Report on Pension Plans Registered in British Columbia

AUGUST 2017

British Columbia
Financial Institutions Commission

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THE FINANCIAL INSTITUTIONS COMMISSION OF BRITISH COLUMBIA (FICOM) IS A REGULATORY AGENCY OF THE MINISTRY OF FINANCE. IT WAS ESTABLISHED IN 1989 TO CONTRIBUTE TO THE SAFETY AND STABILITY OF THE BRITISH COLUMBIA PENSION AND FINANCIAL SERVICES SECTORS.

AUGUST 2017

Table of Contents

ABOUT THIS REPORT 2

CAPITAL AND EQUITY MARKETS PERFORMANCE 2

CANADIAN INTEREST RATES 2

ASSET CLASS RETURNS 2

PLAN MEMBERSHIP 3

PENSION FUNDS AND ASSET MIX 4

TOTAL ASSETS OF REGISTERED PLANS 4

ASSET MIX OF BENEFIT FORMULA PLANS 4

REQUIRED CONTRIBUTIONS TO PLANS 4

FUNDING POSITION OF BENEFIT FORMULA PLANS 5

OVERALL FUNDING 5

GOING CONCERN FUNDING 6

SOLVENCY FUNDING 7

SOLVENCY FUNDING RELIEF 7

TARGET BENEFIT PLAN 8

PROVISION FOR ADVERSE DEVIATION 8

STRESS TESTING 9

RISK ASSESSMENT AND SUPERVISION 9

STEP 1: RISK PRIORITIZATION 9

STEP 2: RISK ASSESSMENT 10

GOVERNANCE SELF-ASSESSMENT AND FICOM'S GOVERNANCE RISK REVIEW 10

GOVERNANCE SELF-ASSESSMENT OF PENSION PLAN ADMINISTRATORS 10

FICOM'S GOVERNANCE RISK REVIEW 10

STAKEHOLDER ENGAGEMENT 11

ISSUES ADDRESSED AT THE FORUM 11

BULLETINS 12

PLAN TERMINATION EXPENSE ASSUMPTIONS 12

PLAN ASSESSMENT 12

About This Report

This is a report on pension plans prepared by B.C.'s Office of the Superintendent of Pensions. This year's report presents a profile of all pension plans registered in British Columbia: defined benefit, defined contribution and target benefit.

The report contains:

- » A summary of financial market performance;
- » A profile of pension plans, membership and contributions;
- » An estimate of the funding position of plans with benefit formula provisions;
- » An assessment of risk related to plans with benefit formula provisions;
- » A discussion of target benefit plans; and
- » A summary of our engagement with stakeholders.

Capital and Equity Markets Performance

CANADIAN INTEREST RATES

Defined benefit plans in B.C. and Canada continue to face challenging conditions, as long-term Government of Canada bond yields used to set interest rates for solvency valuations continue to be low. The solvency interest rate for select and non-indexed pensions has been declining since the end of 2013 and was at 2.20% at December 31, 2016 (see Table 2.1).

Combined with the assumption on improved longevity, the low rates have resulted in increases in solvency liabilities.

Administrators of pension plans appear to recognize this as the "new normal" and are taking steps to mitigate the impact of the trend while exploring ways to improve the management of pension risk. For example, some plans are looking at de-risking strategies that use buy-out and/or buy-in annuities and longevity insurance contracts. (While there has been discussion about the latter, the Office of the Superintendent of Pensions has so far not had any direct enquiry from any plans about longevity insurance contracts.)

TABLE 2.1: GOVERNMENT OF CANADA BOND YIELDS AND SOLVENCY INTEREST RATES.

	Rates in Dec. 2016	Rates in Dec. 2015	Rates in Dec. 2014
Government of Canada bonds[A]			
• Long-term (V122544)	2.34%	2.16%	2.33%
• 10-year (V122543)	1.73%	1.40%	1.79%
• 91-day T-bill (V122541)	0.47%	0.50%	0.91%
Solvency interest rates (non-indexed pensions)[B]			
• Commuted value	2.20%/3.50%	2.10%/3.70%	2.50%/3.80%
• Annuity purchase	3.11%	3.13%	2.52%

[A] *BANK OF CANADA STATISTICS: HTTP://WWW.BANKOFCANADA.CA/RATES/INTEREST-RATES/*

[B] *BASED ON CANADIAN INSTITUTE OF ACTUARIES' GUIDANCE. FOR COMMUTED VALUE, THE FIRST INTEREST RATE APPLIES TO THE FIRST 10 YEARS AFTER THE CALCULATION DATE AND THE SECOND INTEREST RATE APPLIES TO SUBSEQUENT YEARS. THE ANNUITY PURCHASE RATE SHOWN IS THAT FOR AN ILLUSTRATIVE BLOCK WITH MEDIUM DURATION.*

ASSET CLASS RETURNS

During 2016, Canadian equity markets saw substantial gains that were driven by the financial services, energy, and materials sectors. The S&P/TSX Composite Index posted a total return of 21.1%.

