



Pension Investment  
Association of Canada

Association canadienne des  
gestionnaires de caisses de retraite

June 18, 2014

The Honorable Kevin Sorenson  
Minister of State  
Department of Finance  
Canada  
140 O'Connor Street  
Ottawa, Ontario K1A 0G5  
Via E-mail: [pensions@fin.gc.ca](mailto:pensions@fin.gc.ca)

Dear Minister Sorenson:

**Re: Pension Innovation for Canadians: The Target Benefit Plan**

The Pension Investment Association of Canada (“PIAC”) has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC’s member funds are responsible for the oversight and management of over \$1 trillion in assets on behalf of millions of Canadians. PIAC’s mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

We are pleased to have this opportunity to respond to your consultation paper on Target Benefit Plans (TBPs). We acknowledge and support the Department of Finance efforts to sustain and broaden pension plan coverage through the introduction of TBPs for federally-regulated pension plans. We believe this is an important and necessary initiative for the Canadian pension system.

It is our intent to provide a number of high-level observations and recommendations to the Department of Finance in proceeding with legislation and regulations to implement TBPs. The focus of our comments will be on governance, investment policy, and risk management.

**General Comments:**

We support the objectives and guiding principles set out in the paper and note the essential strong link that is necessary between the plan's funding policy and the plan's investment policy.

We believe it is essential to establish a strong governance model to ensure TBPs have the necessary resources, particularly in areas of risk management.

We strongly support transparency and believe that communications which are understandable to members are a key element of maintaining confidence with members in what can be a very complex area.

We encourage regulators to ensure that conversion is not onerous for those plans converting from other pension plan designs.

**Governance**

PIAC has been a long-standing supporter of good governance and has established recognized standards of governance to raise both awareness and application of such standards of excellence.

PIAC believes it is crucial to the success of TBPs that the governance model provide representation to parties bearing the various risks of the plan, which includes the employer and plan members. While good governance requires some key elements, it is likely that there is not a one size fits all, so flexibility would be key. PIAC suggests that the Department of Finance legislate key governance principles and requirements and leave the implementation details to the plan sponsors/administrator.

PIAC strongly supports that Board representation (employer and member) include the possibility of independent directors as proposed in your paper. This will promote effective decision-making and broaden the set of expertise available. The process for selection should encourage use of governance best practices. It is essential that comprehensive education / orientation is both available and required for Board members, given the complexity and linkages between decisions.

We strongly suggest that you may want to look to current models to derive the key governance principles most likely to achieve the desired results. In some cases, a board is responsible for investment policy, administration and valuing the plan. A committee solely of employer and member representatives decide on the level of benefits and contributions without broader plan membership involvement. There is a written policy to guide their decision making. The desired risk level of the plan sponsors is incorporated into formulation of the investment policy, and management of the plan supports both plan sponsors in their decision making. Many companies and public organizations in Quebec also have many years of experience operating with fiduciary boards comprised of plan sponsor and member representatives as the cornerstone of plan governance.

**Risk Management and Funding Policies**

PIAC has also been a significant supporter of solid and effective risk management practices. With TBPs, we believe risk management becomes important to ensure the likelihood of receiving certain benefits and maintaining contribution rates at a desired level.

The time horizon for pensions is long term in nature and risk management is somewhat organic as every plan is different. This makes legislating risk management difficult. PIAC believes that risk management should include reviewing the appropriateness of key assumptions (e.g. rates of return, volatility). We would encourage guidance from the CIA that is developed with industry participation but ultimately believe that the Board should make the call on the approach to risk management, and this should be disclosed to members as appropriate.

With regard to funding policy, we understand the government's desire to ensure that target benefits are paid with a high probability but we would caution against imposing margin requirements or probability tests that are excessive. The CIA paper referenced in your discussion paper illustrates well that margins very quickly compound to unreasonably high levels over any sort of medium-term investment horizon. The essence of the TBP is to fund at a reasonable and prudent level with the flexibility to make course corrections along the way. The imposition of large base case margins for TBPs may discourage employer uptake of TBP's by locking in excess base-case costs; make surplus utilization more likely during periods of "friendly" financial markets; and exacerbate intergenerational issues among plan members.

Rather than target a specific excess funding margin on a run-rate basis, it may be preferable to define a "fully funded zone" where targeted benefits are being provided and contributions are being charged - that is, the plan is neither in a deficit nor in a surplus, and there is no additional deficit funding and no surplus being utilized. Such a fully funded zone may better achieve the counter-cyclicity to contribution and benefit decisions that the government desires. For surplus utilization, one could define the conditions that would (a) allow restoring back to a target level of benefits and contributions, and (b) improving benefits above the target level and reducing contribution rates below the target level.

We would also caution against the introduction of new, more complex valuation and funding practices or standards for TBPs as might be the case with the adoption of the probabilistic approach discussed in your paper.

PIAC supports the requirement for documenting funding policy, deficit recovery and surplus utilization. In reality, they are all interconnected and could be combined into one document to ensure the policies remain consistent. These policies could address how intergenerational risk will be managed. We agree with your assertion that such policies should provide clarity around measures to be taken in the event of surpluses and deficits and ensure that measures are taken in a timely manner, in particular with regards to deficits.

### **Harmonization and Accounting Treatment of TBPs**

PIAC has continually encouraged harmonization of pension regulation in Canada as we believe lack of harmonization to be a key deterrent to the establishment and maintenance of pension plans for organizations national in scope. We urge the government to consult with other pension jurisdictions in encouraging a harmonized regime for TBPs.

PIAC believes that clarification on the accounting treatment of TBPs is a key area of concern to potential TBP plan sponsors in the private sector and clarity should be provided. We would encourage the Department of Finance to bring this issue forward with CPA Canada.

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We thank you for the opportunity to share our thoughts with you, and would welcome an opportunity to meet with the Department of Finance on our comments and suggestions.

Yours truly,

A handwritten signature in black ink, appearing to read "Michael Keenan".

Michael Keenan  
Chair