Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

February 28, 2022

Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
Ottawa, ON
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Dear Sir/Madam,

Re: Pension Investment Association of Canada 2022 Federal Pre-Budget Submission

The purpose of this letter is to share the Pension Investment Association of Canada's (PIAC) 2022 Federal Pre-budget Submission.

PIAC has been the voice for Canadian pension funds since 1977 in matters related to pension investment and governance. PIAC's members manage over $2.4 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.

Funding Rule Reform

PIAC is convinced that now is the time for the reform of long-term, minimum funding rules for federally regulated defined benefit pension plans. We believe Canadian pension jurisdictions need one funding rule, as opposed to a going-concern funding rule and a plan termination (solvency) funding rule. This one funding rule, set as a going concern plus regime, can be properly designed to meet the needs of beneficiaries and plan sponsors to balance the need for benefit security and plan sustainability.

The costs and complexities in having two different funding regimes are significant and many of the solvency funding options have not been successful in solving the pension

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funding problem in Canada. This has directly led to the closing of defined benefit pension plans in Canada. PIAC believes one going concern plus funding regime with appropriate margins for adverse deviations is in the best interests of both pension plan members and plan sponsors. Pension plans are inherently long-term obligations such that short term solvency funding policies are not appropriate. Moving to a going concern plus regime allows for more consistency in DB plan funding which can motivate plan sponsors to continue maintaining their plan rather than removing itself from providing a pension plan to its employees.

PIAC has noted a positive impact on the ongoing maintenance of DB plans in the many Canadian jurisdictions that have moved away from solvency funding to a going-concern plus model. It is our hope these rules can be developed consistently with jurisdictions across Canada, such as Ontario and/or British Columbia to promote the efficiencies of regulatory harmonization. PIAC's membership has considerable experience with many of the intricacies and challenges associated with these issues, and we would be very pleased to provide assistance on this important initiative.

Solvency Reserve Accounts (SRA)

PIAC is supportive of moving ahead with an SRA regime for federal plans. SRAs are a useful tool to manage the inherent procyclical nature of pension funding obligations by encouraging plan sponsors to fund beyond statutory minimums during periods of good economic growth through mitigation of the asymmetries related to trapped surplus. As noted by other pension jurisdictions, many pension plans are the healthiest position they have been since 2009.

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 flexibility and to 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.

Finally, 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.

Environmental, Social, and Corporate Governance (ESG)

PIAC commends the Federal Government on its commitment to ESG concerns through measures such as Bill C-12 (Canadian Net-Zero Emissions Accountability Act). 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, including climate change, 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 in the 2005 and 2009 Freshfields reports
- The PRI's 2015 report on Fiduciary Duty in the 21st Century
- The proliferation of Stewardship Codes around the world that guide investors on responsible investing principles and activities

We are also seeing broad endorsement of reporting standards such as the Task Force for Climate-related Financial Disclosures (TCFD), the Value Report Foundation's SASB standards and regulatory proposals that contemplate mandatory disclosure of GHG emissions from the CSA and SEC. These disclosures aid investors in encouraging the information needed to facilitate investors' consideration of climate change risk and other ESG factors.

As such, we support guidance from the 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.

Variable Payment Life Annuities (VPLAs)

PIAC commends the Federal Government for continuing to facilitate the introduction of VPLAs and for considering PIAC's feedback in its implementation. This is a key step in what could be an important innovation in the Canadian retirement savings landscape. However, PIAC recommends broadening access to VPLAs. At present, VPLAs are only permitted within registered pension plans and PRPPs. While in theory PRPPs can accept transfers of registered money from RRSPs and DPSPs, the access barriers are practically insurmountable. Firstly, PRPPs currently only exist in the context of a given employment link, with Quebec being the sole exception. This effectively blocks millions of Canadians who have assets accumulated through their prior employment plans, including locked-in balances from prior registered defined contribution pension plans. Secondly, PRPPs are not being actively promoted by financial institutions due to harsh price controls. PIAC recommends revisiting the PRPP framework to address these issues: enable individual membership, provide more flexibility with price controls at the early stages of PRPP roll-out and enabling decumulation-only longevity pools (also known as "dynamic pension pools").

Prevention of Regulatory Arbitrage

PIAC supports the prevention of regulatory arbitrage by explicitly providing OSFI with the authority to regulate capital accumulation plans of federally registered employers. That regulation should be concerned with plan member outcomes, as opposed to CRA regulation of the transactional aspects of those plans. The aforementioned plans include but are not limited to Group RRSPs, DPSPs, Group RRIFs and Group TFSAs. As these are employment plans, we recommend that they are regulated in a similar method to other employment plans, where the role of the employer is recognized explicitly, rather than the current treatment as a bundle of individual contracts between each employee and a financial institution.

Current treatment of capital accumulation plans that are not registered pension plans leads to significant systemic problems, not least of which is the continued displacement of registered defined contribution pension plans with the group capital accumulation plans. This displacement is driven by both the difference in the regulatory burden and the mistaken view that the employer has essentially no fiduciary responsibility in administering capital accumulation plans. The CAPSA guideline for capital accumulation plans is the only existing piece of quasi-regulation, but it has never been tested in courts, and no provincial regulator who is a member of CAPSA is provided with explicit authority to regulate capital accumulation plans.

Unclaimed Balances

Regarding federal plan administration, we continue to recommend establishing an opt-in fund to deposit unclaimed balances of missing members, or alternatively a death registry. Such a move would permit greater efficiencies in plan administration and enable plans to maintain proper member records or ensure that there is a central location for missing member benefits. In this case the fund must be optional based on individual plan preference and should not be obligatory.

PIAC appreciates the opportunity to comment and would be pleased to answer any questions you may have.

Yours sincerely,

Sean Hewitt
Chair