Pension Investment Association of Canada

Association canadienne des gestionnaires de caisses de retraite

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Angela Mazerolle
Chair, CAPSA
25 Sheppard Avenue West
Box 21, Suite 100
Toronto, Ontario, M2N 6S6

Via e-mail to capsa-acor@fsrao.ca

Dear Ms Mazerolle,

Re: CAPSA Draft Guideline on Pension Plan Risk Management

The purpose of this letter is to provide comments from the Pension Investment Association of Canada (PIAC) on the consultation of CAPSA's Draft Guideline on Pension Plan Risk Management, dated May 24, 2023.

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.

PIAC members are supportive of the additional resource made available to help plan administrators integrate best practices into their risk management framework and increase awareness of risk management. Considering the varying degrees of plan sizes and level of sophistication of PIAC members, it is important that the guideline remains principles-based and flexible enough to be cost-effectively implemented by smaller plans (<$500 million) and yet still relevant to the very large plans (>$40B) and all those in between.

Comments regarding the content of the guideline:

- We question in section 2 that Pension regulators may request to review the risk management framework prepared by plan administrators on a periodic basis to ensure the pension plan administrator is fulfilling its fiduciary duty. Considering that fiduciary duty is not limited to pension regulators, we strongly suggest limiting it to "fiduciary standard of care" rather than "fiduciary duty".

- We suggest adding a step in Section 5 (Risk Management Process) regarding risk reporting and providing guidance on the required resources to implement a sound risk framework (people, systems, data).
- We suggest that the list of tools to evaluate the risk (section 5.3) not be limited to sophisticated models or simulation techniques. Sometimes, key ratios driven from accounting data are sufficient to track the risk. Liquidity Coverage Ratio (LCR) and leverage ratios are examples of simple but powerful metrics commonly used to manage the risk.
- We suggest incorporating in section 6.6.3 (Investment Risk Management Practices) the rebalancing constraints considerations for illiquid assets when defining Risk-Based Sensitivity Limits. Illiquid asset classes such as private equities, infrastructure and real estate can account for an important part of a pension asset mix and affect the exposure limits to liquid asset classes.
- We suggest adjusting some risk descriptions in Appendix A:
  - Funding risks: we suggest explicitly including maturity risk in the funding risks, representing the risk that the evolution of the plan's demographics increases the financial risks assumed by stakeholders. A good evaluation of the maturity risk is also important to manage and mitigate inter-generational inequity risk.
  - Liability / Pension / Actuarial risk: we suggest adding economic risks in this section (ex.: interest rates, credit spreads and inflation risks). Risk that a movement on interest rates, credit spreads or inflation have an impact on the funding status or contributions to the plan.
  - Investment risks: we suggest clarifying that market risk should be evaluated with an asset-liability perspective considering some market risks (interest rate, inflation, credit) have an impact on assets as well as on liabilities.
- We suggest editing some of the language in section 6.3.2 related to ESG and fiduciary duty:
  - The terms "ESG information", "ESG factors" and "ESG considerations" appear to be used interchangeable in this section and throughout the document. We suggest that "ESG information" be replaced with "ESG factors" as that is the more commonly used language.
  - that the term 'relevant' when discussing ESG information be changed to 'material', as that is the more commonly accepted term.
  - In the sentence "Plan administrators may determine it is consistent with their fiduciary duty to use ESG information, including for ethical or social impact purposes, as a deciding factor or tiebreaker between otherwise economically equivalent investment options (that is, options that provide equivalent expected risk-adjusted returns)", the concept of the tie breaker implies that one has to

make a choice, when it is prudent to integrate material ESG factors into investment analysis which should contribute to long term financial returns.

- We suggest rewording this to: Plan administrators may determine it is consistent with their fiduciary duty to use ESG factors, assessed like any other investment risk in the analysis process, to inform better long-term investment decision-making. We suggest that footnote #9 in section 6.3.4 be reworded to say "Physical risks include rising sea levels, increased flooding, extreme heat events and wildfires. Transition risks are those risks associated with transitioning to a low carbon economy and include increasing disclosure requirements, shifting asset values, changes in consumer preferences and changes in regulations, technology and business practices.
- Section 6.3.5 on Investment Decision-Making includes a reference to investments in 'green' assets. We recommend that CAPSA provide a more complete definition for what this means or suggest that plan administrators could follow existing taxonomies. It is prudent to be careful and conservative when categorizing "green" investments as scrutiny around greenwashing is increasing.

- We suggest simplifying the guideline since all guidelines are merged (leverage, ESG, cyber…) in one single guidance document. For example, sections 6.4.4 to 6.4.8 could be streamlined as the principles to manage the risk have been already discussed in Section 5. We also suggest reviewing the entire guideline to avoid redundancies.
- We suggest limiting the use of suggested definitions of risk appetite, tolerance and capacity to the guideline. Although it is welcomed to have standardized definitions, we think that these notions are largely used and interpreted differently among industry making it difficult and subjective to standardize these definitions.
- We suggest clarifying in section 6.6.2 what is meant by "Plan administrators with less sophisticated investment strategies". In addition, we suggest revising the content of section 6.6.2 to focus specifically on investment risk. Currently the content outlines general risk management practices and does not indicate how it relates to investment risk.
- We suggest that the guideline clearly distinguish expectations of plan administrators vs. asset managers with respect to investment risk management for pension plans that outsource investment management to a third-party asset manager. This includes, for example, clarifying expectations regarding the establishment and execution of the investment risk management practices outlined in section 6.6.3.
- We suggest clarifying in section 6.6 the difference between "investment risk governance" versus "investment risk management".

Thank you for the consideration of our comments. We look forward to continuing to work with you directly and via the Risk Management Committee to strengthen and modernize CAPSA's Draft Guideline on Pension Plan Risk Management to create an effective regulatory environment that helps support and grow the number of Canadians achieving financial security in retirement.

Yours truly,

Peter Waite
Executive Director

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