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Asset Smoothing for Solvency Valuations and Contribution Holidays - Questions and Answers

Archived Content

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Asset Smoothing for Solvency Valuations

Q1. Ontario regulations permit the use of an asset smoothing method for the purpose of a solvency valuation. Does FSCO have a formal policy that imposes a limitation on the application of such method?

A1. FSCO does not have a formal policy limiting the application of an averaging method that stabilizes short term fluctuations in market value of plan assets (asset smoothing method). However, in reviewing any asset smoothing method used in a solvency valuation, FSCO staff will consider the following principles:

- The method should be consistent with the current actuarial practice in Canada, i.e.,the guidelines on asset smoothing methods as set out in the Educational Note issued by the Canadian Institute of Actuaries;
- The method should have the effect of stabilizing the short-term fluctuations in the market value of the plan assets;
- The method should be appropriate for the circumstances of the plan;
- Once an asset smoothing method is adopted for a valuation, it must be applied consistently in future valuations unless otherwise justified by the circumstances of the plan (e.g.,where the plan is merged with another plan); and
- The report should describe the method in sufficient detail so as to enable another actuary to follow the development of the smoothed asset value.

FSCO does not intend to impose a limit on the deviation between the smoothed asset value and the market value. However, the actuary who prepares a report should apply his or her professional judgment as to whether it is appropriate to impose a limit in light of the circumstances of the plan. - 12/08

Contribution Holidays - Application of Subsections 7(3.1) and (3.2) of Regulation 909

Based on the regulations released in June of 2009, contribution holidays for plan fiscal years ending after June 29, 2010 and before January 1, 2013 are not permitted unless an actuarial cost certificate is filed with the Superintendent within the first 90 days of the fiscal year and that cost certificate demonstrates that the plan has sufficient funding excess that can be applied to reduce all or a portion of the contributions for normal cost for the year. These provisions do not apply to designated plans. Below are a series of questions and answers about these requirements.

Timing

Q2. Will there be any ability for plan administrators to request an extension of the deadline for filing the actuarial cost certificate if it proves impossible to complete the work by that date? Our concern is that a plan with a significant surplus (potentially excess surplus from ITA perspective) may be forced to make contributions throughout a fiscal year because of a late filing of the cost certificate (despite the fact that there are sufficient assets in the plan to support a contribution holiday).

A2. Where an actuarial gain under subsection 7(3.2) of the Regulation exists, but the administrator is unable to file the actuarial cost certificate by the deadline, FSCO would consider granting a request for an extension of the time to file the certificate, provided the time period requested for the extension and the circumstances that give rise to the need for an extension are reasonable in the circumstances. (See Policy on Extension of Deadlines for Filings for more information about applying for the extension of a procedural time limit). If the actuarial cost certificate is not filed on time and if an extension of the time for filing the cost certificate is not granted, a contribution holiday cannot be taken. However, there are provisions in the PBA and Regulation relating to refunds of over-contributions that may be of assistance in such a case. - 06/10

Q3. In a situation where the new cost certificate cannot support ongoing contribution holidays, my assumption is that the requirement to remit current service cost contributions would be retroactive to the beginning of the fiscal year. When would this retroactive contribution have to be made?

A3. It is correct that current service contributions would be required retroactively if an actuarial cost certificate is not filed pursuant to subsections 7(3.1) and (3.2) of Regulation 909 or if filed, indicates that normal cost contributions must resume prior to the date the actuarial cost certificate is filed. Under subsection 4(4) of the Regulation, normal cost contributions are payable within 30 days after the month for which the contributions are payable. For purposes of the retroactive contributions that are required due to expiry of the contribution holiday period, FSCO will accept the payment of the normal cost contributions by the later of the time limit specified in subsection 4(4) of the Regulation or 120 days after the beginning of the plan fiscal year. - 06/10

Market value vs. market-related value (smoothing)

Q4. Based on our understanding of the regulations adopted in June of 2009, the determination, under section 7(3.1) and 7(3.2), whether the plan has sufficient funding excess to reduce all or a portion of the contributions for normal cost for the year would be done on a market-value basis and would not reflect the impact of any smoothing that may be used in the actuarial valuations (on either the going concern or the solvency basis). Can you please confirm that this is the case?

A4. For the purposes of clause (a) of subsection 7(3.2), the going concern assets and estimated going concern liabilities should be determined on the same basis used in the last filed valuation report. For the purposes of clause (b) of subsection 7(3.2), both solvency assets and estimated solvency liabilities must be determined on a market-value basis. - 06/10

Preparation of the cost certificate

Q5: The cost certificate is required to include an estimate of the going concern and solvency liabilities as well as the normal cost for the fiscal year commencing on the valuation date of the certificate. In calculating these amounts, would FSCO accept an approach where the amounts of those liabilities and normal cost are rolled forward from the results of the most recently filed valuation (with adjustments for any changes in actuarial assumptions and known significant changes in pension plan demographics over the intervening period)?

A5. In preparing the cost certificate, the actuary should perform the calculations in accordance with accepted actuarial practice, any applicable professional standards and FSCO’s published policies. FSCO will not be providing any specific guidance on the methodology for preparing estimates of the going concern or solvency liabilities and the normal cost. - 06/10

Q6. FSCO's Policy on Actuarial Filing for Plan Amendments contains a requirement for a 5% loading to going concern and solvency liabilities to allow for estimation errors. Would a similar requirement be imposed for the cost certificates that are required to be filed under the new regulations?

A6. While FSCO's Policy applies to actuarial filings at the time of plan amendments, we believe that the guidance contained in the policy with respect to cost certificates is equally applicable to other situations where an estimate of the liabilities is required. Therefore, FSCO strongly suggests that the 5% loading to the going concern and solvency liabilities to allow for estimation errors should be applied in preparing these estimates. - 06/10

Filing of a full valuation report at the same date as the effective date of the cost certificate

Q7. How would the new rules be applied in a situation where a full valuation is filed with the same effective date as the cost certificate and where the full valuation used smoothing (on either the going concern or the solvency basis)? For example, consider a situation where a triennial valuation needs to be filed as at December 31, 2009 for a plan with a December 31st year-end. In this situation, the cost certificate would be due by April 1, 2010 and the full valuation report would be due by September 30, 2010. Let us say that on the market value basis, the plan now has a slight deficit and that on a smoothed basis the plan has sufficient surplus to cover the current service cost for the next couple of years. We are not entirely clear on what happens under the regulations adopted in June of 2009. Specifically, the requirements to file a cost certificate (on a market basis) within 90 days from the beginning of each fiscal year in order to continue current service contribution holidays would suggest that contributions towards current service cost have to be resumed effective January 1, 2010 irrespective of what results are shown in the actuarial valuation report.

A7. In the situation you described where a full valuation is filed with the same effective date as the actuarial cost certificate previously filed, our view is as follows:

- For the first fiscal year covered by a filed valuation report, contributions must be made in accordance with the funding requirements set out in that report, regardless of whether an actuarial cost certificate was previously filed.
- For subsequent fiscal years, contribution holidays must be supported by an actuarial cost certificate prepared and filed in accordance with subsections 7(3.1) and (3.2) of the Regulation. - 06/10