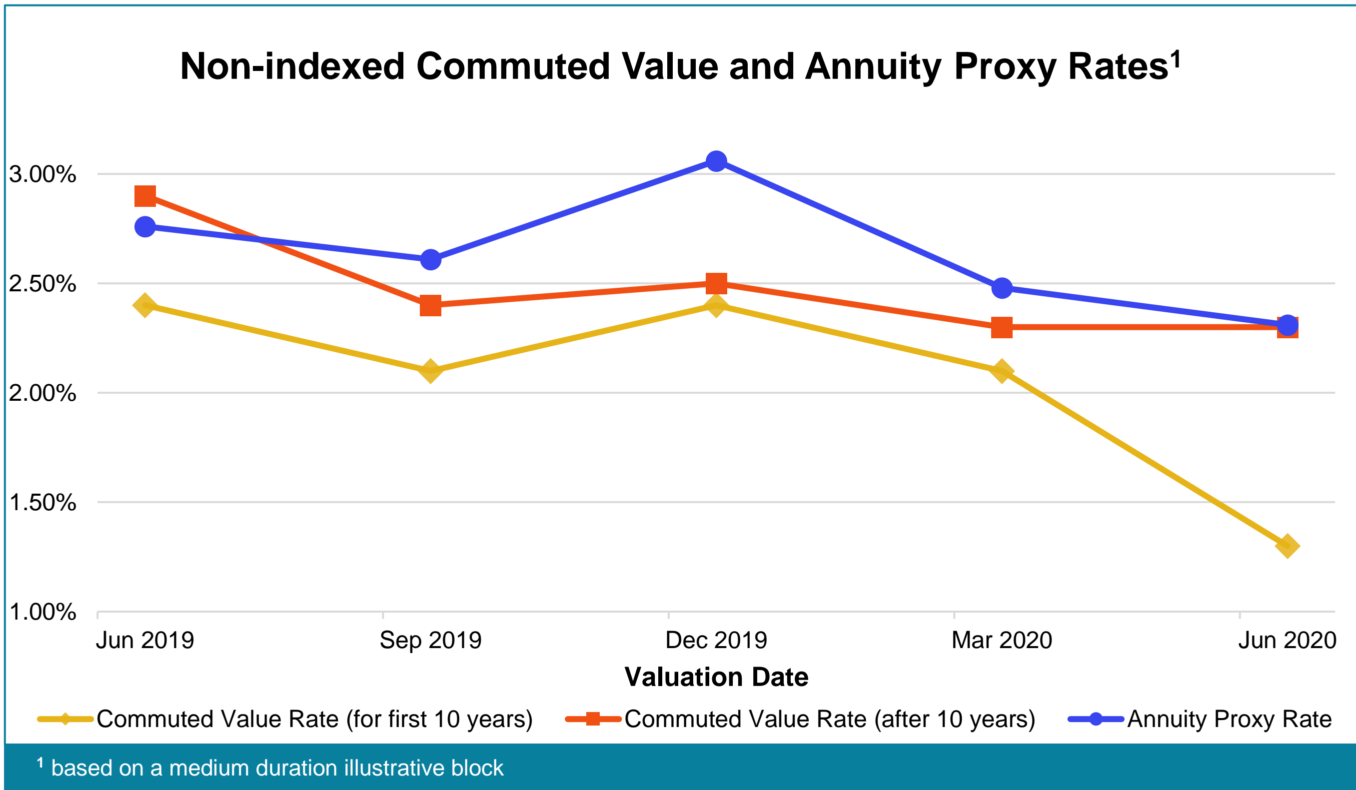
- About three quarters of the plans are estimated to have double-digit investment returns in Q2 2020, however the impact is partially offset by the decline in solvency discount rates over the quarter.
- This resulted in the median projected solvency ratio increasing to 90% at June 30, 2020, up from 85% at the end of March.
- 26% of pension plans are projected to be fully solvency funded at June 30, 2020, while 36% are projected to have a solvency ratio below 85%.

The World Health Organization declared the COVID-19 outbreak as a pandemic on March 11, 2020 and global equity market indices dropped sharply to their lowest levels of the year just before the March 31, 2020 quarter end. Fortunately, fears of continued deterioration did not materialize and capital markets rallied in Q2 2020, even as the economy was constrained by efforts to contain the outbreak. Despite the rebound in asset values this past quarter, the vast majority of plans opened the year in a stronger funded position on a solvency basis. Many plan administrators are reviewing or have reviewed their funding and investment strategies so they can prudently manage their plans through the cycle – those who have not are strongly urged to do so.

