PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

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Ministry of Finance
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Toronto, Ontario
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Dear Sirs and Mesdames:

Re: Rules for Defined Benefit Pension Plans: Description of New Funding Rules

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The Portfolio Management Association of Canada ("**PMAC**"), through its Industry, Regulation & Tax Committee, is writing to comment on an issue of impact to member firms arising out of the province of Ontario's 2018 finalization of legislation and regulations regarding funding rules for defined benefit pension plans (the "**DB plan funding rules**").

Overview

As background, PMAC represents over 270 investment management firms, collectively managing over $1.8 trillion in assets, all of whom are registered to do business in Canada as portfolio managers. PMAC members manage investment portfolios for, among others, private individuals, foundations, universities and pension plans.

PMAC was pleased to provide the Ontario Ministry of Finance (**Finance**) with a submission in response to the January 2018 consultation with respect to DB plan funding rules.

PMAC supports efforts to ensure that DB plans' solvency funding approaches are appropriate and that pension legislation encourages the establishment and maintenance of workplace DB plans that ensure secure retirement benefits for their beneficiaries.

This submission is being made to alert Finance to what we view as a negative and unintended consequence to investors, as well as of unnecessary regulatory burden and cost, of an interpretation of subsections 11.2(8) to 10 of the Pension Benefits Act Regulation 909, regarding the provision for adverse deviations (**PfAD**) calculation.

It is our belief that the issue set out below arose unintentionally and is the result of newly introduced language in the DB plan funding rules not working in concert with existing language in the rules.

The Issue

The newly implemented DB pension funding rules generally require plan sponsors to fund a buffer over the plan's liabilities. The buffer is calculated using the PfAD.

The PfAD calculation is based on the plan's asset mix and, in general, the riskier the asset mix, the higher the amount required as a buffer under the PfAD.

Overall, fixed income investments require a lower PfAD and equity investments require a higher buffer. However, in order for fixed income investments to qualify for the lower buffer treatment, *all* of the fixed income investments in the plan must be investment-grade.

The issue arises with respect to an interpretation provided by the Financial Services Commission of Ontario (**FSCO**) on the PfAD calculation for fixed income assets which provides that, if a plan has *any* non-investment grade investments or *any* non-rated bonds, these investments can taint the entire fixed income category, thus increasing the funding buffer required under the PfAD calculation. This interpretation applies no matter how small the non-investment grade or non-rated bond investments may be compared to the plan's overall portfolio.

FSCO has commented in writing to members that the interpretation of this aspect of the PfAD is necessitated by the interaction of sections 11 and 76 of the Pension Benefits Act Regulation 909, while simultaneously recognizing that such an interpretation is inconsistent with the policy intent of the DB plan funding rules.

Unresolved, this issue is likely to force many Ontario DB plan sponsors to move away from funds that contain any trace of non-investment grade and non-rated fixed income. This would be an undesirable result since use of these funds is increasingly common for DB plan investors looking to generate higher risk-adjusted returns for their portfolios.

In addition to what PMAC views as an undesirable and unintended policy incentive, from a practical perspective, this issue would create various costs for DB plans, including costs related to analyses to establish new portfolios, manager search fees, and transaction costs. None of these outcomes support the policy rationale for the DB pension funding rules, nor are they beneficial to Ontario's capital markets and investors.

The proposed solution

PMAC is writing to Finance, as we understand that FSCO has also done, to raise awareness of the detrimental impact of the wording in the regulation.

To correct the negative impact to investors and fund managers who have added non-investment grade or non-rated bonds to their fixed income portfolios in search of better risk-adjusted returns, PMAC is requesting that Finance amend Regulation 909 as appropriate. For example, adding an additional category to subsection 76(12) for high yield and non-rated bonds could possibly resolve the issue.

PMAC would like to stress that any solution to this issue must also be workable for investment pooled funds (**pooled funds**) and other comingled vehicles. This solution could take the form of a look-through to such funds' underlying investments.

Why pooled funds are important

Pooled funds offer Canadians, particularly the middle class, with access to various asset classes on a cost-effective basis given the ability to find economies of scale by pooling investments and sharing costs. Canadian individual investors and pension plans invest in these pooled funds as retirement savings vehicles. According to a Strategic Insight report from 2017, Canadians have $65 billion invested in pooled funds and the majority of these investments are funds in employer sponsored defined contribution pension plans.

Timing

While the current, transitional PfAD calculation wording does not give rise to the issue set out above, we are nonetheless asking Finance to act urgently to amend the PfAD rules going forward. This is because the PfAD formula that becomes effective in January of 2019 will give rise to these tainting issues and have negative implications for DB plans and their investors.

Conclusion

PMAC would be pleased to speak further with Finance about this issue.

If you have any questions regarding this submission, please do not hesitate to contact Katie Walmsley (kwalmsley@portfoliomanagement.org) at (416) 504-7018.

Yours truly;

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