FSRA Financial Services Regulatory Authority of Ontario

Ontario

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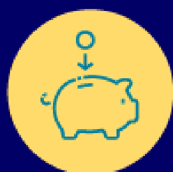

Quarterly update on

Estimated Solvency Funded Status of Defined Benefit Pension Plans in Ontario

September 2024

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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 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 September 30, 2024

After seven consecutive quarters where the median projected solvency ratio steadily increased, the trend has been broken as it deteriorated over the quarter. While the overall funded position of plans remains strong at 121%, this pause serves as a reminder to plan sponsors and administrators to remain vigilant, be future-focused and strategic in managing plan risks as market conditions evolve.

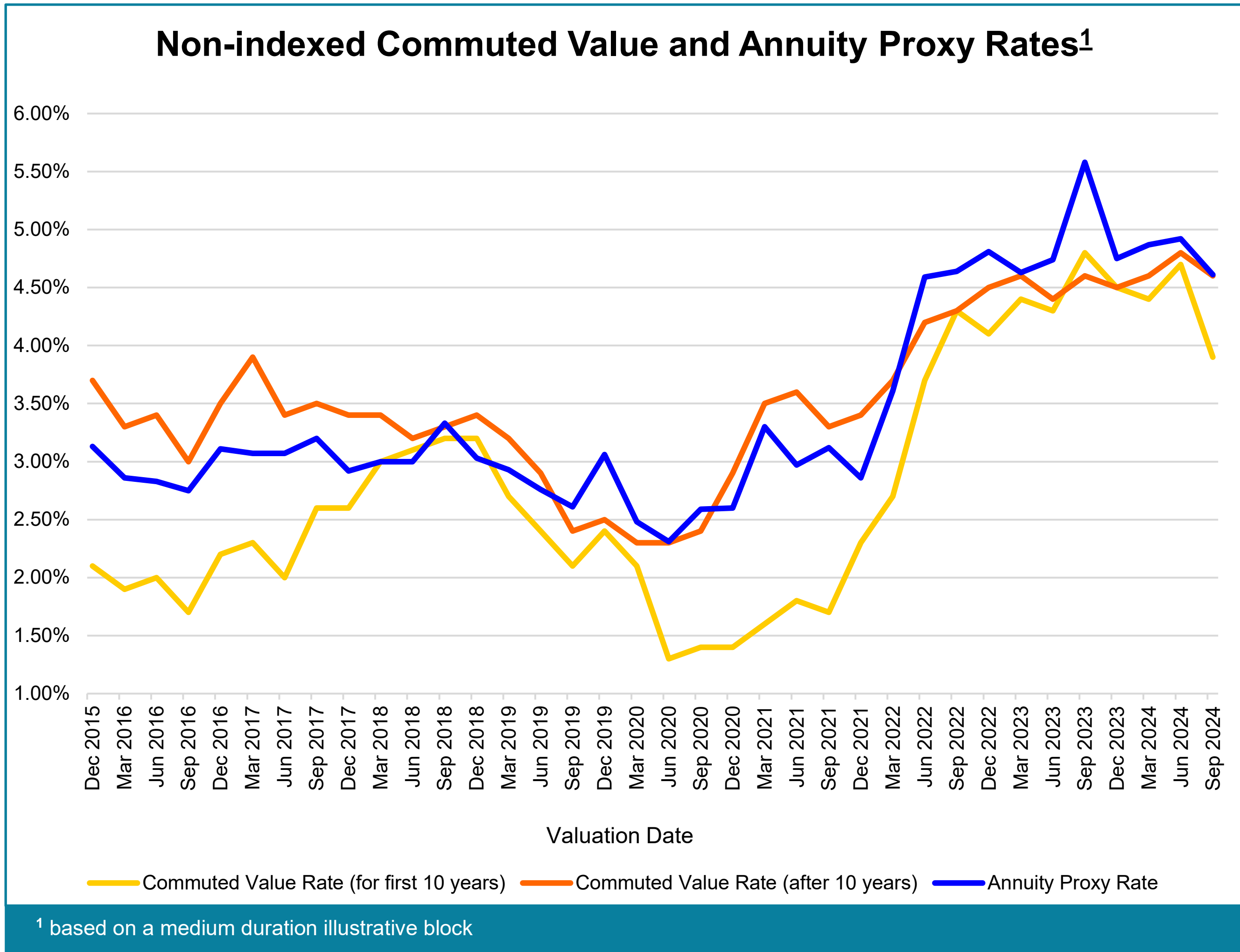
- The median projected solvency ratio was 121% as at September 30, 2024, a 2 percentage point decrease from 123% as at June 30, 2024.
- The percentage of pension plans as at September 30, 2024 that were projected to be fully funded on a solvency basis is unchanged from last quarter, at 90%. Only 2% of plans had a solvency ratio below 85%, also unchanged from last quarter.
- Investment returns were positive across all asset classes in Q3 2024, averaging a net return of 6.3%.
- Solvency discount rates decreased since the last quarter resulting in an increase in plan liabilities, which largely offset the impact of asset gains over the quarter.