U.S. and European equities markets also posted gains in 2016. However, the appreciation of the Canadian dollar against most major currencies resulted in lower adjusted returns, and even in negative returns in the case of non-North American equities.

The rates of return on major asset classes for the four-year period, 2013–2016, are summarized in Table 2.2.

TABLE 2.2: ASSET CLASS RETURNS OF THE GENERAL MARKET, 2013–2016.

	Returns in 2016	Returns in 2015	Returns in 2014	Returns in 2013
Stock returns				
• Canadian equities: S&P TSX Composite	21.1%	-8.3%	10.6%	13.0%
• U.S. equities: S&P 500 (Canadian dollars)	8.6%	21.0%	24.0%	41.5%
• Non-North American equities: MSCI – EAFE (Canadian dollars)	-2.5%	19.0%	3.7%	31.0%
Fixed-income returns				
• FTSE 90-day T-bills	0.5%	0.6%	0.9%	1.0%
• FTSE Universe Bond	1.7%	3.5%	8.8%	-1.2%
• FTSE Long Bonds	2.5%	3.8%	17.5%	-6.2%

[A] SOURCE: AUBIN CONSULTING ACTUARY INC. STATISTICS. HTTP://WWW.AUBINACTUAIRECONSEIL.CA

Based on the valuation reports filed with our office over the last four years, plans have reported a median annual rate of return, net of expenses, of 8.85%. For plans filing valuation reports with a review date of December 31, 2014, the median annual rate of return, net of expenses, was 10.05%. Over the four valuation reporting periods, fewer than 5% of plans reported an average rate of return of less than 5.0% and two plans reported a negative annual rate of return.

Plan Membership

The total number of members in pension plans registered in B.C. did not change substantially from 2014 to 2016, growing to 1,045,000 in 2016 from 992,000 in 2014 (an increase of 53,000; see Tables 3.1 and 3.2).

Since the inception of the new pension legislation on September 30, 2015:

» 41 plans have terminated, the majority of which were defined contribution plans; and

» 24 new plans have applied for registration with the Office of the Superintendent of Pensions, 21 of which were defined contribution plans and 3 defined benefit plans.

The reasons provided for plan terminations included the perception of increased administrative burden with the introduction of the new pension legislation. A number of terminated plans were replaced with group Registered Retirement Savings Plans.

TABLE 3.1: NUMBER OF COVERED MEMBERS IN DEFINED BENEFIT AND TARGET BENEFIT PENSION PLANS AS AT DECEMBER 31, 2016.

Size of Plan	Number of Plans	Total Number of Members
Fewer than 1,000	134	29,250
1,000–4,999	40	79,476
5,000–9,999	12	78,657
10,000 or more	12	784,138
Total	**198**	**971,521**

TABLE 3.2: NUMBER OF COVERED MEMBERS IN DEFINED CONTRIBUTION PENSION PLANS AS AT DECEMBER 31, 2016.

Size of Plan	Number of Plans	Total Number of Members
Fewer than 100	372	11,362
100–499	87	17,888
500–999	13	8,659
1,000 or more	13	35,980
Total	**485**	**73,889**[A]

[A] THIS NUMBER DOES NOT INCLUDE DEFINED CONTRIBUTION PLAN MEMBERS PARTICIPATING IN A PLAN WITH BOTH A BENEFIT FORMULA AND A DEFINED CONTRIBUTION COMPONENT. THEIR COUNTS ARE INCLUDED IN TABLE 3.1.

As Tables 3.1 and 3.2 show, most of the registered benefit formula and defined contribution pension plans continue to be small in terms of membership:

» About 68% of benefit formula plans had fewer than 1,000 members each (the average was 200 members); and

» About 77% of defined contribution plans had fewer than 100 members each.

Pension Funds and Asset Mix

TOTAL ASSETS OF REGISTERED PLANS

The total assets held by all registered pension plans in B.C. as at December 31, 2016, was about $144.5 billion (compared with $128.3 billion at December 31, 2014).[1] This was made up of about $136.2 billion held in benefit formula plans and $8.2 billion held in defined contribution assets (Table 4.1).

Fourteen plans have assets of over $1 billion. Those 14 hold over 85% of the total assets held by all registered plans in the province.

TABLE 4.1: TOTAL ASSETS OF REGISTERED PENSION PLANS AS AT DECEMBER 31, 2016.

Asset Type	Market Value ($ Millions)
Benefit formula component	$136,234
Defined contribution component	$8,245
Total Assets	**$144,479**

ASSET MIX OF BENEFIT FORMULA PLANS

As at December 31, 2016, plans with a benefit formula component registered in B.C. held assets of nearly $136.2 billion (Table 4.1).

The percentage distribution of assets among asset classes for benefit formula plans did not change significantly from 2014 to 2016, with one exception: infrastructure investments. Benefit formula plans reported $11.4 billion in infrastructure investments at December 31, 2016, compared with $6.6 billion at December 31, 2014 — an increase of more than 70% over the two years.

