Pension Investment
Association of Canada
Association canadienne des
gestionnaires de caisses de retraite

January 14, 2021

The Hon. Chrystia Freeland
Minister of Finance
Ottawa, Ontario K1A 0A6

Delivered Via Email: FIN.Pensions-Pensions.FIN@canada.ca

Re: Consultation on Strengthening Federally Regulated Pension Plans

The purpose of this letter is to provide comments from the Pension Investment Association of Canada (PIAC) on the Consultation Paper "Strengthening Canadians' Retirement Security".

PIAC has been the voice for Canadian pension funds since 1977 in matters related to pension investment and governance. PIAC's members manage over $2 trillion of assets on behalf of millions of Canadians. Our mission is to promote sound investment practices and good governance for the benefit of plan sponsors and beneficiaries.

Temporary Relief Measures

PIAC is supportive of the extension of temporary funding relief measures and believes that the consultation document articulates well the challenges facing many companies in the current environment. The necessary extension of economic curtailment measures into 2021 means that many industries will experience two consecutive years with a significant shortfall in operating results relative to normalized levels. Notwithstanding the recovery in capital markets, operating metrics will take longer to repair and there will be many demands on reduced cash flow for plan sponsors for a number of years to come.

Recognizing that companies face a diverse set of challenges, and that individual plan sponsors may have multiple plans with varying funded positions, PIAC recommends that the federal government be open to a variety of relief measures. From a macro perspective, we think that measures which front-end relief into the next 3-5 years will provide the best alignment between what would simultaneously benefit both plan sponsors and the economic recovery. Finally, we recommend that the government move quickly, such that plan sponsors have visibility on pension funding early in the year,

allowing more accurate budgets, and if possible, to re-allocate cash flow toward other business needs, which may aid in the economic recovery.

In terms of the options themselves, our view is that any measures which require consent from plan members will be de facto unviable in most situations other than potentially cases where a plan sponsor is in more acute financial distress. There are fundamental alignment issues with regard to plan funding that are practically difficult to overcome without negotiation, and we believe that most plan sponsors will not want to go down that road unless they have no other choice. In this regard, we strongly recommend against an approval requirement for the one-year extension of the solvency amortization period given the short duration of the proposed measure. PIAC would suggest a disclosure for plan sponsors accessing this option as part of regular plan reporting as an alternative.

We do believe that letters of credit offer an attractive option to reduce up-front cash costs and preserve benefit security and we support some expansion of the limit on the use of letters of credit as they provide near term cash flow relief with protection for plan members compared to options that defer solvency funding. In a similar vein, we also think that surety bonds, which are currently being used by some sponsors to secure non-registered benefits, should be considered for use in solvency funding requirements. From a plan member perspective, they would provide the same level of protection as a letter of credit while offering the plan sponsor competitive pricing and reduce renewal risk by expanding credit capacity, thereby offering relief during these challenging economic times. PIAC would be pleased to discuss this option in more detail with the government at your convenience.

PIAC would caution against unlimited usage of letters of credit, except perhaps for plan sponsors which are government or quasi-government sponsored entities, or which meet demonstrably high credit standards. Off-balance sheet instruments such as letters of credit do not contribute earning assets to the plan which are required in the long-term to fund benefits. Moreover, our understanding is that letters of credit are typically viewed by providers as part of the overall credit exposure to the plan sponsor. In a scenario of a company whose credit profile is deteriorating over time, a large pension related credit facility may serve to impair its overall access to credit.

In terms of alternative valuation methodologies, we support all options which lessen the near-term impact of the decline in interest rates and allow for funding over a lengthened period of time, such as a moving average approach. This would both provide funding relief and perhaps buy some time for the economic recovery to gain traction and mitigate some of the downward pressure on interest rates. We note lastly that federally regulated plan members using the replicating portfolio approach remain strongly of the view that the amendments proposed by OSFI as part of updated actuarial guidance earlier in 2020 be shelved indefinitely. As we indicated in our letter of 13 October 2020, we believe that most plan sponsors are using the replicating portfolio to achieve a very high standard of benefit security already. Moreover, the proposed measures impact most directly the larger plan sponsors who are least at risk from a benefit security perspective. The measures are

counterproductive in the context of the current environment where these sponsors would otherwise channel spending into the economic recovery rather than savings vehicles.

Finally, PIAC reiterates it's view that the need for repeated rounds of temporary relief over a period spanning more than a decade, as clearly enumerated in the consultation paper, is indicative of a pressing need for fundamental reform to the federal solvency rules. Most provincial governments have moved to a going-concern plus regime, which we believe is a more durable model that provides a better balance between appropriate funding and benefit security. Setting a solvency target below 100% on a temporary basis along the lines of many provincial regimes while building towards greater regulatory harmonization among jurisdictions is a relief measure that the federal government is strongly urged to consider.

