FSRA
Financial Services Regulatory Authority of Ontario

ARSF
Autorité ontarienne de réglementation des services financiers

www.fsrao.ca

Report to the pension sector on:

FSRA's New Approach on Reviewing s.19 Commuted Value Transfer Applications

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Introduction

On March 11, 2020, the World Health Organization declared the Coronavirus (COVID-19) a global pandemic and soon after Ontario declared a state of emergency. Between late February and early April, financial markets dropped significantly, and already low interest rates declined further. This combination meant that the transfer ratios of many DB pension plans dropped sufficiently to require those plans to cease commuted value (CV) transfers.[1] Unless a plan administrator determined it was not prudent to continue with CV transfers, plans were required to obtain FSRA's approval in order to recommence carrying out those transfers.

As a result of this market volatility, on May 22, 2020, FSRA released a new Approach document, "Limitations on Commuted Value Transfers and Annuity Purchases (DB pension plans)". The Approach provided guidance to the sector on how FSRA would review applications (Form 10) by plan administrators seeking to continue CV transfers when section 19(4) or (5) of Regulation 909 under the Pension Benefits Act is engaged. This new Approach was accompanied by a new review process, including assembling a multi-disciplinary team to review each application. FSRA was able to consider the circumstances and nuances of each application, avoiding a one size fits all approach.

While the number of Form 10 applications received week-over-week has declined significantly since Q2, FSRA intends to continue with its current approach to reviewing these applications. FSRA also intends to use our findings, as summarized in this report to consider whether adjustments to its Approach and internal processes are required.

What factors did the regulator consider?

Plan administrators and other plan fiduciaries are responsible for prudently managing risks in their pension plans, making decisions taking into account the interests of all beneficiaries to ensure that pension promises can be delivered over the long-term.

In addition to those factors outlined in the Approach, FSRA considered other factors such as the magnitude of the drop from the last filed valuation, any additional contributions made by the employer, the potential further reduction of the plan's Transfer Ratio (TR) if the application were approved in whole or in part, the asset mix of the plan, and the financial health of the plan sponsor.

In some instances, FSRA reached out and engaged with the plan administrator and/or its agent. FSRA usually requested additional information such as the impact of the pandemic on the employer's operations and revenue, any liquidity issues, recent and/or expected number of terminations and historical and expected annual number of CV transfers.

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[1] Sections 19(4) and (5) of Regulation 909 under the Pension Benefits Act.

How many applications did the regulator review and what were the results?

In the second and third quarters of 2020, FSRA reviewed almost 240 Form 10 applications.

Key highlights

- Approximately 80% of the applications were made by single employer pension plans (SEPPs) and 20% by multi-employer pension plans (MEPPs) and jointly sponsored pension plans (JSPPs).
- Approximately 95% of the applications reviewed were approved to pay out all or a portion of each CV transfer.
- Approximately 70% of the applications were approved as requested on the Form 10; however, in almost 25% of the applications, the request was approved for an amount less than requested.
- 5% of the applications received no approval, largely due to concern that continuing to pay out CVs did not adequately protect plan members whose pension benefits remained in the plan.

SEPP applications

The table below broadly shows a breakdown of FSRA's approvals as well as the approximate TR ranges for each.

Approval Received	Number of Applications	Average SEPP Updated TR Range[1]
Approval to transfer the full CV	49	0.75 – 0.90
Approval to transfer the full CV with a top-up payment *or* Transfer only up to the TR (balance within 5 years)	115	0.65 – 0.79
Approval to transfer the full CV with a top-up plus PfAD payment	14	0.60 – 0.75
No Approval	13	0.50 – 0.65
Total SEPP Applications	**191**	

[1] Updated TR in this column refers to the TR identified on the Form 10 as the updated TR (most recently determined TR). Outliers and plans that offered a top up payment but which would have been approved for a full CV without a top up payment have been removed from the range. This is to provide a more instructive understanding of the TR ranges per type of approval received.

Key observations

- Generally, SEPPs with TRs that were at least 0.75 received approval to transfer full CVs.
- SEPPs with TRs between 0.65 and 0.79 generally received approval to transfer full CVs with a top-up payment (or to transfer at the TR with the balance paid in at most 5 years).

MEPP applications

FSRA received over 40 applications from MEPPs which generally received approval to continue with CV transfers.

The Form 10 application focuses on the TR of a plan – which is similar to a wind-up funded ratio. Under the legislative framework, most MEPPs are not required to fund on a solvency basis. FSRA engaged many of these plans initially to assist in determining other relevant metrics in evaluating these applications, including:

- Details regarding the reduction of the number of hours worked by members that directly affected the employers' or employees' contribution amounts.
- A plan's going concern funded ratio.
- The unique ability of these plans to reduce pension benefits retroactively.

In addition, in some MEPPs, FSRA observed very low ratios of lump sum payouts compared to plan assets, and this was confirmed in conversations with several plan administrators.

The engagement with these plans was helpful in better understanding the relevant metrics to consider and the unique characteristics of MEPPs.

