Financial Services Regulatory Authority of Ontario

Autorité ontarienne de réglementation des services financiers

www.fsrao.ca

Quarterly update on

Estimated Solvency Funded Status of Defined Benefit Pension Plans in Ontario

September 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 September 30, 2020

Solvency positions improved over the quarter ending September 30, 2020, as the market continues to recover from the pandemic-induced shocks in March.

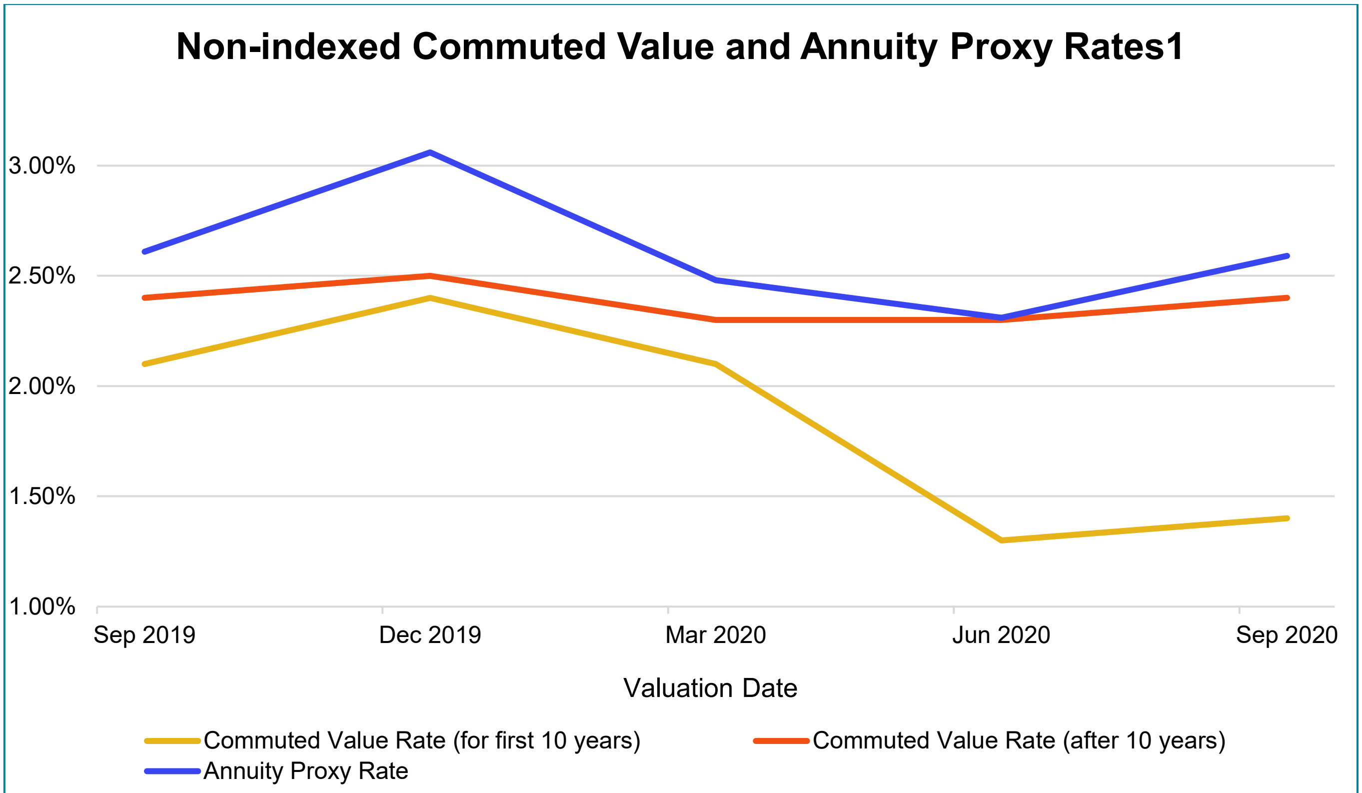
- This resulted in the median projected solvency ratio increasing to 94% at September 30, 2020, up from 90% at the end of June (and 85% at the end of March).
- Nevertheless, this remains below the level of 99% at December 31, 2019.
- The improvement increased the percentage of pension plans that are projected to be fully solvency funded to 34%, while reducing to 25% those that are projected to have a solvency ratio below 85%.

Six months after the COVID-19 pandemic began, global equity markets have made a remarkable recovery. There remains much uncertainty with respect to the economy as the world awaits the development of effective vaccines and therapeutics to treat COVID-19. Despite the rebound in asset values the past two quarters, most plans opened the year in a stronger funded position on a solvency basis. It remains as important as ever for plan administrators to review their funding and investment strategies so they can prudently manage their plans through the cycle. Many have already completed their reviews or are in the process of doing so – others are urged to do likewise.

