Pension Investment Association of Canada

Association canadienne des gestionnaires de caisses de retraite

January 13, 2023

Michael Sabia
Deputy Minister
Finance Canada
90 Elgin St.
Ottawa, Ontario K1A 0G6
Via Michael.sabia@fin.gc.ca

Re: Pension Investment Association of Canada (PIAC) calls on Finance Canada to reverse its decision to abruptly cease the issuance of Real Return Bonds.

Dear Deputy Minister Sabia,

The Pension Investment Association of Canada (PIAC) has been the voice for Canadian pension funds since 1977 in matters related to pension investment and governance. PIAC's members manage over $2.8 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.

The purpose of this letter is to bring to your attention PIAC's surprise and concern upon learning in the most recent Fall Economic Statement the announcement to immediately cease the issuance of real return bonds (RRBs). This decision was made without fulsome consultation or warning and impacts our members' ability to responsibly invest and manage the pension entitlements of hard-working Canadians. Moreover, Canada is now an outlier in the developed world by abandoning its RRB program. As a result, PIAC is calling on the Government of Canada to reverse its decision and begin issuing real return bonds in 2023.

The Importance of Real Return Bonds:

As long-term investors responsible for managing long-term liabilities, pension plans are logical purchasers of RRBs. Many of our pension plans pay a pension benefit that is indexed to inflation so that pensioners maintain their purchasing power. Thus, for those plans choosing to buy and hold RRBs, it can serve as a valuable investment tool to keep up with the need to pay out indexed pensions.

In the current inflationary environment, RRBs have a heightened significance as a tool for pension plans to meet their obligations to their members. Asset managers are increasingly being asked to create portfolios that can achieve a certain level of inflation protection. RRBs can perform a unique role as an inflation-protected liability hedge for the portfolio.

With such pressure to maintain inflation sensitive portfolios, the abrupt end to issuing RRBs will force pension plans to look to alternative markets outside of Canada, and to more complex, administratively expensive and less liquid real assets, to manage inflation risk. Inflation linked bonds issued by other sovereigns, or other inflation sensitive assets such as real estate or infrastructure are not only more expensive, complex and less liquid; they do not have the same direct linkage to Canadian inflation. Furthermore, smaller pension plans, and plans with a mature demographic may not have the scale or timeframes to seek out alternative investments. Thus, the government has removed a valuable investment tool for pension funds in Canada.

Harming the Secondary Market*:*

The abrupt end of RRB issuance worsens the relative illiquidity of RRBs leading to even more unreliable market information. Effectively, the decision has created a “dead asset”, handcuffing pension plans that are looking to build liquidity through inflation sensitive assets. More importantly, as stated by the Canadian Bond Investors’ Association, bid-ask spreads are substantially wider, and some maturities have become untradeable making market data for calculating risk limits unreliable.

Inadequate Consultations Informing Assumptions:

The decision to cease the issuance of RRBs was made based on consultations that led the Department of Finance to conclude that there was low demand for RRBs. Unfortunately, this decision was made without robust consultations with some of the primary purchasers of RRBs, including certain pension plans, insurance companies, and other sophisticated investors.

While RRBs have typically exhibited a lower level of liquidity than nominal bonds, it does not mean that there is low demand for the product. Institutional investors for RRBs typically use RRBs as part of a buy and hold strategy, for the purpose of matching cash flows against future benefit payments indexed to inflation. It would be a mischaracterization to state that limited liquidity equals a general lack of demand.

Impacting Hard-Working Canadians:

For all of our pension plans, their obligations are to their members who show up to work every day expecting that their pension plan will be able to meet the promised benefit. Government interventions such as this, make pension plan administration and investment more difficult, and may push plans to seek alternative investments in potentially riskier markets. Now more than ever investors face greater pressure to seek out inflation sensitive assets. Aging demographics are likely to only amplify this demand in the future. This decision reduces the diversity of assets available to pension plans and also raises questions about the Government of Canada's confidence in addressing the current inflationary environment.

PIAC is calling on the Government of Canada to reverse its decision and begin reissuing RRBs. We would be happy to meet with you or your staff to discuss the contents of this letter or answer any questions.

Yours truly,

Peter Waite
Executive Director

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