FSRA
Financial Services Regulatory Authority of Ontario

Ontario

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Quarterly update on

Estimated Solvency Funded Status of Defined Benefit Pension Plans in Ontario

March 31, 2024

25 Sheppard Avenue West
Suite 100
Toronto ON
M2N 6S6
Telephone: 416-250-7250
Toll free: 1-800-668-0128

25, avenue Sheppard Ouest
Bureau 100
Toronto (Ontario)
M2N 6S6
Téléphone: 416 250-7250
Sans frais: 1 800 668-0128

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 achieving the desired outcomes and enhancing the ability to withstand periodic stresses. 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 March 31, 2024

The median projected solvency ratio reached another all-time high at the end of the first quarter of 2024. Positive asset returns with persisting high interest rates strengthened the funded status, with 90% of plans projected to be fully funded as at March 31, 2024.

- The median projected solvency ratio was 122% as at March 31, 2024, a 3% increase from 119% as at December 31, 2023.
- The percentage of pension plans that were projected to be fully funded on a solvency basis as at March 31, 2024 was 90% compared to 89% as at December 31, 2023. The percentage of plans falling below an 85% solvency ratio was 2%, unchanged from last quarter.
- The investment returns in Q1 2024 averaged a net return of 2.3%.
- Overall solvency discount rates increased marginally since the last quarter resulting in a slight decrease in plan liabilities.

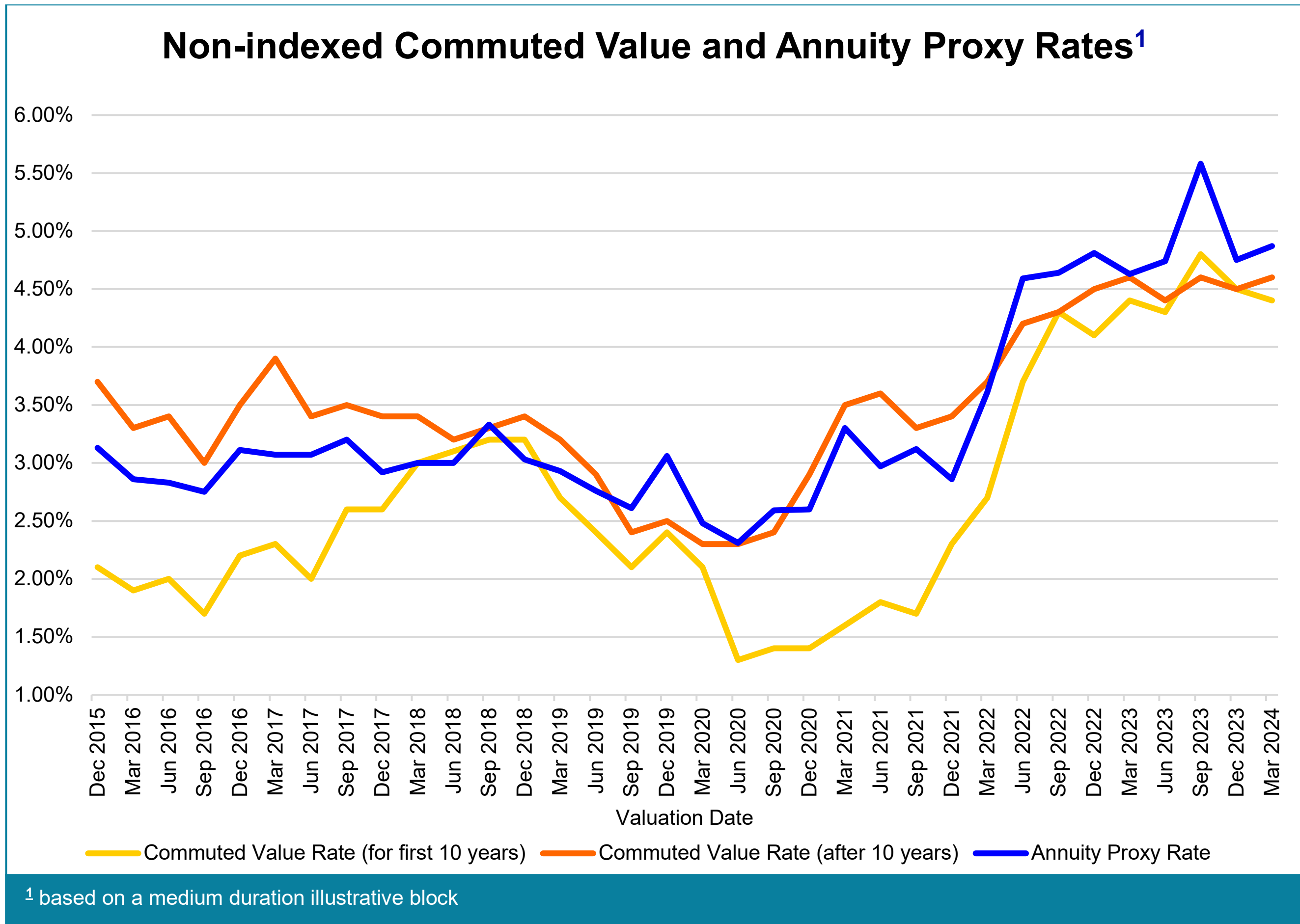
The current level of solvency discount rates, which started trending higher since early 2022, has led to a significant decline in liabilities for defined benefit pension plans. Consequently this has contributed to a marked improvement in funding levels throughout 2022 and 2023, with 90% of pension plans estimated to be in surplus in Q1 2024. While the current state of affairs should be celebrated, plan administrators and sponsors need to be prepared for potential future changes, particularly in long-term interest rates. The Bank of Canada maintained its key overnight rate at five per cent for the sixth consecutive time, waiting for sustained evidence of declining inflation before considering rate cuts. As an example of the potential impact of lower rates – if solvency discount rates reverted to the low levels seen in 2021, the median solvency ratio could potentially decrease 25%.