Administrators also reported higher allocations in the "other investments" category: $7.6 billion in 2016 compared with $6.7 billion in 2014. This category includes hedge funds, private equities and financial derivatives.

As part of the risk-based supervision process, the Office of the Superintendent of Pensions will be engaging with plan administrators in future to achieve a better breakdown of the contents of the "other investments" category.

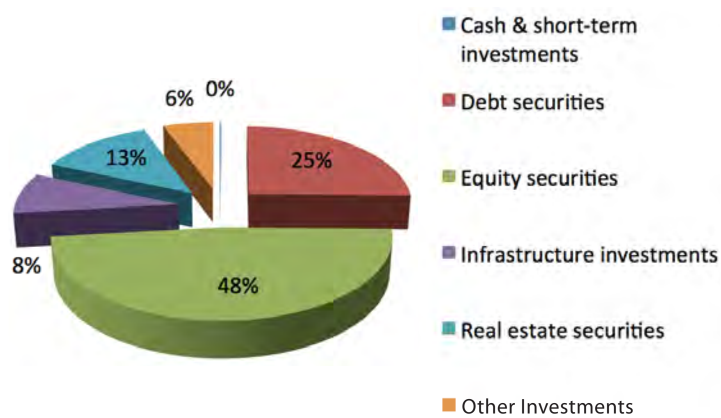
[1] WE ARE USING 2014 FOR COMPARISON PURPOSES BECAUSE THE AUGUST 2016 REPORT USED DATA AS AT DECEMBER 31, 2014.

TABLE 4.2: MARKET VALUE OF ASSETS IN BENEFIT FORMULA PLANS, AS AT DECEMBER 31, 2016.

Asset Class	Market Value ($ Million)	Market Value (% of Total)
Cash & short term investments	200	0.1
Debt securities	34,134	25.2
Equity securities	64,897	47.9
Infrastructure securities	11,382	8.4
Real estate securities	17,366	12.8
Others investments	7,595	5.6
Total	**135,574[A]**	**100**

[A] THIS EXCLUDES SMALL PLANS THAT ARE NOT REQUIRED TO FILE A BREAKDOWN OF ASSET MIX INFORMATION.

FIGURE 4.1: PERCENTAGE DISTRIBUTION OF ASSET ALLOCATIONS IN BENEFIT FORMULA PLANS, AS AT DECEMBER 31, 2016.



Required Contributions to Plans

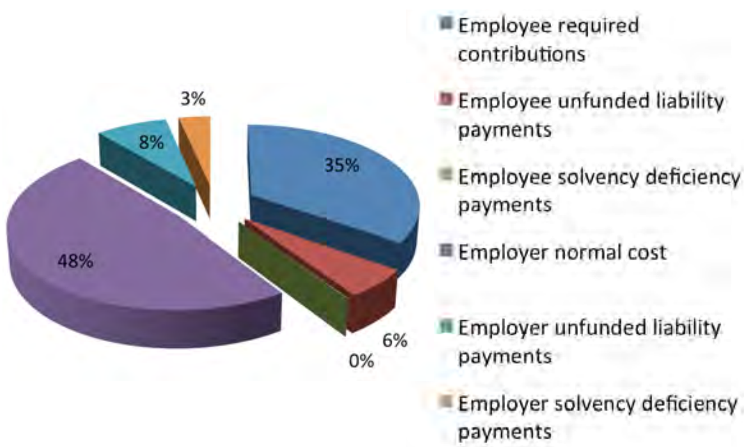
The total amount of contributions required to fund both new accruals and past benefit accruals did not change significantly in 2016 from the previous year (Table 5.1). Total required contributions in 2016 were about $4.5 billion compared with $4.4 billion in 2015.

Over 80% of required contributions ($3.8 billion) went toward covering the cost of providing new benefit accruals; less than 20% was applied to paying for past service liabilities (Figure 5.1).

TABLE 5.1: CONTRIBUTIONS, BY TYPE, TO FUND BENEFIT FORMULA PLANS IN 2016.

Type of Contributions Made ($ Thousands)	Amount Contributed in 2016	Amount Contributed in 2015
Employee required contributions	$1,555,848	$1,421,266
Employee unfunded liability payments	$262,019	$346,263
Employee solvency deficiency payments	$3,969	$5,200
Employer normal cost	$2,162,280	$2,058,235
Employer unfunded liability payment	$349,009	$442,345
Employer solvency deficiency payment	$153,805	$106,394
Total employer and employee contributions	**$4,486,930**	**$4,379,703**

FIGURE 5.1: PERCENTAGE DISTRIBUTION OF CONTRIBUTIONS TO BENEFIT FORMULA PLANS, AS AT DECEMBER 31, 2016.



The total amount of required contributions to fund defined contribution plans in 2016 was $408 million compared with $389 million in 2014, an increase of $19 million. Members contributed an additional $26 million in 2016 to their defined contribution accounts in the form of voluntary contributions.

Funding Position of Benefit Formula Plans

The funding analysis provided in this section is based on the projected funding position[2] of all benefit formula plans at the end of 2015 and 2016. The figures do not include public sector plans.

