



Pension Investment  
Association of Canada

Association canadienne des  
gestionnaires de caisses de retraite

May 26, 2011

Tim Thomson  
Project Manager  
Financial Services Commission of Ontario  
5160 Yonge Street, Box 85  
Toronto ON M2N 6L9

Dear Mr. Thomson:

**RE: FSCO Risk-Based Regulation Framework**

PIAC is pleased to present our comments and observations on FSCO's Risk-Based Regulation Framework. 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.

**PIAC Response to Consultation Questions**

**General questions**

1. *Do you agree with FSCO's overall approach to risk-based regulation?*

**PIAC Response:** Yes, PIAC supports and congratulates the government on the development of this framework which will contribute to the goal of enhancing the sustainability of pension plans in Ontario.

2. *Do you think that the proposed Framework will help FSCO more effectively regulate registered pension plans?*

**PIAC Response:** Yes, we do. It is within the regulator's key responsibilities to identify and flag risks that impair the ability of a financial vehicle being regulated to fulfill its promised purpose.

### Specific questions

3. *Do you agree with the design principles on which the Framework is based?*

**PIAC Response:** Yes, PIAC supports the principles for the risk-based approach to regulation, but at the same time recommends that application of such principles do not lead to onerous compliance requirements that could discourage plan sponsors from establishing and maintaining pension plans.

**Recommended:** Refine the following two principles by adding the following concepts:

- Consistent: All the risk measures taken together, not only stand alone, should lead to a consistent measure of risk exposure across all plans.
- Informed: Education should be the first response to 'emerging risks'.

4. *Do you agree that the Regulatory Response Model is an appropriate way to regulate pension plans and to guide regulatory response actions?*

**PIAC Response:** Yes PIAC does, however the proverbial "devil is in the detail" of what triggers the categorization of plans into one of the four quadrants would apply. Our key concerns and recommendations are as follows:

- Lack of clarity on definitions and metrics in the analysis makes it difficult for plan sponsors to understand both how the data will be collected and how it would be used.

**Recommended:** Clarify all terms and metrics so that a plan sponsor could calculate themselves how they would be rated using the quantitative measures.

- Communications need to be ongoing and fulsome. It should be the goal of FSCO to have no surprises for plan sponsors.

**Recommended:** Carefully plan the communication process to include:

- Raising general level of awareness of the process amongst plan sponsors
- Clarifying how and when various steps will apply
- Clarifying what plan sponsors will be asked for, and what FSCO will calculate from other data provided. For example, it appears that the Fund benchmark return (for the Investment Performance Concerns metric) will be calculated indirectly using asset mix information provided in the SIP&P. This can be a complex calculation and using indirect data is likely to produce different results from the benchmark used by the plan sponsor. Sponsors should have to option to provide this measure directly, if desired.

- Advise plan sponsors annually if their plan is not under investigation, or when an investigation has been completed and their plan is clear of any issues that might lead to a Tier 2 investigation.
- Contacting plan sponsors if potential issues exist to advise and enable them to provide clarifying information before the issue escalates and additional or unnecessary analysis is conducted by the regulator. (For example, a large allocation to illiquid assets may cause a plan to be considered higher risk; however the plan sponsor may have an analysis demonstrating how this lowers plan risk).
- Identifying the individual risk rating and rationale to plan sponsors in a customized letter. The letter should include the specific risk indicators and their calculation and provide benchmarking used.
- Maintaining confidentiality by ensuring the results of a specific plan's risk-rating are not publicly available to enable organizations to appropriately manage labour relations and reputational risks.

5. *Are the risk universe and related risk indicators appropriate for risk assessment purposes? Are there any other risk indicators that should be taken into account?*

6. *Have we identified the right data sources and regulatory tools in support of the Framework? Are any data unnecessary or too difficult to obtain? Are there any additional data we should collect and use?*

**PIAC Response to Q5 and Q6:** The Financial Risk indicator categories of Funding and Investment are appropriate, but we are concerned that some of the indicators such as Credit Quality and Currency Risk will be very complex to evaluate with very little to be added to the score either way.

PIAC believes that the Funding Risks should be weighted more heavily in the scoring of a plan than the Investment Risks. This weighting is currently 60%/40%, but it is not clear if this will be maintained if and when the data for the new indicators are developed and how the weightings will be redistributed to include the future enhanced measures.

Further, it should be expected that diversification and risk management will usually be more complex for larger funds. This will speak to analytical and measurement tools needed as well as the requirement for investment knowledge, sophistication and experience on the part of the FSCO reviewers. This also points to the need to consider all risk indicators as a whole and in the context of the entire fund.

**Recommended:**

- Ensure that there is a balance between the materiality of the measure and the complexity in calculating it.
- A better measure of overall diversification / concentration is needed rather than focussing on individual risks such as currency risk and credit quality risk in isolation.

- What about a measure for leverage?
- Ensure that the weightings applied to the Funding Risk Indicators are over weighted relative to the other Risk Indicators for the other Categories, since Funding Risk is the most important measure of benefit security.
- The financial risk of the plan sponsor is a key factor in determining the safety of the benefits, so developing the intelligence process to collect this data should be a focus.

7. *Do you have any comments on the regulatory process flow and the related business processes?*

**PIAC Response:** PIAC believes that key to the success of this regulatory process is the education and experience of FSCO staff who will be implementing it.

**Recommended:**

- Subjective judgements should be minimized wherever possible.
- FSCO staff should be carefully trained to ensure metrics are calculated and analyzed consistently and fairly between plans.
- FSCO should establish a review committee to ensure the subjective judgements of staff are consistent between staff.
- Once the new risk-based framework has been in place for a year and more data is available on Tier 1 vs. Tier 2 ratings, these results should be shared publicly and if necessary the metrics and measures recalibrated to ensure the framework is meeting the desired goal within an appropriate allocation of resources both for FSCO and the plan sponsors.

8. *Do you consider the transition plan reasonable, in the light of FSCO's regulatory capacity and the stakeholders' expectation?*

**PIAC Response:** We take this question to refer to the gradual implementation of the Framework. PIAC generally agrees that this is reasonable, as long as the education, communication and engagement with plan sponsors is comprehensive and ongoing (as discussed in other sections of this letter) and that FSCO resources are adequate. For example, PIAC supports e-filing, assuming FSCO has the IT infrastructure to bring this information into the framework.

**Recommended:** As development and implementation of this project continues, FSCO should periodically re-evaluate the resources available to ensure they are adequate and effective, and ensure that additional knowledgeable resources are available, if required.

9. *Do you agree that the proposed stakeholder education and engagement activities would enhance stakeholders' understanding of FSCO's risk-based regulation approach?*

**PIAC Response:** Yes, PIAC supports comprehensive communication and engagement with stakeholders and the customer service approach described in the paper. As already stated in this submission, we believe the communication with individual plan sponsors should be ongoing and customized to their plan results.

**Recommended:** Communication should have multiple stages encompassing awareness, education and clarification of specific plan status within the process, even before a conclusion is made on the appropriate rating.

In conclusion, we reiterate our congratulations to FSCO on this important work to enhance the security of pension plans and funds in Ontario. We thank you for this opportunity to share our thoughts with you.

PIAC would be pleased to discuss our comments and observations with you further if desired.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Barbara Miazga', with a stylized flourish at the end.

Barbara Miazga  
Chair