

CAPSA

December 9, 2002

Mr. Patrick Johnston
Chairperson
Canadian Institute of Actuaries Committee on
Pension Plan Financial Reporting
c/o Buck Consultants
ATCO Centre
909-11th Avenue S.W., Suite 720
Calgary, Alberta
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Dear Mr. Johnston:

Subject: Standard of Practice for Determining Pension Commuted Values

On behalf of the Canadian Association of Pension Supervisory Authorities (CAPSA), I am submitting comments on the Exposure Draft of the Standard of Practice for Determining Pension Commuted Values. As you know, CAPSA represents all the regulators responsible for the supervision of private pension plans in Canada.

This standard is critical to all pension regulators in Canada, since it affects both the determination of individual members' commuted values and the solvency position of pension plans. As you know, some pension standards regulations refer specifically to the 1993 Standard and, therefore, will need to be amended to reflect a new CIA standard, while other regulations are worded to automatically capture a new standard. Even in the latter case, a supervisory authority may have the power of specifying assumptions and methods that it deems appropriate. As a result, pension regulators will want to assess the impact of any new standard on members and on the solvency of plans.

1. Interest Assumption and Volatility of Commuted Values

The current standard uses a market discount rate for the first 15 years and a fixed rate of 6% beyond 15 years. The proposed standard, on the other hand, intends to use a combination of market rates for the entire duration of the calculation. We believe this approach will result in more volatility in commuted values. This means that the commuted value payable to terminating members will be more dependent on the month of termination and that plans' solvency liabilities will fluctuate more over time. We feel it would be desirable to modify the proposed approach in such a way that the volatility in commuted values would be reduced.

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2. Adjustment to Interest Discount for Credit Risk and Expenses

We note that a change was made in the proposed standard from what was included in the discussion draft published in 2001. The discussion draft used provincial bonds as the basis for determining a net adjustment to the interest discount of 0.25% for credit risk net of expenses. The exposure draft has now changed the indicator to corporate bonds rated AA, to raise the credit risk net of expenses from 0.25% to 0.75%.

We find that the sidebar on page 8 of the exposure draft does not clearly explain the rationale for the change. It is said that the change reflects corporate credit risk for unfunded plans and a substantially lower credit risk for fully funded plans. Yet, there is no indication of the premium associated with, or the weight assigned to, each situation. We feel that more justification of the change in approach should be disclosed.

All versions of the proposed standard have extended the structure of discount rates for non-indexed annuities directly to rates for indexed annuities. While this could be easily accepted when the net adjustment to the rate was 0.25%, we find it difficult to accept a net adjustment of 0.75% for indexed annuities, since there is no market for real-return provincial or corporate bonds, and therefore no basis to justify such a high premium. Even though a net adjustment of 0.75% may prove acceptable for non-indexed annuities, we believe that the adjustment should be lower for indexed annuities.

3. Mortality

We agree that the complexities involved in the generational mortality tables are not warranted at this time. While we found the interest rate adjustment approach acceptable, we prefer the new approach of a projection to a specified year. Furthermore, we find the exposure draft approach more appropriate, since it does not provide a choice for the actuary.

4. Complexity of Calculations

We observe that the proposed standard increases the complexity involved in the calculations of commuted values relative to the current standard. Since the proposed method is based on two discount rates that can change monthly, a number of plan administrators currently relying on printed factor tables for calculations or using a computerized system where tables are embedded, will be forced to consider other solutions for the delivery of administrative services, thereby incurring transition costs and, possibly, higher ongoing costs.

You will no doubt understand that, as regulators, we often receive comments from plan administrators on the high costs of compliance and administration activities for defined benefit pension plans. We would hope to avoid unwarranted increases in administrative costs as a result of a new standard.

5. Valuation Date

The proposed standard, as well as the current standard, includes wording to the effect that an administrator empowered to do so can determine the effective date of a commuted value calculation. At least one of our regulators has encountered difficulties with the application of this clause. We would suggest that you provide advice on types of situations where a plan administrator could legitimately make such a determination.

6. Consultations

We feel that the CIA would benefit from broad consultations with interested parties outside of the CIA membership on an issue such as this, which can have a real effect on individual Canadians and corporate entities. Evidence of such consultations and reporting on representations received and the manner in which

they were reflected would be helpful to CAPSA members and stakeholders in the adoption or approval of the new standard. In fact, the consultation process required by regulation amendments in some jurisdictions may reveal opposition to parts of the standard, which the local government would have to take into consideration.

In this regard, we wish to bring to your attention that a protocol was established between CAPSA and the CIA in the spring of 2001 on the subject of consultations. As part of this protocol, the CIA agreed to send pension standard documents at the discussion draft stage to members of the CAPSA Actuarial Sub-Committee and, for documents at the exposure draft stage, to CAPSA members and stakeholders. I understand that a list of stakeholders was provided at the time but please let us know if you need a new copy.

We trust that these comments will prove helpful to the Committee in its continuing work on this standard. Please feel free to contact me if you wish to discuss these issues more extensively.

Yours truly,

P. Gail Armitage
Chair, Canadian Association of
Pension Supervisory Authorities

Link to Canadian Institute of Actuaries website: www.actuaries.ca