[2] OR ON ACTUAL FUNDING POSITION IF A VALUATION REPORT AT THE INDICATED DATES WAS FILED.

- A ***going concern valuation*** of a plan provides an evaluation of the plan's funded status, assuming that the plan continues indefinitely and benefits continue to be paid.
- The ***going concern funded ratio*** of a plan is the ratio of the plan's going concern assets to the plan's going concern liabilities.
- The ***solvency valuation*** of a plan estimates the plan's ability to meet its obligations, assuming that the plan is terminated and must pay all of its obligations immediately.
- The ***solvency ratio*** of a plan is the ratio of the plan's solvency assets to the plan's solvency liabilities.

OVERALL FUNDING

Table 6.1 shows the key funding figures for benefit formula plans at December 31, 2015, and December 31, 2016.

TABLE 6.1: FUNDING FIGURES FOR GOING CONCERN AND SOLVENCY VALUATIONS, AS AT DECEMBER 31, 2015, AND DECEMBER 31, 2016.

2015	Going Concern Valuation ($ Million)	Solvency Valuation ($ Million)
Total assets	$31,517	$33,235
Total liabilities	$26,922	$35,754
Aggregate funding balance	$4,595	-$2,519
Total funding balance for plans in deficit	-$112	-$4,064
Total funding balance for plans in surplus	$4,707	$1,545
Aggregate funding ratio	117%	93%

2016	Going Concern Valuation ($ Million)	Solvency Valuation ($ Million)
Total assets	$32,431	$33,821
Total liabilities	$27,350	$36,462
Aggregate funding balance	$5,081	-$2,641
Total funding balance for plans in deficit	-$796	-$4,346
Total funding balance for plans in surplus	$5,878	$1,705
Aggregate funding ratio	119%	93%

The aggregate going concern funding position continued to improve from 117% as at December 31, 2015, to 119% as at December 31, 2016. The going concern surplus — that is, assets less liabilities — increased to $5.08 billion as at December 31, 2016.

The aggregate solvency position remained unchanged at 93% for both years. The estimated total deficit, however, increased from $2.52 billion as at December 31, 2015, to $2.64 billion as at December 31, 2016. The projected total amount of solvency deficit that must be funded by plans in deficit is estimated to be almost $4.35 billion as at December 31, 2016. This was a further increase of $282 million over the December 31, 2015, results. Plans with solvency deficiencies are therefore expected to increase payments to amortize their solvency deficits.

Plan administrators have taken advantage of funding relief available to them to reduce the payments required to amortize solvency deficiencies.

For example, as at December 31, 2016, plans held $1.255 billion in letters of credit to secure solvency special payments required to be made to their funds. In 2016, plans were able to reduce their required annual solvency special payments from $229 million to $54 million through other funding relief granted by the Office of the Superintendent of Pensions. A number of multi-employer negotiated cost plans have been exempted from making solvency special payments — an exemption that amounted to about $227 million in 2016.

Most of these multi-employer negotiated cost plans have been converted to target benefit plans since September 2015 and will therefore not be required to make payments to fund their solvency deficits.

Over two-thirds of benefit formula plans registered in B.C. are estimated to have had a solvency deficit at December 31, 2016. The solvency relief provided by the October 2016 Order in Council was in recognition of the expected increase in special payments that plan sponsors would be required to make to amortize their growing solvency deficiencies.

We estimate that without the funding relief and using a "fresh start" funding approach (see page 7 of this report), plans would have been required to contribute $927 million annually to amortize the 2016 deficit over five years. With the funding relief provided under Schedule 8 of the Pension Benefits Standards Regulation, it is estimated that plans will be required to contribute $489 million annually to amortize the estimated solvency deficit over 10 years.

GOING CONCERN FUNDING

One of the most significant assumptions in determining the going concern liabilities and normal actuarial costs for a pension plan is the going concern discount rate (or valuation interest rate). This rate represents the long-term expectation of investment return given the asset allocation policy of the plan.

Data from valuations filed with the Superintendent of Pensions between 2013 and 2016 does not show a significant difference in terms of the median going concern discount rates used. The rates fall within a relatively narrow range of between 5.0 and 5.5%. Over 60% of plans filing valuations between 2013 and 2016 used going concern discount rates which fall between 5.0 and 5.9%. About 15% of plans used discount rates of 6.0% or higher.

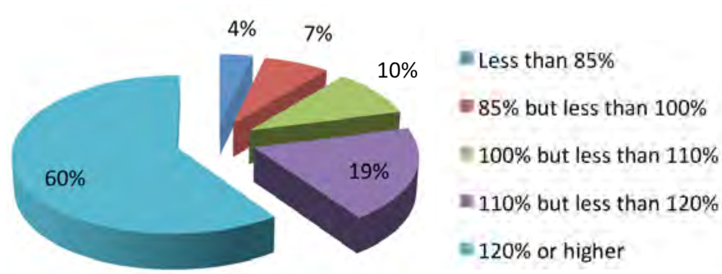
Table 6.2 and Figure 6.1 show the range of estimated going concern funding ratios for benefit formula plans at December 31, 2016.

