PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

August 29, 2019

Financial and Corporate Sector Policy Branch,
Ministry of Finance
PO Box 9418 Stn Prov Govt
Victoria, BC
V8W 9V1

Email: PBSA.SolvencyReview@gov.bc.ca

Dear Sirs and Mesdames:

Re: A Review of the Solvency Funding Framework under the *Pensions Benefits Standards Act*: A Consultation Paper

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Background

The Portfolio Management Association of Canada[1] (**PMAC**) is pleased to have the opportunity to provide feedback on the Ministry of Finance's (**Ministry**) consultation with respect to "A Review of the Solvency Funding Framework under the Pensions Benefits Standards Act: Report on Stakeholder Committee Process" (the **Report**). Capitalized terms used in this letter but not defined shall have the meanings given to them in the Report.

As background, PMAC represents over 275 investment management firms registered to do business in Canada as portfolio managers. PMAC members manage investment portfolios for, among others, private individuals, foundations, universities and pension plans.

Overview

PMAC's submission on the Ministry's consultation titled "A Review of the Solvency Funding Framework under the *Pensions Benefits Standards Act* (the Act): A Consultation Paper" (the **Initial Consultation**) supported adopting Enhanced Going Concern Funding Rules with a provision for adverse deviation (**PfAD**). PMAC is pleased to see that the Ministry intends to go in this direction.

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[1] PMAC was established in 1952 and represents firms that manage total assets in excess of $2.5 trillion. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. For more information about PMAC and our mandate, please visit our website at http://www.pmac.org/.

However, we believe that additional detail and a more meaningful opportunity for stakeholder engagement is warranted, and that the 28-day consultation period is not sufficient. This is especially the case in light of the Ministry's intention to enact the amendments by way of regulation prior to year-end when balanced against the importance of ensuring that pension funding rules better support long-term Plan sustainability and benefit security and encouraging DB Plans to continue to provide lifetime pensions to their members and other beneficiaries.

Fundamentally, PMAC questions the rationale underlying the proposed PfAD calculation. For example, we do not agree with the Guiding Principle that PfAD requirements based on investment mix inappropriately influence decision-making and the suggestion that it is not the Ministry's role to influence investment decision-making for DB Plans. The investment mix affects pension plan risk, and we do not view policies aimed at reducing risk as being inappropriate – in fact, this is essential to the long-term stability of DB Plans.

Key Recommendations

In order to preserve and foster a healthy pension eco-system, PMAC has the following key recommendations stemming from the Report:

1. The Ministry should revisit the proposals in the Report to consider the broader risks to Plans beyond the interest rate risk alone. Moreover, the Ministry should reconsider the Guiding Principle that PfAD requirements based on investment mix inappropriately influence decision-making, as well as the underlying suggestion that it is not the Ministry's role to influence investment decision-making for DB Plans;

2. The Ministry should provide more specificity regarding the PfAD formula in order to enable stakeholders to assess the potential impact of such a PfAD on Plans, plan members and other beneficiaries, and should consider the unintended consequences of the proposed approach;

3. The Ministry should seek to harmonize pension regulation with other major Canadian jurisdictions so that plan members and other beneficiaries benefit from the same levels of protection and reductions in underlying Plan complexity and compliance costs, no matter their jurisdiction of residence; and,

4. The Ministry should extend the timeframe for comments on the Report.

Feedback

Additional feedback on each of our four key recommendations is set out below.

1. **Consider broader risks to Plans than the interest rate risk alone**

PMAC members feel that the proposed PfAD Technical Details take an overly-narrow view of Plan risk. PMAC asks the Ministry to revisit the proposals in the Report to consider the broader risks to Plans beyond the interest rate risk alone.

Based on our reading of the proposed PfAD formula, it appears designed to build up a margin as interest rates rise and then release the margin as rates fall. Our reading is that, were interest rates to fall to zero per cent, the PfAD would treat the Plan as not having any risk. We believe this may be an unintended consequence of the proposal and/or that this may be based on the assumption that long term interest rates will invariably rise from their current levels. PMAC believes that the proposed PfAD formula will not provide the intended Plan contribution stability if interest rates were to fall from their current levels.