Looking ahead, it would be prudent for plan administrators to adopt a proactive approach to risk management and reassessment of investment and funding strategies in order to maintain the financial health of their pension plans.

Projected solvency position as at March 31, 2024	Q1 2024	Q4 2023	Q4 2022
Median solvency ratio	122%	119%	112%
Percentage of plans with a solvency ratio greater than 100%	90%	89%	81%
Percentage of plans with a solvency ratio between 85% and 100%	8%	9%	17%
Percentage of plans with a solvency ratio below 85%	2%	2%	2%

The projected solvency position, in aggregate, improved since last quarter. The 3% increase in the estimated median solvency ratio since December 31, 2023 is attributable to:

- Positive Q1 2024 pension fund investment returns
    - The average first quarter 2024 gross and net, after expense, return estimates were 2.6% and 2.3%, respectively.
- Marginal change in solvency discount rates
    - The non-indexed commuted value discount rates for the select period decreased by 10 bps and for the ultimate period increased by 10 bps. The non-indexed annuity purchase discount rate increased by 12 bps. This resulted in an overall decrease in pension liabilities.



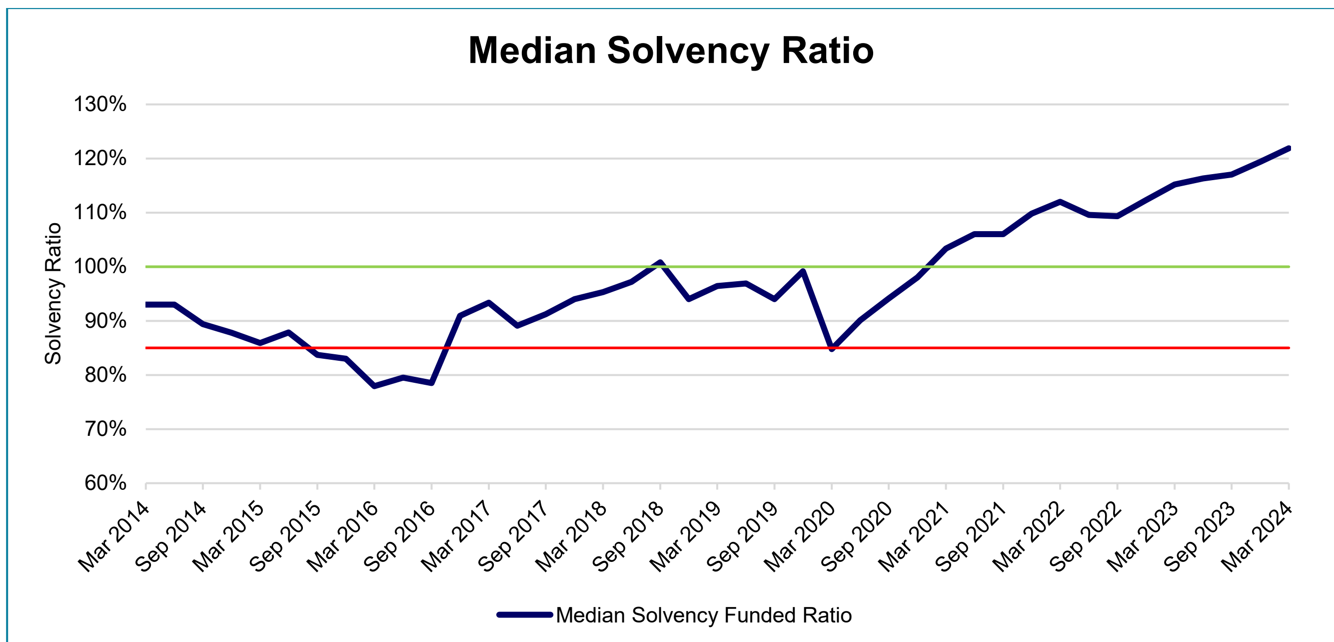
[1] based on a medium duration illustrative block