TABLE 6.2: NUMBER OF BENEFIT FORMULA PENSION PLANS BY ESTIMATED GOING CONCERN FUNDED RATIO, AS AT DECEMBER 31, 2016.

Going Concern Funding Ratio	Number of Plans
Less than 85%	7
85% but less than 100%	14
100% but less than 110%	19
110% but less than 120%	37
120% or higher	114
Total	**191**

Approximately 11% of plans were estimated to have a going concern funded ratio of less than 1 at December 31, 2016 (using benchmark discount rates set by the Superintendent of Pensions), compared with 17% at December 31, 2015.

FIGURE 6.1: PERCENTAGE DISTRIBUTION OF ESTIMATED GOING CONCERN FUNDED RATIOS FOR ALL BENEFIT FORMULA PLANS, AS AT DECEMBER 31, 2016.



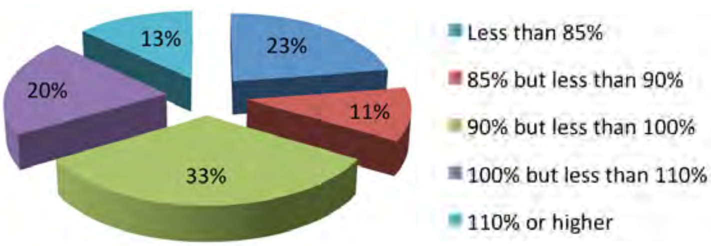
SOLVENCY FUNDING

Table 6.3 and Figure 6.2 show the distribution of estimated solvency ratios of plans at December 31, 2016.

TABLE 6.3: NUMBER OF BENEFIT FORMULA PENSION PLANS BY ESTIMATED SOLVENCY RATIO, AS AT DECEMBER 31, 2016.

Solvency Ratio	Number of Plans
Less than 85%	43
85% but less than 90%	21
90% but less than 100%	63
100% but less than 110%	39
110% or higher	25
Total	**191**

FIGURE 6.2: PERCENTAGE DISTRIBUTION OF ESTIMATED SOLVENCY RATIOS FOR ALL BENEFIT FORMULA PLANS, AS AT DECEMBER 31, 2016.



Solvency Funding Relief

Over the last 10 years, the provincial government has provided temporary solvency relief to administrators of defined benefit plans registered in B.C. to enable them to manage the financial stresses of funding their plans. The relief provided has been either statutory relief granted by government (e.g., a solvency moratorium for multi-employer negotiated cost plans) or relief exercised under the discretionary authority of the Office of the Superintendent of Pensions.

In recognition of the continuing low interest rate environment and its impact on the solvency funding position of pension plans registered in B.C., the Lieutenant Governor in Council approved an Order in Council, effective October 24, 2016, that extended the period over which pension plans would be required to fund solvency deficiencies. (See Schedule 8 of the Regulation.)

The amendment to the Regulation permitted an administrator, on submission of written election to the Office of the Superintendent of Pensions, to consolidate all existing solvency deficiencies into one new solvency deficiency at the review date (i.e., a "fresh start"). The amendment allowed for the new solvency deficiency to be amortized over a period not exceeding 10 years (extended from the usual five-year requirement).

This funding extension is available only for actuarial valuations filed with review dates between December 31, 2015, and December 31, 2017, inclusive.

To date, administrators of 11 pension plans, with a valuation review date of December 31, 2015, have applied to the Office of the Superintendent of Pensions to extend their plan's solvency amortization period based on this amendment. The 11 plans had a combined unamortized solvency deficiency balance of $546.6 million as at December 31, 2015, which required annual payment of $248.6 million in 2016. With the application of the extension, including a "fresh start," the total of annual solvency deficiency payments in 2016 is estimated to be $61.8 million.

Multi-employer negotiated cost plans have also been eligible to apply for an exemption under Schedule 5 of the Regulation. A request for an exemption under Schedule 5: Multi-Employer Negotiated Cost Exemption must be filed on or before December 31, 2016, and such an exemption cannot extend beyond December 31, 2017.

Since 2010, the Office of the Superintendent of Pensions has received 35 applications for exemptions to making solvency deficiency payments. Most plans with solvency exemptions have converted to target benefit plans since September 30, 2015. At December 31, 2016, five plans still had active exemptions from making solvency payments. Of this number, four have applied to convert to a target benefit provision as of January 1, 2017.

Target Benefit Plans

The Government of British Columbia introduced target benefit pension plans under the new *Pension Benefits Standards Act*, S.B.C 2012, c.30, effective September 30, 2015. This plan component provides for a contribution level that is fixed but a benefit level that can vary depending on the funding position of the plan, without requiring the approval of the Office of the Superintendent of Pensions to reduce benefits (if applicable).

Currently, only multi-employer negotiated cost plans can establish and convert accrued benefits, as well as prospective benefits, to a target benefit component. Non-collectively bargained multi-employer plans can establish target benefit plans or incorporate target benefit provisions into their existing plan design, but only on a prospective basis.