We further note that there are other potential significant risks to Plans – such as equity market risk – that warrant inclusion in the PfAD but which we do not see adequately addressed in the Report.

Additionally, PMAC believes that it is appropriate for pension regulation to influence investment strategies for example, through policies that encourage desirable investing behaviour.

Quoting from page 2 of PMAC's January 2019 submission:

> [T]he exact formulae used to calculate the PfAD are of utmost importance to review during the consultative phase to ensure that there are no unintended negative consequences. The component parts of the PfAD calculation can either promote or inhibit the alignment of a Plan's investment objectives with the best interests of stakeholders, including Plan members.

2. Tension between simplicity and predictability of outcomes for the Canadian pension sector and investors

PMAC is concerned that the high-level nature of the proposed PfAD calculation makes it very difficult for stakeholders, including the Ministry, to predict what impact the PfAD may have on Plans and plan members.

While PMAC is supportive of easy-to-understand regulations where they are required to be understood by everyday investors, we do not believe that PfAD calculations should be overly simplified for that reason alone. If some additional complexity is required to achieve the desired outcome (i.e. Plan stability), the ends will justify the means. PMAC further notes that Plan sponsors often rely on internal experts for many aspects of the operation of their Plans. Due to the involvement of these experts, we believe that specificity is more important than simplicity in this regard.

Based on the Technical Details, there is almost no ability to predict or assess whether the PfAD would have unintended negative consequences on investment behaviour and overall plan risk management. The inability to foresee how Plan sponsors may react to these rules is concerning to PMAC.

3. Harmonization of pension regulations

Closely connected to the first two recommendations is our request that the Ministry seek, where at all possible, to align British Columbia's pension regulations with those in other Canadian jurisdictions. PMAC advocates for harmonized legislation and regulations because we believe investors benefit from having the same level of protections, as well as from reductions in underlying Plan complexity and compliance costs that are passed along to those plan members and other beneficiaries.

4. Additional explanation and time for feedback

Considering the questions and comments above, PMAC requests that the Ministry extend the deadline to provide comments on the Report. Prior to being able to provide more meaningful feedback on the Report, we first believe the Ministry should provide additional detail regarding the rationale for the proposed PfAD formula set out in the Report.

We believe that certain of the Guiding Principles and the statements made in Section 6 "Rationale for PfAD" merit further explanation and context, as these are not necessarily universally accepted approaches to funding buffers for Plans.

For example, certain members disagree with the Guiding Principle that states: A PfAD should be based on the main risk that most DB pension plans are exposed to but cannot control, which is interest rate risk. PMAC is of the view that changes in interest rates affect both Plan assets and liabilities and that it is the net effect that is the most relevant risk to a Plan. Interest rate risk may be controlled through the better matching of interest rate sensitivity between assets and liabilities. The amount of interest rate risks Plans opt for is a choice. As such, PMAC believes the Ministry should reconsider and/or more fully explain the rationale for this Guiding Principle and its impact on the proposed PfAD.

PMAC notes that there are two references to "innovative investment strategies" in the document, as follows:

- "A PfAD should neither reward nor penalize plans for innovative investment strategies that appear to increase fixed income allocation but retain market risk."

- "In addition, many plan sponsors would adopt innovative investment strategies to avoid PfAD funding requirements."

Both instances appear to suggest that "innovative investment strategies" are necessarily inappropriate. On the contrary, we believe that innovation in the asset management industry is positive and can be a useful tool for a Plan sponsor to address evolving needs.

We believe that the Ministry will receive better and more informed comments from stakeholders once additional background information on these statements can be reviewed and evaluated.

Moreover, if material changes are made to the proposed PfAD, we believe that an additional round of stakeholder comment would be appropriate.

Conclusion

We recommend that the Ministry re-examine its approach to the role of the regulator in encouraging sound investment behavior, in the ability to manage risks beyond just interest rate risk and to provide additional information and opportunity for stakeholder feedback on the Technical Details in the Report.

We would like to thank the government of British Columbia and the Ministry for this initial work and for your on-going commitment to strengthening the province's retirement income system.

If you have any questions regarding this submission, please do not hesitate to contact Katie Walmsley (kwalmsley@pmac.org) at (416) 504-7018.

Yours truly,

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