Projected Solvency Position as at September 30, 2020	Q3 2020	Q2 2020	Q4 2019
Median solvency ratio	94%	90%	99%
Percentage of plans with a solvency ratio greater than 100%	34%	26%	48%
Percentage of plans with a solvency ratio between 85% and 100%	40%	38%	42%
Percentage of plans with a solvency ratio below 85%	26%	36%	10%

The projected solvency position of pension plans continued to improve in the third quarter of 2020. The 4% increase in the estimated median solvency ratio since June 30, 2020 is attributable to:

- Positive Q3 2020 pension fund investment returns
  - The average third quarter 2020 gross and net, after expense, return estimates are 2.3% and 2.1% respectively.
- An increase in solvency discount rates
  - There was an increase of 10 bps in the non-indexed commuted value discount rates and 28 bps in non-indexed annuity purchase discount rate.

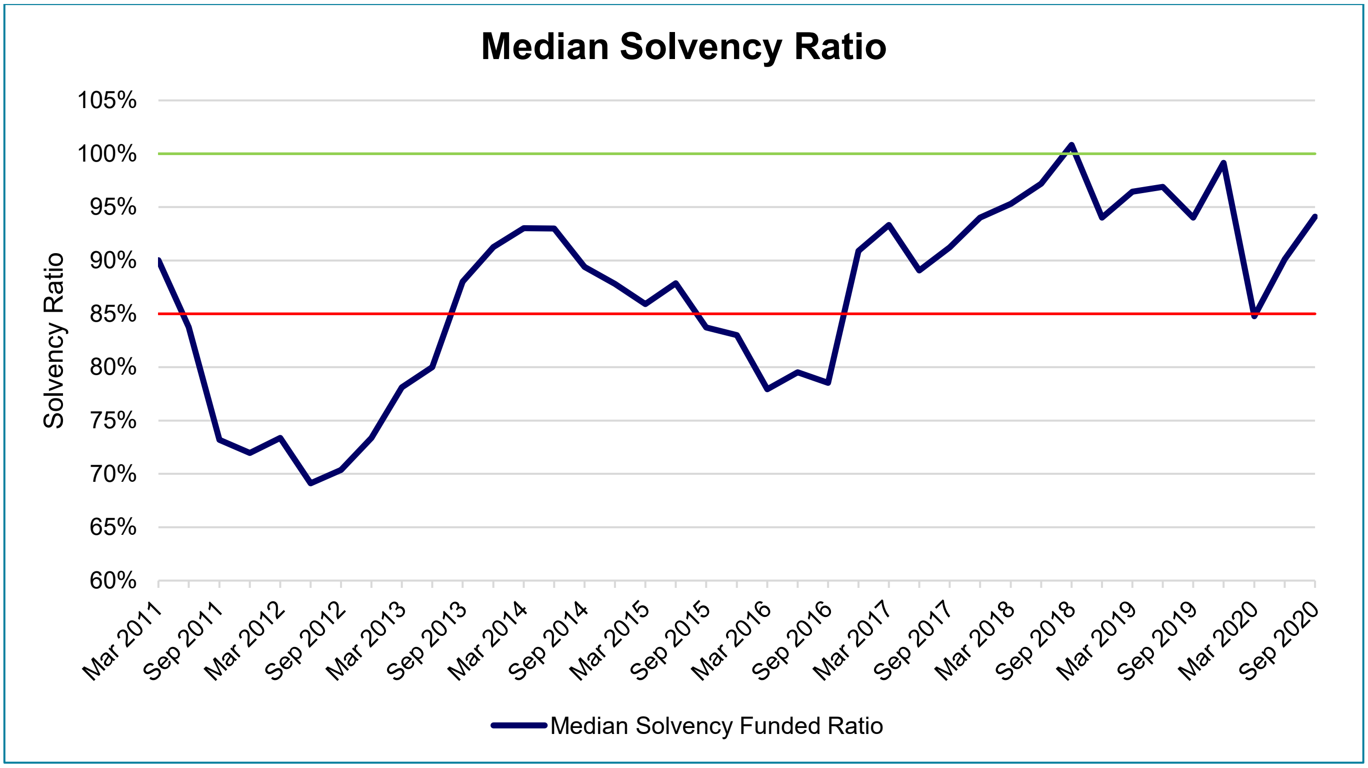


[1] based on a medium duration illustrative block

In Q3, due to COVID-19, countries around the world were operating with various business and gathering restrictions in place to allow businesses to open and economic activity to increase. Many countries had been experiencing a decrease in COVID-19 cases from initial peak levels, but are now unfortunately seeing an increase, in what is being called a 'second wave'.

While still elevated from pre-COVID-19 levels, Statistics Canada data shows the Canadian unemployment rate has started to decline, from 13.7% in May to 10.2% in August, and the latest CPI inflation rate of 0.1% (August year-over-year) remains below the Bank of Canada's target range. The S&P/TSX Composite and MSCI World equity market indices were positive in Q3, maintaining their large gains from Q2.