Thirty pension plans were registered in B.C. with target benefit components, as at December 31, 2016. These plans have combined assets of $9.5 billion and a total of 215,000 members (52,000 of whom are currently receiving retiree benefits from their plans).

To date, one defined contribution plan has converted entirely to a target benefit component. This plan also includes an option for members to convert their accrued defined contribution accounts to a target benefit.

With the introduction of target benefit plans, pension plan administrators have raised a number of issues about the funding structure and other provisions under the current pension legislation. The following is a sample of the challenges and issues raised:

» Communication to members;

» Training of administrators and trustees;

» Variability in provision for adverse deviation (PfAD);

» Definition of the "equity" component of the PfAD calculation;

» Calculation and disclosure of the solvency deficiency; and

» Payment of commuted values in multi-jurisdictional plans.

The Superintendent's office continues to receive enquiries and suggestion from trustees about the challenges of administering target benefit plans. We are committed to reviewing and providing guidance as and when it is feasible to do so.

Target benefit plan facts, as at December 31, 2016

» Out of the 30 plans with a target benefit plan component, 21 have filed actuarial valuations to support the conversion to target benefit. The remaining plans are expected to file valuations with a conversion date of December 31, 2016.

» The 21 plans had a going concern funding excess of $363 million. Four plans reported a going concern funding deficit. More than half of the plans also reported solvency deficiencies. Legislation requires that plans report their solvency deficiencies, if any, even though they are not required to fund for it.

» Accessible going concern excess was reported as $140 million as at the conversion date.

The following table (Table 8.1) provides information and assumptions used in preparing valuation reports for plans that have converted to a target benefit component as at December 31, 2016.

TABLE 8.1: TARGET BENEFIT PLAN FACTS, AS AT DECEMBER 31, 2016.

	Median %
Funded ratio	120
PfAD	17.2
Equity allocation	48.0
Assumed discount rate	5.6
Benchmark discount rate	5.55
Average rate of return	**6.8**

PROVISION FOR ADVERSE DEVIATION

Under the *Pension Benefits Standards Act*, all target benefit plans must include an appropriate provision for adverse deviation (PfAD). The PfAD is an additional reserve or buffer to assist the plan in times of adverse experience. The PfAD level is dependent on factors prescribed by legislation, including the plan's investment strategy and discount rate assumptions used in the valuation.

The magnitude of PfADs reported to date varies significantly, from a high of 34.5% to a low of 11.7%. The legislation provides that where a pension plan is amended to convert from a defined benefit provision to a target benefit provision, the additional payments required to fund the PfAD need not begin until the third anniversary of the date on which the conversion occurred. Plans that are not converting accrued benefits, however, are required to fund the PfAD immediately.

To date, the Office of the Superintendent of Pensions has received feedback from plan administrators in connection with the prescribed components of the PfAD, the magnitude of the PfAD, the volatility of the PfAD and other matters. The Superintendent will continue to review these comments and feedback and will provide guidance when appropriate.

STRESS TESTING

The aim of stress testing a target benefit plan is to examine whether the plan is sufficiently funded to meet its target benefit obligations under significant adverse conditions. The Superintendent of Pensions intends to use stress testing results as a regulatory tool to assess the financial and demographic risk to which a plan is exposed, in order to determine a supervisory response.

Under section 60 of the Regulation, a reviewer of a plan with a target benefit provision must do all of the following in a manner that is satisfactory to the Superintendent:

» Choose factors that pose a material risk to the plan's ability to meet the funding requirements under the Regulation.

» Provide justification for the risk factors chosen.

» Identify and explain how possible adverse changes in each selected risk factor could potentially impact funding (without the other risk factors changing).

Two elements of stress testing are scenario analysis and sensitivity testing. These important tools are part of the analysis of the risks facing the financial condition of a pension plan. Such examination and testing can enhance the understanding by stakeholders (e.g., administrators, plan members, the regulator) of their plan's financial vulnerability and viability.

The Superintendent of Pensions expects that, for each stress condition identified, the trustees will advise whether the expected contributions under the plan would be sufficient to provide the benefits targeted under the plan. Where the contributions are not deemed to be sufficient, the trustees or actuary should identify remedial measures — in keeping with the plan's benefit, funding or investment policy — that would allow the plan to meet the prescribed funding requirements. The remedial measures might include a reduction or elimination of benefits, a contribution increase, a change in investment strategy, or any combination of all those.

Risk Assessment and Supervision

During the 2016 reporting period, the Office of the Superintendent of Pensions continued to focus on advancing the risk assessment and supervision process for pension plans registered in B.C. We have continued to make adjustments to our risk review process while recognizing the challenges that plan administrators face in the current economic environment.