Projected Solvency Position as at June 30, 2020	Q2 2020	Q1 2020	Q4 2019
Median solvency ratio	90%	85%	99%
Percentage of plans with a solvency ratio greater than 100%	26%	14%	48%
Percentage of plans with a solvency ratio between 85% and 100%	38%	35%	42%
Percentage of plans with a solvency ratio below 85%	36%	51%	10%

The projected solvency position of pension plans improved in the second quarter of 2020. The 5% increase in the estimated median solvency ratio since March 31, 2020 is attributable to:

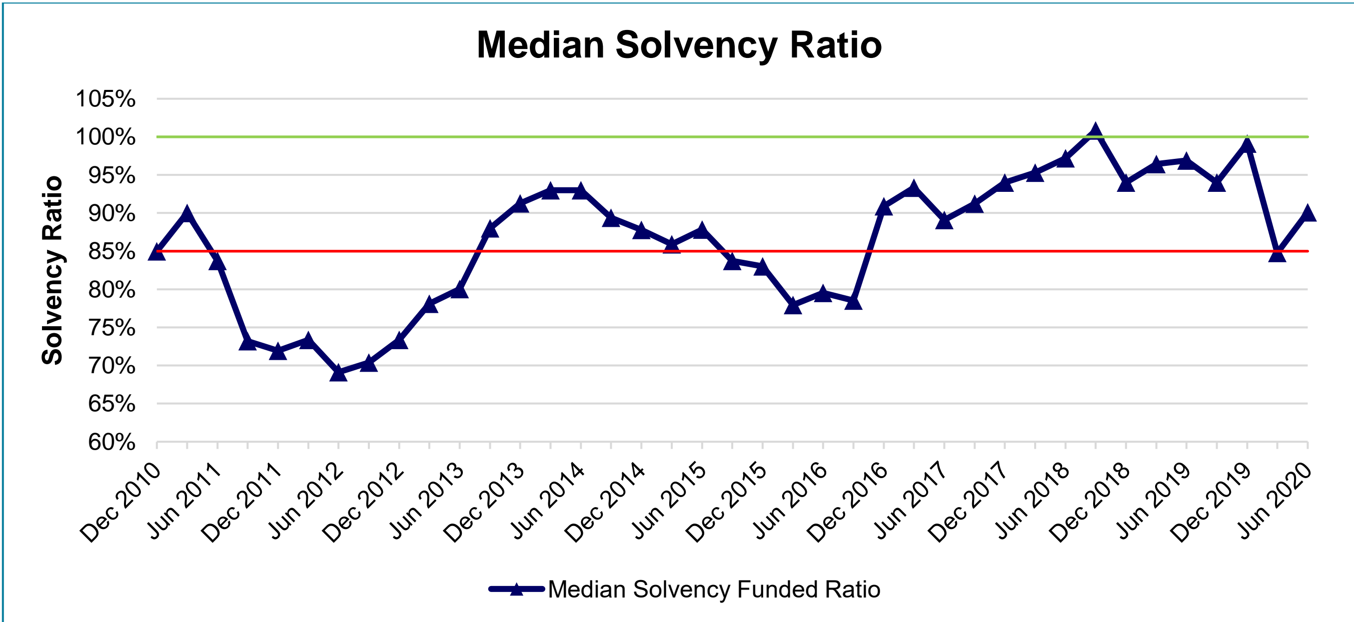
- Strong Q2 2020 pension fund investment returns from the rally in capital markets in Q2
  - The average second quarter 2020 gross and net, after expense, return estimates are 11.1% and 10.9% respectively.
- A decrease in solvency discount rates
  - There was a significant decrease of 0.80% in the commuted value discount rate applicable in the first 10 years, reaching historical lows. However, the solvency discount rates applicable for longer durations were relatively flat.



COVID-19 continues to have a major negative impact upon world economies. Canada, as well as other countries, have thankfully seen a decline in new COVID-19 cases from earlier peak values, while unfortunately some countries are still experiencing an increase in new cases. Canadian provinces and other parts of the world have begun plans to reopen their economies, providing a path towards increased economic activity.

U.S. and Canadian financial market conditions have improved. Equity markets have recovered sharply, with the S&P 500 up 21% and the S&P/TSX Composite up 17% for the quarter. As well, oil price benchmarks have rebounded from this year's lows, but still remain below last year's levels. Economically, real gross domestic product is expected to have declined dramatically in Canada and many other countries. At May, the Canadian unemployment rate has increased rapidly to 13.7% from 5.6% in February and CPI inflation of -0.4% is below the Bank of Canada's target range band.

Fiscal and monetary policies remain supportive. In the US, individuals and businesses received funds from the CARES Act and there are now discussions for another large relief package to possibly follow. The Federal Reserve continued with select asset purchases to support the functioning of markets and maintained a federal funds target range of 0% to 0.25% for the quarter. In Canada, the COVID-19 Economic Response Plan includes $212 billion for direct support of individuals and businesses. The Bank of Canada increased liquidity in funding markets through asset purchase programs and has kept the overnight target rate at 0.25% throughout the quarter.