As the saying goes, the only constant is change. This is the reality that faces pension plans, and it is why FSRA continues to emphasize the need for plan sponsors and administrators to actively manage evolving risks to safeguard the financial health of their pension plans. While the recent drop in long-term interest rates has driven up liabilities, it has been offset by solid investment returns. With inflation trending downwards, potential further interest rate declines could negatively affect funding levels. Sponsors can use stress tests, modeling and other analytical tools to help them manage risks and maintain financial resilience.

Projected Solvency Position as at September 30, 2024	Q3 2024	Q2 2024	Q4 2023
Median solvency ratio	121%	123%	119%
Percentage of plans with a solvency ratio greater than 100%	90%	90%	89%
Percentage of plans with a solvency ratio between 85% and 100%	8%	8%	9%
Percentage of plans with a solvency ratio below 85%	2%	2%	2%

The projected solvency position, in aggregate, declined since last quarter. The 2 percentage point decrease in the estimated median solvency ratio since June 30, 2024 is attributable to:

- Fall in solvency discount rates
  - The non-indexed commuted value discount rates, for the select and ultimate periods, decreased by 80 bps and 20 bps, respectively and the non-indexed annuity purchase discount rate decreased by 31 bps, resulting in an increase in pension liabilities.
- Q3 2024 pension fund investment returns
  - The average third quarter 2024 gross and net, after expense, return estimates were 6.6% and 6.3%, respectively.



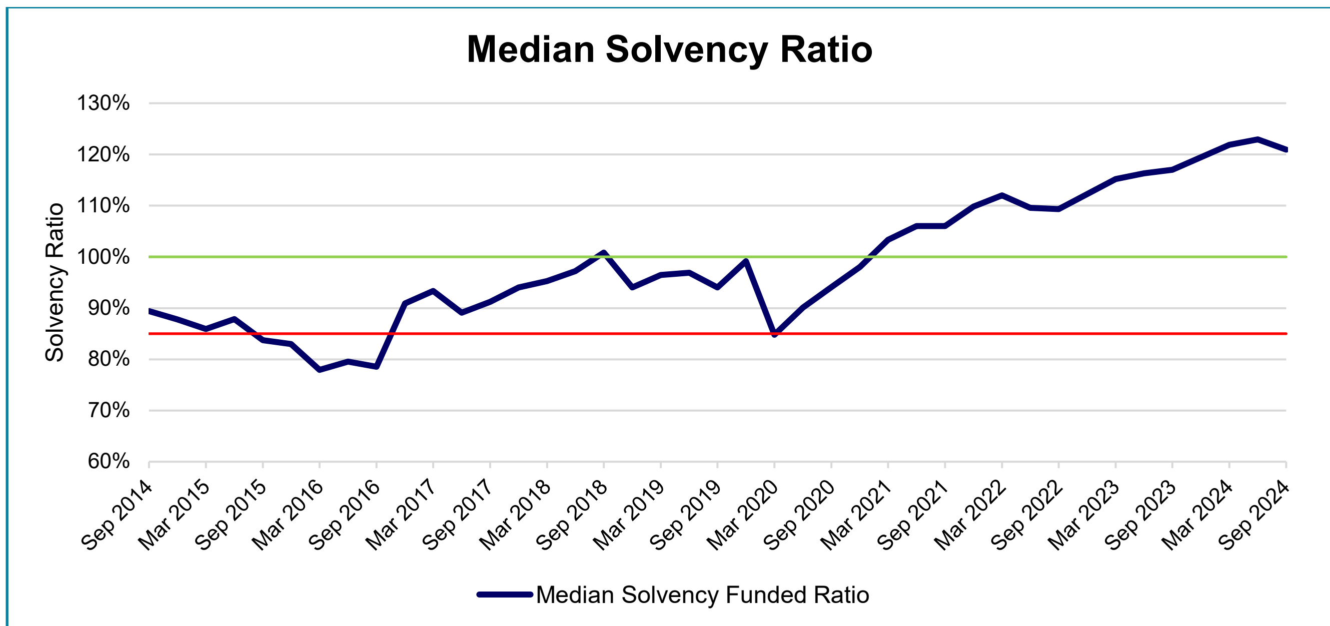
[1] based on a medium duration illustrative block