Risk-based regulation or supervision typically involves "systematised decision making frameworks and procedures to prioritise regulatory activities and deploy resources…, based on an assessment of the risks that regulated firms pose to the regulator's objectives."[3]

At FICOM, our primary regulatory objective is to enhance the benefit security of plan members. Our activities therefore focus on increasing the probability that promised or targeted benefits will be paid. We achieve this by building a culture of risk-based supervision. The risk-based supervision activity is a dynamic process, and we will continually revisit and modify our risk assessment as additional information becomes available. We consider the concept of risk-based supervision to be not only an activity but also a way of making our daily supervision decisions.

We undertake our risk-based supervision activity through a two-step process: risk prioritization and risk assessment.

STEP 1: RISK PRIORITIZATION

This step involves determining key risk indicators for all plans based on data reported by administrators. Key risk indicators are risk factors that provide early warning about a plan's ability to meet its funding obligations. These key indicators enable us to determine the plans with the highest relative risk.

From this exercise, we assign more resources to plans with the highest relative risk in order to develop a better understanding of the issues that could potentially have an impact on benefit security. At FICOM, we have made changes to how we assess the key risk indicators since the adoption of the risk-based process, and we will continue to refine the process based on the results of our ongoing analysis.

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[3] *PROFESSOR JULIA ROBERTS, LONDON SCHOOL OF ECONOMICS, PRESENTATION TO ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), DECEMBER 1, 2008: RISK-BASED REGULATION. WWW.OECD.ORG/GOV/REGULATORY-POLICY/44800375.PDF*

In 2017, based on the results of the Step 1 process, 16 plans have been selected for the Step 2: Risk Assessment. The number of plans selected recognizes the limits of the resources available to the Superintendent to undertake a comprehensive review of the plans with the highest risk.

STEP 2: RISK ASSESSMENT

This step involves a comprehensive assessment of the plans that have been identified as having the relatively highest risk. Our assessments are based on four key risk factors:

- Funding risk;
- Investment risk;
- Governance risk; and
- Plan sponsor risk.

FICOM has continued to make changes internally to advance our risk assessment process. Our goal is to develop a better understanding of the risks posed to members' benefit security. Our staff will engage plan administrators and trustees in developing an understanding of the risk profile of the plans selected.

Governance Self-Assessment and FICOM's Governance Risk Review

GOVERNANCE SELF-ASSESSMENT OF PENSION PLAN ADMINISTRATORS

In May 2016, FICOM undertook a governance self-assessment of all pension plans registered in British Columbia. Administrators were provided with a voluntary self-assessment questionnaire. They were not required to identify the plans for which they were responding. The objective was to develop a baseline of the confidence that plan administrators have in the effectiveness of current governance policies and the processes of administrators.

A summary of our findings from administrators' responses:

- Most administrators responded that they were very confident in their understanding of their duties as administrators of their pension plan.
- Administrators agreed that they had some documented processes in place to ensure they were providing the appropriate controls and oversight of their pension plan.
- Administrators agreed most strongly that they had reviewed their pension plan's investment policy over the last 12 months.
- Administrators were not confident that they had identified and prioritized the financial and governance risks to their pension plan.
- Administrators were not confident that they had processes in place to improve the learning of individuals (such as pension managers, staff and trustees) involved in the administration of their pension plan.
- Administrators were generally confident in their understanding of their oversight functions. These include reviewing compliance reports of investment managers, monitoring compliance with funding reports, and exercising oversight of service providers.
- Administrators were not confident they were providing the appropriate tools to members, such as access to information on their websites.

FICOM'S GOVERNANCE RISK REVIEW

In 2017/2018, FICOM will be undertaking a governance assessment of pension plan administration using a two-pronged process aimed at:

- Understanding and building governance capacity among administrators; and
- Using governance assessment as a risk assessment tool.

Two key aspects in governance assessment:

- *Plan Administration* – Issues/concerns associated with ineffective or inefficient processes or systems in the administration of a pension plan.
- *Plan Risk Management* – Issues/concerns associated with risk management functions, including controls and oversight.

FICOM's governance risk review will focus on four broad function areas:

Roles and responsibilities – The administrator must clearly describe and document the roles, responsibilities and accountabilities of all participants in the pension plan governance process.

Risk identification – The administrator must identify material risks faced by the pension plan, in order to assess and prioritize such risks.

Controls and oversight – The administrator must have documented processes to ensure the plan complies with all regulatory requirements. This should include performance measurements and continuous monitoring.

Communication and reporting – The administrator must have a documented communication plan that will ensure that members are informed, understand their benefits, and have tools available to determine their levels of benefits.

As part of our governance review, the Office of the Superintendent of Pensions will ask the administrators of all plans selected for the Step 2 Assessment to provide FICOM with copies of their governance policies and their most recently completed written assessment of the plan.

Stakeholder Engagement

One of the key strategic objectives of the Office of the Superintendent of Pensions for 2016/2017 was to engage stakeholders in discussions and seek their opinions about the introduction of the new pension legislation. To that end, the Office of the Superintendent held its first pensions stakeholder engagement forum in March 2017, in Vancouver. The aim was to create a forum for stakeholders to share their experiences of how the new legislation is affecting the administration of their plans.