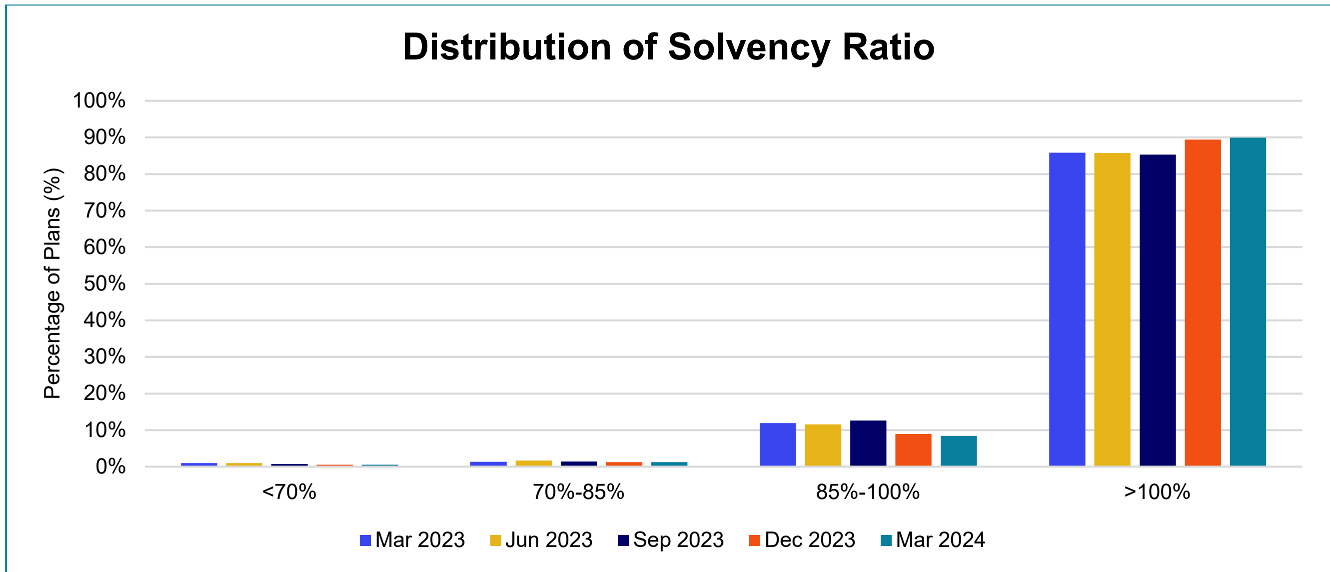
The first quarter of 2024 provided strong equity returns and declining inflation, but the Canadian economy also experienced concerns about rising shelter costs and long-term declines in labour productivity. Trade disruptions caused by geopolitical tensions continued to be a factor affecting the Canadian and international economies. Canadian GDP increased 0.6% and 0.4% in January and February 2024, respectively, and the Bank of Canada (BoC) increased their 2024 GDP growth forecast to 1.5% from 0.8%. Canadian CPI inflation declined to 2.8% in February 2024, from 3.4% in December 2023, and the BoC expects inflation to reach 2% in 2025. The shelter component of CPI was 6.5% in February, raising concerns about the Canadian housing market and the costs of shelter for average Canadians. Unemployment increased to 6.1% in March 2024 amid worries about declining labour productivity.

The first quarter of 2024 saw modest increases in Canadian government benchmark bond yields, with the 2-year rate increasing to 4.17% and 10-year rate increasing to 3.45%. Equities markets continued to provide strong positive returns, with the S&P / TSX Composite Index returning 6.6% in Q1 2024, while the FTSE Canada Universe Bond Index returned -1.2%. The Canadian dollar declined relative to the US dollar by about 2%, dropping to 0.7386 USD per Canadian dollar.

Global equities also performed well in Q1 2024 with the S&P 500 Index returning 13.3%, the MSCI EAFE Index returning 8.5% and the MSCI Emerging Markets Index returning 5.0% (all in CAD$).

In Q1 2024, the BoC held the policy interest rate at 5.00%, the same level from July 2023, and the US Federal Reserve maintained the federal funds target range at 5.25% to 5.50%. Both the BoC and the US Federal Reserve proceeded with quantitative tightening and continued to reduce balance sheet holdings while messaging an openness towards rate reductions should positive data on inflation develop.





Methodology and assumptions

1. The results reported in each plan's last filed actuarial valuation reports (assets and liabilities) were projected to March 31, 2024 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 and Short-Term Investments	Canadian Equities	Foreign Equities	Fixed Income	Real Estate	Other
3.5%	19.2%	19.7%	50.1%	6.4%	1.1%

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

	FTSE Canada 91-day T-Bill Index	S&P / TSX Total Return Index	MSCI World Total Net Return Index	FTSE Canada Universe Bond Index	FTSE Canada Long Term Bond Index	Cohen & Steers Global Realty Majors Index
Q1 2024	1.2%	6.6%	11.7%	-1.2%	-3.6%	2.3%
Q4 2023	1.3%	8.1%	8.7%	8.3%	14.8%	14.3%
Q3 2023	1.2%	-2.2%	-1.4%	-3.9%	-9.5%	-3.9%
Q2 2023	1.0%	1.1%	4.5%	-0.7%	0.6%	-2.5%