Median Solvency Ratio
Solvency Ratio
105%
100%
95%
90%
85%
80%
75%
70%
65%
60%
Dec 2010
Jun 2011
Dec 2011
Jun 2012
Dec 2012
Jun 2013
Dec 2013
Jun 2014
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Dec 2016
Jun 2017
Dec 2017
Jun 2018
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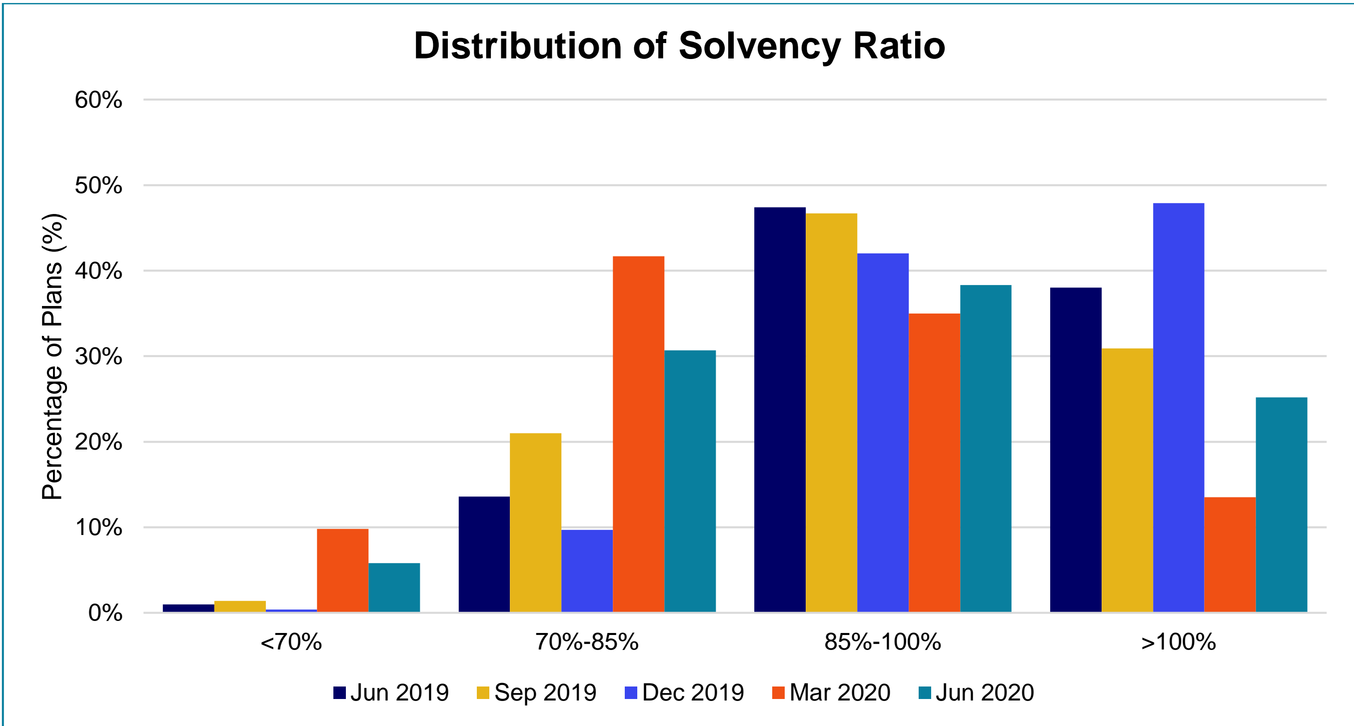
Jun 2020
Median Solvency Funded Ratio


Distribution of Solvency Ratio
Percentage of Plans (%)
60%
50%
40%
30%
20%
10%
0%
<70%
70%-85%
85%-100%
>100%
Jun 2019
Sep 2019
Dec 2019
Mar 2020
Jun 2020

Methodology and Assumptions

1. The results reported in each plan's last filed actuarial valuation reports (assets and liabilities) were projected to June 30, 2020 based on these assumptions:
   - sponsors would use all available funding excess and prior year credit balance for contribution holidays, subject to any statutory restrictions;
   - sponsors would make normal cost contributions and special payments, if required, at the statutory minimum level;
   - cash outflows were assumed to equal pension amounts payable to retired members as reported in the last filed valuation report. Plan administration costs were not directly reflected in cash outflows, but indirectly through net, after expense investment earnings.
   - projected liabilities were calculated based on the Canadian Institute of Actuaries' (CIA) Standards of Practice for Pension Commuted Values and the CIA annuity purchase guidance applicable at the projection date.

2. Each plan's actual net rates of return are calculated based on its most recently filed Investment Information Summary (IIS) information. Where returns needed to be estimated, this was done using the IIS asset allocation in combination with market index returns, offset by a 25 basis point quarterly expense charge.

   The following table summarizes the average IIS plan asset allocations by major asset class based on the most recent filed IIS:

Cash	Canadian Equities	Foreign Equities	Fixed Income[2]	Real Estate	Other
2.4%	21.4%	21.5%	48.8%	4.7%	1.2%

[2] 50% FTSE TMX Universe Bonds and 50% FTSE TMX Long Term Bonds.

   Market index returns on the major assets classes have been as follows:

	S&P / TSX Total Return Index	MSCI World Total Net Return Index	FTSE TMX Universe Bond Index	FTSE TMX Long Bond Index
Q2 2020	17.0%	14.2%	5.9%	11.2%
Q1 2020	-20.9%	-13.3%	1.6%	0.2%
Q4 2019	3.2%	6.3%	-0.8%	-1.9%
Q3 2019	2.5%	1.9%	1.2%	2.5%