Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

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Christian Nordin
Policy Manager
CAPSA Secretariat
c/o Financial Services Commission of Ontario
5160 Yonge Street, Box 85
Toronto ON M2N 6L9
E-mail: capsa-acor@fsco.gov.on.ca

Dear Mr. Nordin:

RE: CAPSA's Draft Guideline on Pension Plan Prudent Investment Practices and Self-Assessment Questionnaire, and the Draft Guideline on Pension Plan Funding Policy

Thank you for allowing PIAC to present its comments and observations on CAPSA's Draft Guideline on Pension Plan Funding Policy ("Funding Guideline") and the Draft Guideline on Pension Plan Prudent Investment Practices and Self-Assessment Questionnaire ("Investment Guideline and Questionnaire"). As an association representing the largest pension funds in Canada, PIAC is well-positioned to provide meaningful and constructive input to your consultation process.

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.

Funding Guideline

<u>Benefits of Implementing a Funding Policy</u>
PIAC agrees that a funding policy is a component of a good governance framework. However, discretion over what is included in the funding policy is a plan sponsor decision. In this regard, PIAC believes:

- The CAPSA Funding Guideline should not dictate a level of funding requirement that would change the minimum funding rules already prescribed in pension legislation;

- The funding policy should not repeat what is in other governing documents, such as the Statement of Investment Policies and Procedures (“SIPP”); and

- Flexibility in creating a funding policy is essential to reflect the unique issues for different types of pension plans, for example single employer pension plans (“SEPP”) versus multi-employer pension plans (“MEPP”) or jointly sponsored pension plans (“JSPP”).

Plan sponsors need to have assurance that following all the regulatory requirements (i.e. meeting minimum funding) when adopting a funding policy will continue to be viewed as a significant element of a best practices approach.

Sponsor Flexibility and Applicability of the Funding Guideline

As noted in the Funding Guideline, the plan sponsor can act in its own interest with consideration for its own stakeholders with an implied duty of good faith to its pension plan beneficiaries. Although the Funding Guideline acknowledges that plan sponsors require flexibility and that competing organizational demands are important considerations, PIAC feels that this point should be further stressed.

For a SEPP the decision to fund the pension plan beyond the minimum is clearly within the plan sponsor’s discretion as the funding entity. The Funding Guideline suggests that a funding policy should be communicated widely whereas PIAC notes that for a SEPP communication with plan beneficiaries may not be optimal. For example, funding may be a collective bargaining issue.

The Funding Guideline has more practical application to a MEPP or JSPP where funding directly impacts beneficiaries via benefit levels that may fluctuate as often as annually. As a consequence, communication with beneficiaries and a high level of transparency are appropriate for these types of plans.

PIAC agrees with CAPSA’s recommendation on communication between the administrator and the sponsor as key to the prudent management of the plan and the ability to meet short and long term obligations. The caveat is that the level and form of communication should still be left to the administrator’s or sponsor’s discretion.

Policy Interaction

The funding of a pension plan is impacted by its benefit policy, which is reflected in the plan text, funding arrangements and collectively bargained benefits. Although this is not directly discussed in the Funding Guideline, changes to one policy (for example SIPP or funding policy) cannot be viewed in isolation and the interaction between policies must be considered as part of a good governance framework.

Finally, the sponsor is already expected to provide input into the selection of actuarial assumptions and methods. It is unclear how Item 9 in the Funding Guideline changes this and PIAC is concerned that the focus on issues such as margins for adverse deviation will interfere with plan sponsor discretion.

Investment Guideline and Questionnaire

PIAC supports initiatives that seek to harmonize investment practices across jurisdictions so therefore PIAC is supportive of the Investment Guideline and efforts to provide practical tools such as the Questionnaire. In this regard, it appears that most items covered in the Investment Guideline are already required elements of investment policy in most Canadian jurisdictions. It is not clear though, whether there are additional requirements set out in the Investment Guideline that might effectively result in CAPSA creating an additional regulatory layer for plans.

In addition to concern over the applicability of the Investment Guideline in various jurisdictions, PIAC has concerns on a variety of specific issues related to the Questionnaire, including:

- the degree to which Plan Administrators can rely on the Questionnaire to meet their fiduciary and prudency requirements;
- the level of detail in the Questionnaire and the use of a prescriptive approach rather than employing a prudence standard;
- the inconsistent format of the Questionnaire;
- the duplication across other CAPSA Guidelines and within the Questionnaire itself;
- the distinctions between defined contribution and defined benefit plans and between corporate and other types of sponsors; and
- in some cases, specific terminology within the documents is not always appropriately used.

