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 30, 2023

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 September 30, 2023

Despite a negative investment return during the third quarter of 2023, most pension plans have maintained their upward trajectory over the past year since Sept 30, 2022. This resilience has led to the median projected solvency ratio attaining a historic peak.

- The median projected solvency ratio was 117% as at September 30, 2023, a 1% increase from 116% as at June 30, 2023.

- The percentage of pension plans that were projected to be fully funded on a solvency basis as at September 30, 2023 was 85% compared to 86% as at June 30, 2023. The percentage of plans falling below an 85% solvency ratio was 2%, unchanged from last quarter.

- The investment returns in Q3 2023 averaged a net return of -4.5%.

- Solvency discount rates continued to rise, leading to a decrease in plan liabilities which offset the impact of asset losses over the quarter, resulting in a small improvement in the median solvency ratio.

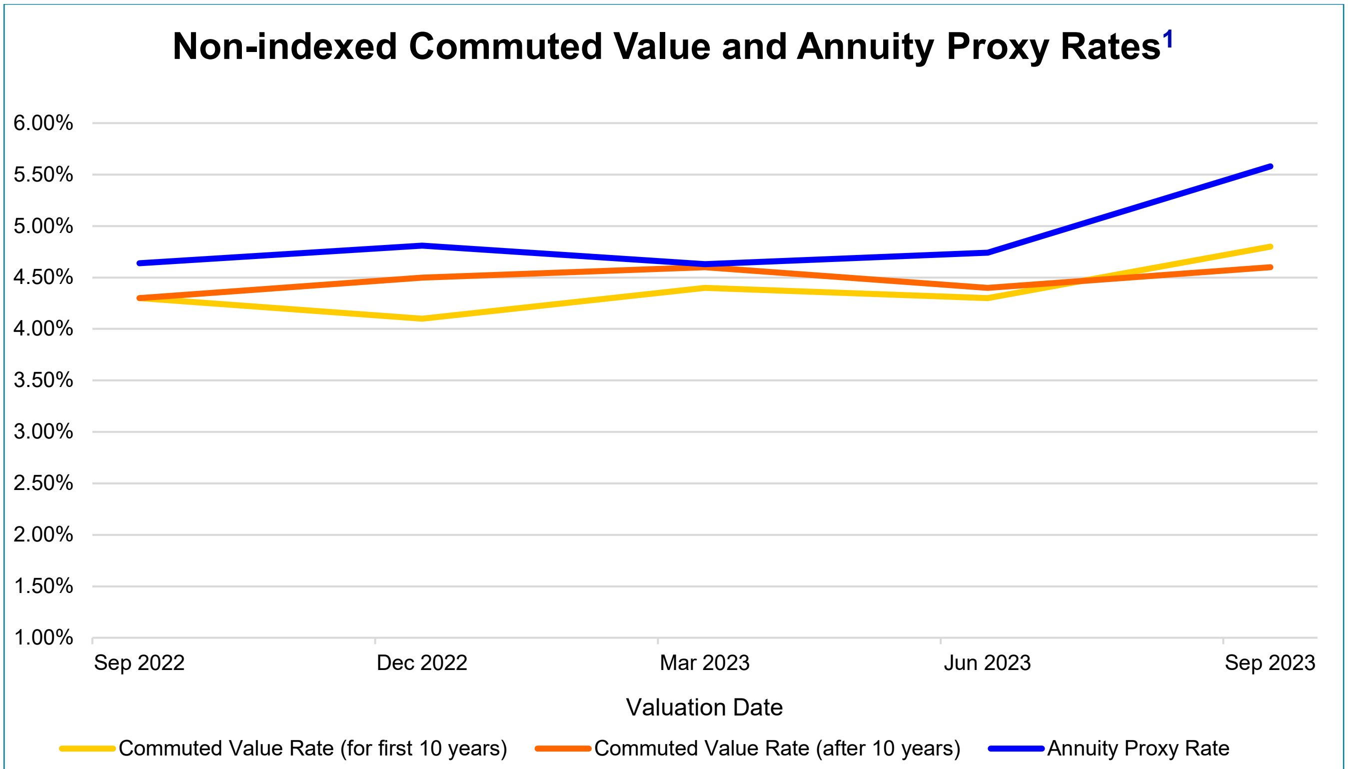
The prevailing high-interest rate environment has significantly bolstered the financial health of most pension plans by lowering the value of pension obligations. Furthermore, pension plans that have implemented de-risking strategies have successfully reduced volatility of the funded status of their plans. It is imperative to acknowledge that while these positive trends are indeed encouraging, the global landscape remains intricate and uncertain. Recent geopolitical events, such as the Israel-Hamas conflict, serve as a reminder of the paramount need for vigilance and agility when managing pension plans. The importance of maintaining ongoing diligence and adaptability is essential in securing the future financial well-being of plan beneficiaries.