Plan Governance and Administration

PIAC is opposed to the proposal to require plan member and retiree representation for all plans. While we generally believe that joint representation and sponsorship promotes long-term sustainability for plans where funding and risks are jointly shared, it is important to note that many single employer plans are solely funded by the employer, are closed to new entrants, and/or governed in a public company context through a board of directors. A blanket requirement for plan and retiree involvement in decision-making would likely lead to the creation of additional governance layers with unclear benefits for plan sponsors or members in many cases.

We believe that most of our federal plan members have established procedures for sharing information with employees and retirees around the pension plan, which often includes regular meetings between management and employee and/or retiree committees as well as communication of key elements of pension funded status. To the extent the federal government is concerned about communication and disclosure, PIAC would be pleased to liaise with our members to provide a better understanding of current practices.

PIAC has no concerns about the proposal to require federal plans to establish a governance policy as we believe that most members already do this. Alignment with CAPSA guidance would be eminently sensible and a step forward toward a more harmonized national regulatory landscape. We note that some larger companies sponsor both federal and provincial plans and harmonization would be particularly welcome in these instances.

Similarly, we think that most plan sponsors have already established funding policies as a matter of best practice and we have no objection to formalizing such a requirement. Again, we think that alignment with CAPSA guidance would be the most efficient route to take. We concur with the observation noted in your paper that there is likely limited value to a funding policy for a single employer plan which is fully at the employer risk as funding in these cases is typically driven by regulatory requirements.

Environmental, social and governance factors

PIAC members operate within a fiduciary framework that imposes a duty of loyalty and a duty of prudence on plan administrators. Pension plan trustees are required to act in good faith and in the best interests of plan members and beneficiaries while preserving the intergenerational fairness of the plan(s). PIAC believes, because of the potential for ESG factors to have financial impacts on plan investments now and well into the future, it is within the scope of our members' role as fiduciaries, as currently defined, to consider these in their investment processes.

Further, we have observed a growing consensus to this point, as reflected in:

- The conclusions drawn the 2005 and 2009 Freshfields reports
- The PRI's 2015 report on Fiduciary Duty in the 21st Century
- Broad endorsement of reporting standards such as the Global Reporting Initiative, the Task Force for Climate-related Financial Disclosures and the Sustainable Accounting Standards Board (SASB).
- The proliferation of Stewardship Codes around the world that guide investors on responsible investing principles and activities.

As such, we support guidance from Federal Government affirming that the consideration of ESG factors, including climate change, in the investment process is consistent within a fiduciary framework and which encourages pension plans to both consider ESG factors in the investment process and to disclose how ESG is integrated into the management of pension assets. As a general comment, PIAC believes such guidance would be helpful and valuable to pension plan administrators but would not support guidance if it were overly prescriptive, we prefer a more principles-based approach.

Solvency Reserve Accounts (SRA)

PIAC is supportive of moving ahead with an SRA regime for federal plans, although we would advocate for a more flexible approach to funding the SRA than proposed in the consultation document. The key advantage of an SRA structure is to enable plan sponsors to direct funds to the pension plan during periods when corporate cash flow is robust while taking the question of trapped surplus off the table. Limiting eligible SRA contributions to solvency special payments seems like a lost opportunity to potentially allow more funding into a plan at times when available sponsor cash exceeds minimum funding requirements. In particular, we see no regulatory rationale for not permitting solvency deficit contributions in excess of regulatory minimum funding requirements to be directed to an SRA. We support permitting employer normal cost contributions to be made to an SRA in cases where an employer is in a position to reduce them under 9(5) of the PBSR. Increased funding, be it to an SRA or otherwise, supports benefit security and aligns with regulatory objectives, and a narrow SRA window reduces optionality to no obvious advantage for any stakeholder group.

In terms of retroactive application, we recommend that the regulations permit unused excess solvency special payments to be transferred to the SRA in cases where the plan

text clearly provides for sponsor ownership of surplus. This would allow plan sponsors who have funded in excess of regulatory minimums in recent years to benefit from the proposed regime.

With respect to legal structure, we recommend that Finance be flexible and allow plan sponsors to choose a preferred approach (either a separate trust or a separate account under the same trust) provided they can demonstrate legal certainty with respect to segregation of assets. Plan sponsors may, for example, choose to invest SRA contributions similarly or differently than main plan assets and flexibility around structure will potentially allow for optimization with existing investment structures.

PIAC supports a requirement that a 105% solvency and going concern threshold be met following a withdrawal from an SRA. We also support a five-year period over which the eligible surplus can be withdrawn. As the surplus will change every year, there will likely need to be a recasting of the amortization schedule on an annual basis in cases where eligible surpluses exist. We also recommend that SRA withdrawals be transferable to meet employer DC funding obligations in cases where a plan sponsor maintains a hybrid DB/DC plan.

Disclosure to members regarding the SRA should be included in annual statements and does not need to go beyond the amounts contributed or withdrawn. We would caution against disclosure which might imply to members that a plan has two solvency ratios (i.e., with or without the SRA) as the SRA is structured to be an integrated and robust component of overall benefit security.