Regarding fiscal and monetary policy, the U.S. government is discussing another fiscal stimulus package, and the U.S Federal Reserve, at its September FOMC meeting, maintained the federal funds target range at 0% to 0.25% and decided to continue asset purchases over the coming months. In Canada, the Federal government's COVID-19 Economic Response Plan provided support for individuals and businesses, and its throne speech discussed plans for further support measures. The Bank of Canada kept its overnight target rate at 0.25% and continued with asset purchases.


Median Solvency Ratio
Solvency Ratio
105%
100%
95%
90%
85%
80%
75%
70%
65%
60%
Mar 2011
Sep 2011
Mar 2012
Sep 2012
Mar 2013
Sep 2013
Mar 2014
Sep 2014
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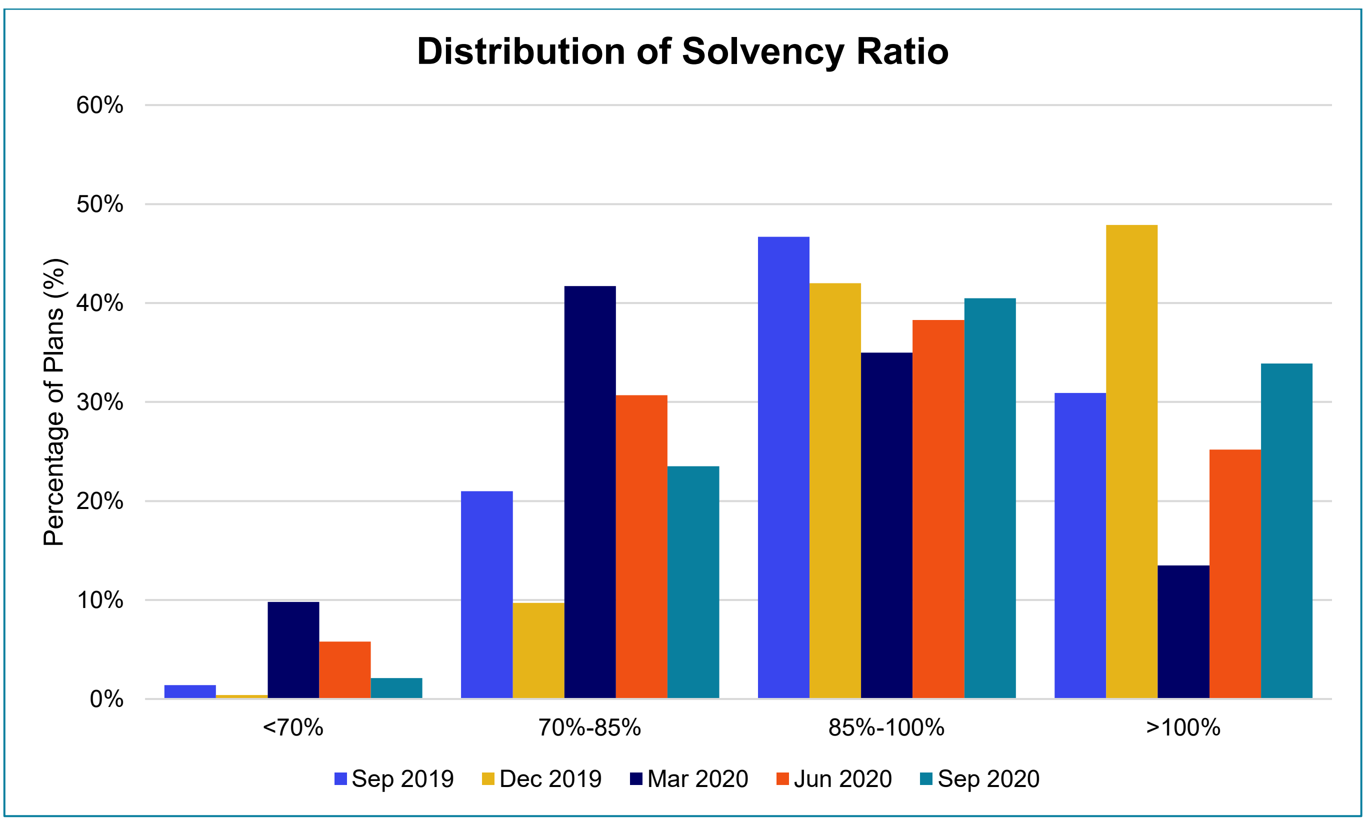
Median Solvency Funded Ratio


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

Methodology and Assumptions

1. The results reported in each plan's last filed actuarial valuation reports (assets and liabilities) were projected to September 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
2.9%	21.4%	21.3%	47.4%	5.4%	1.6%

[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
Q3 2020	4.7%	5.8%	0.4%	-0.3%
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%