Projected Solvency Position as at September 30, 2023	Q3 2023	Q2 2023	Q4 2022
Median solvency ratio	117%	116%	112%
Percentage of plans with a solvency ratio greater than 100%	85%	86%	81%
Percentage of plans with a solvency ratio between 85% and 100%	13%	12%	17%
Percentage of plans with a solvency ratio below 85%	2%	2%	2%

The projected solvency position, in aggregate*, improved slightly since last quarter. The 1% increase in the estimated median solvency ratio since June 30, 2023 is attributable to:

- Rise in solvency discount rates.
  - The non-indexed commuted value discount rates, for the select and ultimate periods increased by 50 bps and 20 bps, respectively and the non-indexed annuity purchase discount rate increased by 84 bps, resulting in a decrease in pension liabilities.
  - This favorable impact more than offset the reduction in plan assets from the negative pension fund investment returns.
- Negative Q3 2023 pension fund investment returns.
  - The average third quarter 2023 gross and net, after expense, return estimates were -4.3% and -4.5%, respectively.

* Note: Results account for a significant number of new actuarial valuation filings in the third quarter of 2023, with approximately one in three Ontario DB pension plans monitored in this report filing new valuations during this period.

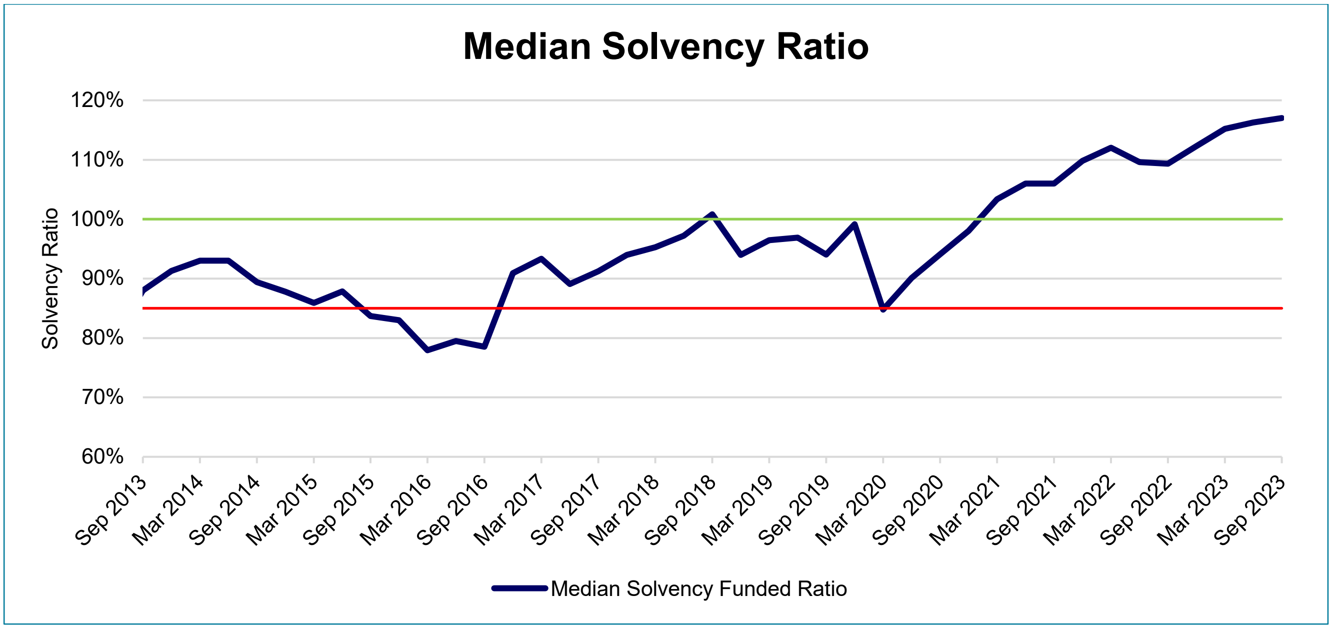


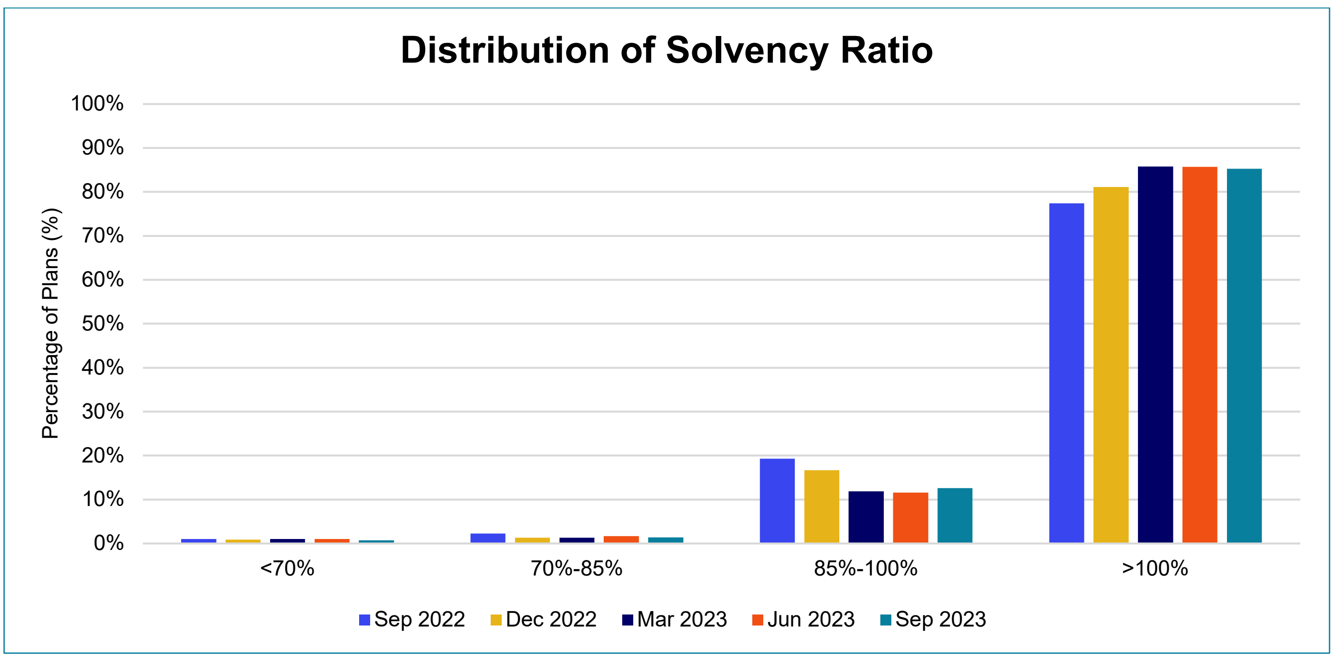
[1] based on a medium duration illustrative block