The event was attended by over 100 people, including plan administrators, trustees, fund holders, plan sponsors, consultants, actuaries, accountants, lawyers, representatives from the B.C. financial policy branch, and staff from the Superintendent's office.

ISSUES ADDRESSED AT THE FORUM

The forum covered a wide variety of issues relevant to the administration of plans registered in B.C., such as the following:

Administration – Among the topics discussed were shortened life expectancy, pension eligibility, jointly sponsored pension plans, and ancillary benefits. There was an open forum discussion to highlight the expectations of the Superintendent's office and to provide guidance and direction where required. The Superintendent emphasized that the determination of eligibility for shortened life expectancy benefits should not be based on an arbitrary period determined by plan administrators.

Governance and assessments – The new legislation introduced the requirement for pension plan administrators to develop a governance policy and undertake periodic assessments of the operation of their pension plan. A panel shared their experience from three perspectives:

» *Consultants* – The approach to governance and assessment should not be a one-size fits all, but instead should recognize the unique features of individual plans. While off-cycle assessments are not required, they can be a prudent practice to enable administrators to identify issues early.

» *Board of trustees* – Each board of trustees is unique and governance and assessments should therefore recognize the unique characteristics and skill sets of its members. Boards can use different approaches to assessment, such as a self-assessment or a third-party assessment. However, there has to be a clear board objective on which the assessment is based.

» *Regulator* – A formalized governance role — like the statutory requirement now in place — ensures good outcomes in terms of the security of member benefits. Governance is about understanding the controls and oversight in place in order to achieve the core objectives of the plan. The regulator therefore expects plans to provide demonstrated evidence of effective assessment. Governance assessment is more than ticking a box or meeting legal requirements: it should be a measure of the core beliefs and objectives of the plan and how those are attained.

Target benefit plans – Target benefit plans were introduced in B.C. when the new legislation was enacted in September 2015. The general consensus at the forum was that stakeholders are still trying to understand the funding requirements and administration of this new plan design.

The issues discussed included reporting and disclosure, funding rules, and communication of the pension promise/deal to members. The negative perception in jurisdictions elsewhere of similar plan designs has not helped in communicating the benefits of target benefit plans to members. Trustees indicated that they are using the conversion as an opportunity to engage with and educate their plan members.

Solvency funding – Pension regulators recognize there is a need to find a funding method other than the traditional solvency method for defined benefit plans to suit the current economic environment. The funding method introduced by Quebec incorporates some of the features of the B.C. rules, such as the use of a "banker's clause" (which is similar to the solvency reserve account) and the stabilization provision (which is similar to the provision for adverse deviation for target benefit plans in B.C.). The Superintendent will continue to follow developments in both Quebec and other jurisdictions.

Post-event survey responses summary – The general feedback from participants was that they found the sessions very useful and informative, and as an opportunity to hear about and discuss issues of common interest. Over 95% of participants who responded to the feedback survey indicated they would be very interested in attending future sessions; and they encouraged the Superintendent to undertake further stakeholder engagements in future.

Presentation documents from the forum are available at:
www.fic.gov.BC.ca/index.aspx?p=pension_plans/stakeholder

Bulletins

PLAN TERMINATION EXPENSE ASSUMPTIONS

In June 2017, the Office of the Superintendent of Pensions published Bulletin PENS 17-002 to address the concerns about the termination expense assumptions included in funding valuation reports. The bulletin outlined the Superintendent's expectations about the assumptions employed in the actuarial reports for pension plans with benefit formula provisions.

We have recently had a number of plans where the termination assumptions used for solvency funding purposes significantly differed from the actual cost incurred in terminating the plans. Allowances for termination expenses included in the wind-up valuation reports were significantly higher than what had been reported in the funding valuation reports previously filed with the Superintendent. As a result, member benefits had to be reduced because of the much higher assumed costs included in the wind-up report and because plan assets were also insufficient to fully fund the plan's obligations.

Solvency valuations should provide for expenses that may reasonably be expected to be paid by the pension fund between the valuation date and the date when all plan benefits are settled and assets are distributed. The Superintendent expects the actuary to make and disclose the assumptions as to when the wind-up might reasonably occur after the termination date, taking into account delays that might occur up to the date of final settlement.

The Superintendent will continue to monitor the situation and could request the plan actuary to provide details of termination expense allowances included in future funding valuation reports.

PLAN ASSESSMENT

In June 2016, the Superintendent of Pensions published Bulletin PEN 16-005 to clarify the timeline for the completion of the first triennial (three-year) assessment of plans, as provided by the legislation. The deadline for the completion of the first written assessment with an effective date of December 31, 2016, will be December 31, 2017.

Plan administrators are not required to file their completed written assessments with the Superintendent, but must be able to provide a copy to the Superintendent on request. Staff of the Office of the Superintendent intend to request such copies from a sample of selected plans for review after December 31, 2017.

Notes

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WWW.FIC.GOV. BC.CA

OR CALL OUR TOLL-FREE PHONE LINE: 1 (866) 206-3030.

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