Notification by plan administrators who temporarily cease CV transfers

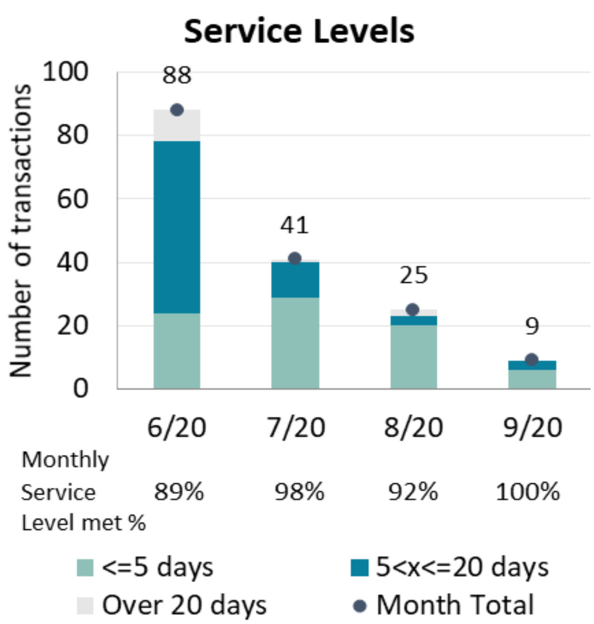
FSRA also received notifications from nine pension administrators indicating a decision to voluntarily and temporarily cease CV transfers. Most of these plans were SEPPs.

As a fiduciary, FSRA expects that the plan administrator would have considered many factors in arriving at that decision, including the plan's funded level, the plan sponsor's financial stability, the level of terminations expected, the prospect of decreasing employer contributions in the short-term or other relevant variables. FSRA has acknowledged these plan administrators' decision to cease CV transfers and will follow up with them; such plans should have a plan to be able to recommence CV transfers in the coming months.

How Long did it take the regulator to process applications?

FSRA's Approach outlined two streams, expedited and in-depth, with service standards of five business days and 15-20 business days respectively.

The graph below illustrates FSRA's response time for Form 10 applications.



Key Observations:

- FSRA developed its new Approach to CV transfer applications throughout April and May. While some applications were processed during that time, most applications were put on hold pending the release of FSRA's new Approach.
- FSRA worked throughout June to process the applications that were put on hold the previous months (approx. 80) as well as many of the 88 applications that were submitted in June.
- After June 2020, FSRA met the service standard over 92% of the time.

[1] Graph does not include 76 applications received March – May 2020 prior to issuance of new Approach.

Key Learnings

1. Calculating and Identifying a 10% TR drop:

- The 10% drop is a relative calculation not an absolute one. For example, if the last valuation report showed a TR of 80% and the administrator determined that the TR dropped to 71%, this would be a drop of 11.25%, not 9% and would trigger an automatic cessation of CV transfers.
- If a significant event occurs, an administrator must satisfy itself that the plan's TR has not dropped 10% or more since its last filed valuation report, triggering the legislated cessation of CV transfers. Many plan administrators have adopted a practice of monitoring the plan's TR on a quarterly or other regular basis. While this is a prudent practice, if a significant event occurs, a plan administrator should not wait for a time that coincides with a planned update or full valuation (unless that delay is minimal) to determine whether a drop of 10% has occurred. At most, one month would be at the long end of such a timeframe.
- A full valuation is not required to determine a 10% drop. Roll forwards with reasonable assumptions and approximations are acceptable.

2. **Determining a plan's last filed valuation report:** Sections 19(4) and 19(5) refer to the report most recently filed under section 3, 4, 13 or 14 of the regulations. A cost certificate with respect to an asset transfer is not such a report and should not be used to determine whether a 10% TR drop occurred.
3. **Investment Information Summary (IIS) filing inaccuracies:** Plan administrators should closely follow FSRA's instructions for completing the IIS. In particular, the split of benefits paid (line 341) and transfers from the pension plan (line 351 - transfers into other pension plans, LIRAs, LIFs, LRIFs, etc.) needs to be entered correctly so that FSRA is able to appropriately consider how CV transfers could potentially impact the transfer ratio.
4. **Timing of submitting a Form 10 application:** While plan administrators should take steps in reasonably short order to determine if CV transfers must cease, the plan administrator may delay submitting an application to FSRA until it receives a request from a beneficiary for a CV transfer. However, the TR date submitted on the application must be as at the date when the plan administrator knew or ought to known that the pension plan's TR had dropped. For example, for the vast majority of plans filing a Form 10 application with FSRA in 2020, the new TR was calculated as of a date in March or April. If a plan administrator did not file the Form 10 until September, the TR should still have been provided as at the March/April date.
5. **Factors contributing to the TR drop:** There was no clear trend between underlying factors, such as asset mix, liability characteristics, actuarial assumptions used, and the level of the drop in the TR.
6. **Misclassification of assets:** FSRA also observed that plans investing solely or primarily in pooled funds or balanced funds frequently reported the level of fixed income vs equity investments incorrectly. Reporting should be based on the nature of the underlying assets. FSRA is aware that the IIS filing (Form 8) and instructions require more clarity.