To ensure that SRA withdrawals are not based on stale information, we support a requirement that withdrawals only occur in the calendar year following an actuarial valuation as well as a requirement that the plan sponsor does not have any reason to believe that the plan funded position would fall below the minimum 105% thresholds following a withdrawal. We note that the requirement that any eligible surplus can only be withdrawn over five years mitigates much of the risk related to the timing of any single withdrawal.

Variable Payment Life Annuities

PIAC commends the federal government for moving ahead with legislative amendments to facilitate the introduction of VPLAs. This is a key first step in what could be an important innovation in the Canadian retirement savings landscape.

At a high level, PIAC recommends that the government's overall approach should be to allow the VPLA market to develop in a flexible and innovative fashion, subject to a general guidance on process with a view to ensuring appropriate disclosure and actuarially robust structures. As the consultation paper notes, there are different approaches along a number of technical dimensions that a VPLA sponsor may reasonably choose, and we would therefore not recommend overly prescriptive regulation.

PIAC supports a maximum period of three years between filings of an actuarial valuation with OSFI and between benefit adjustments. For clarity, we do not think that the filing of the actuarial valuation and the timing of the benefit adjustment need be linked – for example, a sponsor that chooses to adjust benefits annually should not be required to file an annual valuation with OSFI. We note that a VPLA sponsor has no incentive to arrive at anything other than an actuarially fair valuation for participating members. We also agree that the draft legislative proposal should be amended to not require annual benefit adjustments as VPLA sponsors may adopt different models.

We agree with your proposed approach as regards partial annuitization and unlocking. Both of these represent continuity with existing rules governing DC plans which is appropriate and do not appear to be VPLA issues, per se. PIAC recommends that the government consider further what rules should govern withdrawals from a VPLA. While we believe that locked in capital will be a design feature that VPLA sponsors may choose, the ability to withdraw at least some capital may be a feature that plan members value (similar to early death payouts commonly found in life annuities) and it is likely possible to offer such a feature in an actuarially sound manner. It is therefore not clear to us that a withdrawal feature should be ruled out by regulation.

With regard to entering into a VPLA prior to retirement, we expect that most plan sponsors would default to a VPLA offering at retirement with a view to ensuring that their employees have a complete perspective on their financial situation at the time of making the decision. Having said that, it may be reasonable to let the market develop without prescribing this outcome by regulation.

PIAC agrees with the discussion around disclosure. We would note that most plan sponsors will want to include required disclosure in the annual member statement to reduce administrative burden and the regulations should allow for this.

PIAC agrees that spousal consent should be required for member's electing VPLA benefits, if the VPLA benefit is defined in reference to the electing plan member's single life. That consent is required to ensure joint and survivor pension benefits for eligible spouses, as required by PBSA s.22(2), and not in the context of portability provisions. VPLA benefits remain governed by the same plan, RPP or PRPP, and there is no transfer out of the plan, hence no basis for applying portability provisions. An alternative to this process, which would be administratively simpler and consistent with other existing provisions, is to define VPLA benefits under an RPP in reference to joint and survivor benefits, in which case no secondary spousal consent would be required. Valuation of the VPLA fund can be performed on a joint and survivor basis, as with a defined benefit plan.

With regard to plan termination, a portability option that should be eligible is a VPLA transfer to another VPLA vehicle, which would in practice likely be a DC/PRPP to another PRPP transfer.

Finally, PIAC supports the view that existing PBSA provisions around standard of care should apply for VPLA's. While it is reasonable to assume that some companies will

decide not to sponsor decumulation vehicles in any form to avoid a continuing level of fiduciary engagement with retired employees, it is also appropriate that one set of principles govern the federal RPP complex both in the accumulation and decumulation periods. This will be a necessary part of the decision-making analysis for potential VPLA plan sponsors.

Ministerial Guidelines for Defined Benefit Plan Sponsors

PIAC supports the thrust of the proposed guidelines on the process for seeking special funding relief. The guidelines make it clear that the Department of Finance is looking for management, shareholders, and plan members to share in the costs of putting struggling plans on a sustainable financial footing, which is appropriate.

We note when considering plan sponsor behaviour in the lead-up to a funding relief request, that normal course payment of dividends and/or share buybacks in the face of an underfunded pension plan is not in itself indicative of a lack of discipline around pension funding. With the trend decline in interest rates, many plan sponsors have been dealing with more or less permanent solvency pension deficits for the last decade despite meeting all their solvency funding obligations. This has not however eliminated the need to also meet other stakeholder capital demands which are critical to maintaining access to capital for growth and investment.

Restrictions on borrowing

While not raised in the consultation paper, PIAC recommends that the federal government permanently remove the restriction on borrowing by pension plans as part of its review. As we have indicated, this restriction has become antiquated and is out of step with standard market practice and with supervisory and regulatory guidance. PIAC will follow up with a more detailed submission on this topic.

Yours sincerely,

Natasha Trainor
Chair

20 Carlton Street, Suite 123 Toronto, Ontario M5B 2H5
Tel 1-416-640-0264   Fax 1-416-585-3005   info@piacweb.org   www.piacweb.org