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

February 8, 2023

Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
Ottawa, ON
K1A 0G5
Via Email: budget2023@fin.gc.ca

Dear Sir/Madam,

Re: Pre-Budget Consultations 2023

The Pension Investment Association of Canada (PIAC) is submitting this letter to provide our input to the Department of Finance on the 2023 budget as it relates to the pension plan regulatory environment in Canada. There are four substantive issues that we would like to highlight, which are explained in more detail below:

1. Funding Reform to a going concern plus funding model consistent with other Canadian jurisdictions,
2. Continued facilitation of the implementation of Variable Pay Life Annuities,
3. Review of the implications of Bill C-228 on Canadian corporations and the pension plans they sponsor, and
4. The decision to cease issuing Real Return Bonds.

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.

Funding Rule Reform

PIAC strongly encourages the federal government to join with the majority of provincial jurisdictions in Canada to reform funding requirements for federally regulated pension plans. As mentioned in PIAC's previous submissions to the Department of Finance, PIAC is convinced that it is necessary to reform long-term, minimum funding rules for federally regulated defined benefit (DB) 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 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. At the current time it appears that Finance Canada is an outlier in recognizing and acting on the need for pension funding reform. 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.

Variable Payment Life Annuities (VPLAs)

PIAC continues to encourage the Federal Government in facilitating the introduction of VPLAs. This is an important innovation in the Canadian retirement savings landscape to provide decumulation options for defined contribution arrangements. As mentioned in our submission last year, PIAC recommends broadening access to VPLAs beyond money purchase products and broadening the scope of offering to RRSPs as well.

In setting standards for VPLAs, PIAC encourages the Federal Government to refrain from setting limits to which entities can offer a VPLA. The Government should promote a broad scope of service providers, including registered pension plans, to encourage a competitive landscape for retirees. Furthermore, standards should seek to promote thorough and transparent communication to members to ensure informed decision making and should refrain from setting prescriptive measures on funding and adjustment limits.

Finally, as PRPPs would be permitted to transition to a VPLA should a member chose to do so, PIAC recommends revisiting the PRPP framework to address the following issues: enabling individual membership, providing more flexibility with price controls at the early stages of PRPP rollout and enabling decumulation-only longevity pools (also known as "dynamic pension pools" or VPLAs).

Bill C-228: An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Pension Benefits Standards Act, 1985

Bill C-228 is intended to ensure that claims concerning unfunded liabilities or solvency deficiencies of pension plans and claims related to the termination of participation in group insurance plans are prioritized during bankruptcy proceedings. While on the surface this appears to be a laudable goal, there are some important adverse consequences of this Bill that need to be understood.

PIAC agrees that pension security is paramount for our pension plan members. However, we strongly disagree that the method to achieve pension security is through adopting a super-priority for unfunded pension liabilities and employee retirement benefits in insolvency situations. The overall impact on the pension and business environment would be harmful and result in unintended adverse consequences for those this Bill aims to assist.

Our submission to the Standing Committee on Finance on October 18, 2022 set out our key observations on this Bill and we urge the government to consider the alternative solutions set out in that submission including:

- working with stakeholders to restructure operations to sustain business activity;
- adopting funding rules under the PBSA consistent with most pension jurisdictions who now follow a going concern plus regime;
- easing SEPP to MEPP merger processes; and
- utilizing Solvency Reserve Accounts to help improve plans' funded status during periods of underfunding.

If the Bill does proceed to be adopted, PIAC urges the government to consider the technical amendments set out in our October 18th submission to lessen the blunt impacts of the Bill's provisions.

Cessation of Real Return Bonds (RRBs)

On January 13, 2023, PIAC made a submission to Finance Canada expressing our surprise and concern over the outlier position of the Canadian government in ceasing to issue RRB's. In that submission we identified the following issues and called on the Government of Canada to reverse its decision and begin issuing real return bonds in 2023.

RRBs are important investment tools for pension plans, particularly those that provide indexed benefits. 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. This is something that will be even more important as a result of the implications of Bill C-228.

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.

Furthermore, 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.

For all of the pension plans that PIAC represents, 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.

Conclusion

PIAC appreciates the opportunity to provide our thoughts on issues for the upcoming budget process. We cannot help but observe the relationships between issues PIAC has advocated for in the past. As mentioned in our 2022 pre-budget submission, we continue to support funding rule reform towards one – going-concern – funding regime for federally regulated defined benefit pension plans as well as creating enabling standards for VPLAs. Furthermore, we wish to emphasize the heightened need for funding reform in light of the risks presented by the government's decision to no longer issue RRBs and the implications of Bill C-228. Pension security for the participants in our members pension plans is of paramount to our work and thus we view the risks presented by these two items as significant with potentially adverse consequences to the pension sector.

We would be pleased to provide any further clarification on our thoughts if desired.

Yours truly,

Peter Waite

Peter Waite
Executive Director