Referring to our prior submission dated April 30, 2010 regarding “The Prudence Standard and the Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment” (http://www.piacweb.org/submissions_to_government.html), we reiterate the need to distinguish between investment policy issues and implementation issues, with the former being important for the Investment Guideline.

In presenting our comments in this letter, the goal is not to comment on all sections and articles of the Investment Guideline and Questionnaire, but we will use one or two specific examples to demonstrate our perspective.

<u>Overlapping Policies</u>
The Investment Guidelines overlap with CAPSA Funding Guidelines and other Guidelines issued by CAPSA. Many items related to appropriate delegation and documentation are included in the CAPSA Governance Guidelines and Governance

Self-Assessment Questionnaire. Further, many items related to defined contribution plans are included in the CAPSA Capital Accumulation Plan Guidelines. The original consultation document was named "The Prudence Standard and the Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment". The sections related to Prudence and the Roles of Plan Sponsor and Plan Administrator are now duplicated in the Funding Guideline and the Investment Guideline. For example, CAPSA is suggesting that both the Funding Guideline and the Investment Guideline require a section on Risk.

PIAC agrees that the overlapping areas are important and should be considered during policy setting and decision making. However, a pension plan is typically managed as a comprehensive entity and a requirement to address the same issue in every policy is not practical. A holistic view rather than specifically itemizing written areas for each policy is common and should be acceptable.

Distinction Between Defined Benefit and Defined Contribution Plans

Although the Investment Guideline recognizes that defined contribution (DC) plans are different from defined benefit (DB) plans, they state that any of the Guidelines/Questionnaire can apply to DC plans. However a specific section for DC plans is included in the Questionnaire. Clarity on DB versus DC is required.

General Clarity Issues

CAPSA's Questionnaire should provide plan sponsors with a tool to ensure they have met all prudent standards and regulatory requirements related to the investment policies of their plan. The Questionnaire references the federal investment rules and the need to ensure that the SIPP is reviewed regularly so it remains in compliance with relevant pension legislation. It needs to be clear that simply completing the Questionnaire is not a guarantee that a plan administrator has met the prudence standard or has discharged its broader statutory obligations. PIAC suggests making an explicit statement in section 5 that the Questionnaire is not an exhaustive list of regulatory requirements. It would also be useful to include references or links (at the date of publication) to appropriate jurisdictional requirements for SIPPs.

To make the Questionnaire useable and practical for the plan sponsor, PIAC recommends that it be written in a consistent format. For example, using a question based approach rather than using a mix of formats (points to consider, checklists, some open questions). The preamble to each section in the Questionnaire puts forward several relevant considerations, which are then followed by lists of additional (and in some cases overlapping) considerations in a table format. We also note the significant overlap between many sections. For example, section 4 makes repeated references to the investment objective, which is the heading for section 3.

PIAC also notes that the Questionnaire in particular is too specific in some areas to apply to all types of plans. Some parts of the Questionnaire are based on investment beliefs and/or investment perspective that vary by plan and may be construed as limiting factors. For example, section 4, article 2, mentions risk mitigation by investment style (e.g. value/growth or index/active). Although style diversification may be one way to diversify investment risk, such an approach may be appropriate in some markets and not others. Similarly, using correlation as a risk mitigation factor is a legitimate tool but, as demonstrated in the 2008 market crisis, historical correlations can be unstable.

Article 2 of section 4 in the Questionnaire lists certain types of risks. In this section, investment risk appears redundant; market risk and interest rate risk are not necessarily separate; further, the definition of demographic risk is not clear. Reference made to risk tolerances should often refer to risk identification and the degree of acceptance or mitigation. For example, the reference on page 3 states that the "...investment function should be undertaken in accordance with the prudential principles of security and liquidity...". While liquidity is an important risk, PIAC is concerned that this reference elevates liquidity to a fundamental principle. PIAC also notes that, for clarity, terminology needs to be consistently and accurately applied.

Conclusion

We reiterate PIAC's support for the principles based approach underlying the Funding Guideline and the Investment Guideline and Questionnaire. The changes we have suggested are to provide additional clarity and avoid duplication between CAPSA and the regulatory authorities and between a funding policy and other governing documents.

PIAC would welcome the opportunity to discuss our comments and observations with you further.

Yours sincerely,

Barbara Miazga
Chair