During the third quarter of 2023, bond yields increased and steepened, equity markets declined, the Canadian dollar fell in value relative to the US dollar, and shelter costs and unemployment increased slightly. Statistics Canada data indicates annual CPI inflation stood at 3.3% and 4.0% in July and August, respectively, while core inflation was 3.2% and 3.3% in July and August, respectively. Core inflation omits the most volatile components of the CPI index, as defined by the Bank of Canada (BoC). The shelter component of CPI increased by more than the aggregate CPI index, increasing by 6.0% from August 2022 to August 2023. Unemployment increased from Q2, and stood at 5.5% in September, up from 5.4% in June. Canadian GDP, month-over-month, did not grow in July, but did increase year-over-year, with July 2023 GDP 1.1%, higher than July 2022 GDP. The BoC revised their GDP forecast for 2023 upward in July, but their 2024 and 2025 forecasts downward, to 1.8%, 1.2%, and 2.4%, respectively, from 1.4%, 1.3%, and 2.5%, in their previous monetary policy report.

At the end of Q3, the Canadian government bond yield curve remained inverted, with the 10-year benchmark yield 84 basis points below the 2-year benchmark yield. At the end of Q2, the 10-year benchmark yield was 132 basis points below the 2-year benchmark yield. However, the curve underwent “bear steepening” from Q2 to Q3, with the 2-year benchmark yield having risen by 29 basis points to 4.87%, while the benchmark 10-year yield rose 77 basis points to 4.03%, reducing the difference between the 2-year and 10-year yields. US government bond yields also increased and steepened during Q3, with the 10-year yield rising to 4.57%. In Canadian markets, for Q3, the FTSE Canada Universe Bond index decreased 3.9% and the S&P/TSX Composite equity index returned -2.2%. The Canadian dollar decreased in value relative to the US dollar, and stands at 0.7365 US dollars per Canadian dollar at quarter end.

Central banks around the world continued to hike interest rates in Q3. The BoC had one policy interest rate hike of 25 basis points, on July 12th. The target for the policy rate at the end of Q3 stood at 5.00%. The US Federal Reserve had one federal funds rate hike on July 26th of 25 basis points. The upper limit for the US federal funds target range as of the end of Q3 was 5.50%. Both the BoC and the US Federal Reserve proceeded with quantitative tightening and continued to reduce balance sheet holdings, decreasing their total assets from Q2 to Q3. As at the end of Q3, the overnight index swaps markets were pricing in one additional interest rate hike of 25 basis points for Canada during the next two quarters, but no additional interest rate hikes in the US over the next two quarters.


Median Solvency Ratio
120%
110%
100%
90%
80%
70%
60%
Solvency Ratio
Sep 2013
Mar 2014
Sep 2014
Mar 2015
Sep 2015
Mar 2016
Sep 2016
Mar 2017
Sep 2017
Mar 2018
Sep 2018
Mar 2019
Sep 2019
Mar 2020
Sep 2020
Mar 2021
Sep 2021
Mar 2022
Sep 2022
Mar 2023
Sep 2023
Median Solvency Funded Ratio


Distribution of Solvency Ratio
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Percentage of Plans (%)
<70%
70%-85%
85%-100%
>100%
Sep 2022
Dec 2022
Mar 2023
Jun 2023
Sep 2023

Methodology and assumptions

1. The results reported in each plan's last filed actuarial valuation reports (assets and liabilities) were projected to September 30, 2023 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
3.7%	19.1%	19.6%	50.3%	6.2%	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
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%
Q1 2023	1.1%	4.6%	7.6%	3.2%	4.7%	-0.1%
Q4 2022	1.0%	6.0%	8.2%	0.1%	-1.0%	3.6%