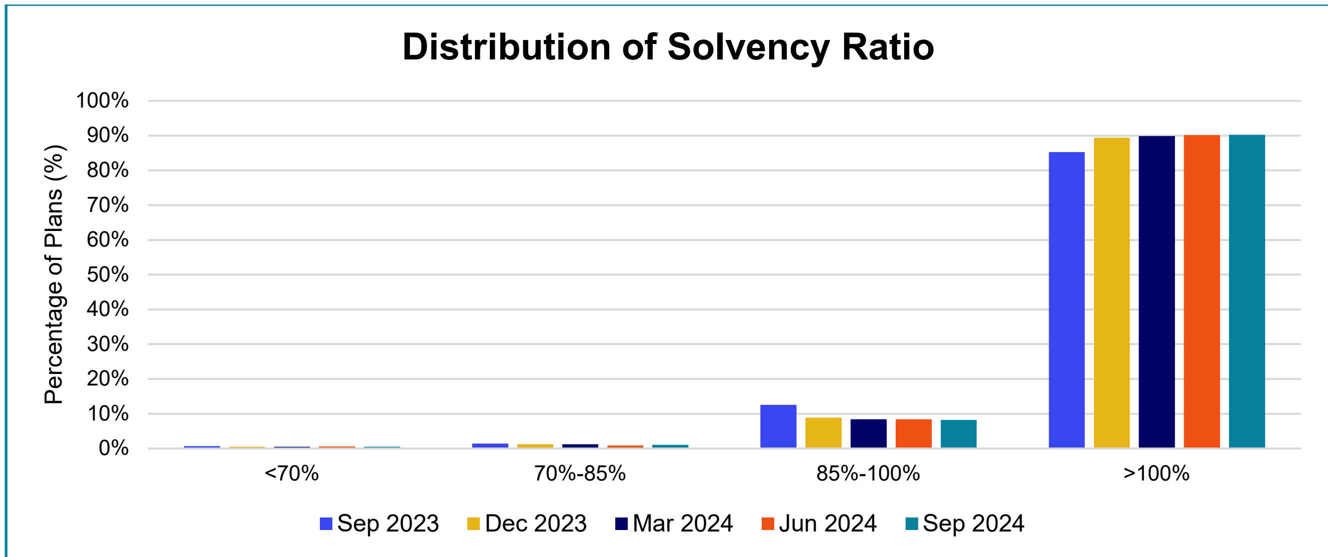
Canadian interest rates substantially decreased in the third quarter of 2024, equity market returns were strong, and inflation continued to decline. While Canadian GDP grew 1.5% from July 2023 to July 2024, and the Canadian CPI inflation rate decreased to 2% in August, the shelter component of CPI remained higher than normal at 5.3% in August. The Bank of Canada's (BoC) July 2024 Monetary Policy Report revised its projections for 2024 and 2025 GDP growth to 1.2% and 2.1%, respectively, down from 1.5% and 2.2% in the previous report. The BoC has pointed out that Canadians are spending less on discretionary items while allocating a larger share of their incomes to servicing debt.

The Canadian yield curve has shifted lower, ending the prevailing 2-year vs 10-year inversion, with the 2-year rate now at 2.91% and the 10-year rate reaching 2.95%. The FTSE Canada Universe Bond index returned 4.66% in Q3 2024, and the S&P / TSX Composite

Index provided a strong return of 10.54%, even though Q3 was volatile for equities. Chinese equities rallied upward at the end of Q3, driven by an announcement in September of more government stimulus of the economy by China's Central Bank easing monetary policy.

The Canadian policy interest rate was cut by 25 basis points twice, once in July and once in September, bringing the policy rate to 4.25% at the end of Q3 2024. The US Federal Reserve cut the Federal Funds Target Range 50 basis points to 4.75%-5% in September. The Canadian dollar increased 1.1% to 0.7394 USD in Q3. The US Federal Reserve proceeded with quantitative tightening and continued to reduce balance sheet holdings in Q3, while the BoC's total assets increased slightly from quarter-end Q2 to quarter-end Q3 2024. At the end of Q3, the swaps market was pricing in rate cuts totaling about 1% in October and December in Canada, and in November and December in the US.





Methodology and Assumptions

1. The results reported in each plan's last filed actuarial valuation reports (assets and liabilities) were projected to September 30, 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
3.4%	17.8%	18.3%	53.1%	6.2%	1.2%

   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
Q3 2024	1.2%	10.5%	5.0%	4.7%	5.8%	14.6%
Q2 2024	1.3%	-0.5%	3.8%	0.9%	0.2%	-0.9%
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%