September 29, 2023

CAPSA Secretariat
25 Sheppard Avenue West
Box 21 - Suite 100
Toronto, Ontario M2N 6S6
Sent via email

To Whom It May Concern:

RE: CAPSA Pension Plan Risk Management Consultation

Thank you for the opportunity to provide our comments on the CAPSA Pension Plan Risk Management Consultation.

ACPM is the leading advocacy organization for plan sponsors and administrators in the pursuit of a balanced, effective and sustainable retirement income system in Canada. We are the voice of retirement plan sponsors, administrators and trustees in the private and public sector and our membership represents retirement income plans that cover millions of plan members.

Purpose, scope, structure, and utility of guideline

We agree that proportional risk management is essential for pension plans. However, we are concerned that the draft Guideline is trying to cover too many diverging topics and audiences, thereby impairing its practical applicability.

While it advocates for a risk management framework for all pension plans, the draft Guideline lacks a structural framework that would allow plan administrators to implement a process to identify, evaluate, manage and monitor material risks. The information provided may affect the risk profile of a pension plan. However, the draft Guideline is overwhelming to the reader. It appears to be the culmination of information from a variety of different sources and it would benefit from a careful review and refinement for consistency and brevity. A shorter document would better focus plan administrators' attention on the steps to be taken to establish an effective risk management program.

The draft Guideline should also consider the target audience. We fear that the majority of plan administrators will not be equipped to make any practical use of this guideline. Section 2.1 acknowledges proportionality, but, aside from this initial acknowledgement, there is little consideration of or express guidance for smaller plans within the Guideline. A self-assessment questionnaire, similar to the Guideline No. 4 Pension Plan Administrator Governance Self-Assessment Questionnaire, would help plan administrators focus on the risk management sections that are most relevant to their situations as opposed to diluting their resources by trying to accommodate every facet of this lengthy guideline.

To illustrate, Section 5.4, page 11, states that "it can be the case that the costs of implementing a control exceed the possible costs of addressing the risk after it materializes." A similar statement is found in section 6.3.1, page 23, which states "Cost-efficiency is another relevant consideration; risk adjusted returns are prudently assessed on a net-of-fees basis." These two statements should be made of general application. They usefully illustrate the challenge that can arise for smaller plans who must consider whether the cost of particular efforts to manage risks will exceed the anticipated improvement in risk-adjusted returns. However, these are the only two cautions of this nature provided in the draft Guideline. This lack of general guidance leaves the administrators of smaller plans to determine whether and how to incorporate the principles into their governance, whether through their own resources or by incurring material consultant expenses.

Though the draft Guideline states that it is intended for all plan administrators of defined benefit, defined contribution, pooled registered, target benefit or hybrid pension plans, most of the content addresses issues applicable to primarily defined benefit and, perhaps to some extent, target benefit plans. More direction on how a plan administrator can adapt their risk management practices to better reflect their own situation is needed, particularly for small plans and defined contribution plans.

Finally, there is a confusion of purpose between providing a guideline to establish an effective risk management process and providing educational background on risk management in general. The draft Guideline states "A priority for CAPSA is to ensure that this Guideline is relevant and helpful for all pension plans." To achieve this objective, we suggest the following:

- Separate the educational from the practical. The draft Guidelines should be focused on what plan administrators should be doing to fulfill their fiduciary duties. Educational material can be made available as supporting material rather than overburdening the draft Guidelines.

- Provide a clearer vision of what compliance looks like. The CAPSA governance guidelines (current version, before the proposed revision) provides a series of discrete principles with a self-assessment tool.

- Focus on pension-specific material where CAPSA can add value. For non-pension specific material - for example, cybersecurity underpinnings - CAPSA should defer to subject matter experts as plan administrators should also do.

- Anchor the guideline in a plausible framework. One approach would be to leverage regulators' risk assessment frameworks to bring them to a plan administrator's point of view. For example, OSFI's risk matrix, which it uses to assess the "overall safety and soundness" of the plans it regulates, focuses on the significant activities of actuarial, administration, asset management and communication functions broken down into inherent risks: investment, valuation, operational, legal / regulatory and strategic. These categories essentially encompass the risks identified in the draft Guideline. Indeed, the risks identified in Sections 3 and 6, and the risk table in Appendix A largely overlap with the risk matrix. For example, cybersecurity is part of the operational inherent risk, while ESG and leverage are subsets of investment risks.

(Note that in Section 3, there is a reference to "liquidity" where the term "liability" would be a better fit, aligning with Appendix A.) Governance is not directly mentioned as a risk in the matrix but would underpin the controls and oversight functions.

OSFI risk matrix

Significant Activities	Inherent Risks					Quality of Risk Management		Net Risk
	Investment	Pension / Valuation	Operational	Legal and Regulatory	Strategic	Controls	Oversight	
Actuarial								
Administration								
Asset Management								
Communication to Members								
							Overall Net Risk	

- Provide more guidance to plan administrators on what types of risks may be most material for their plans. For example, a pure DC plan would not have actuarial risks for the plan administrator. Another approach would be to triage between risks to better identify the most critical ones affecting all plans and who is best placed to manage them (i.e., administrator, investment manager, etc.).

- Revise the specific risk "chapters" in Section 6 to follow the same steps of identifying, evaluating, managing and monitoring risks, as per Section 5, to adopt a uniform approach.

- Consider using broader categories of risks for Section 6 where specific risks can be filed, such as operational risk and investment risk.

In our view, the most widely read and appreciated CAPSA Guideline to date, Guideline # 4, the Pension Plan Governance Guideline, is 10 pages in length, plus a glossary and a separate self-assessment questionnaire and FAQ. The 10 pages in Guideline 4 set out clear principles at a high enough level for every type of plan and plan administrator to contemplate and incorporate into day-to-day plan administration. The self-assessment questionnaire is a practical means to monitoring the adherence to principle. One of these principles, Principle 7, is the objective of having every plan administrator set out a risk framework unique to their plan. The purpose of the new Risk Management Guideline is to elaborate on Principle 7.

What makes CAPSA Guideline 4 on Governance so successful is its brevity and focus on principles, not prescription. There is definitely scope to elaborate on any one of the eleven principles in Guideline 4, but ACPM's view is that CAPSA should follow the same approach as in the document which creates the original call for plans to implement risk management frameworks – brevity and a focus on principle. In particular, ACPM would prefer to see a Risk Management Guideline that is no more than 10 to 15 pages in length, possibly with ancillary documentation such as is contained in some of the proposed appendices, and possibly with a self-assessment tool as well.

Specific Comments - Section 4: Defining the Risk Appetite, Tolerance and Capacity

We found the suggested analytical framework, as set out in Section 4, to be confusing. Taking parts of each to contrast with each other, we note:

Risk Appetite – is the amount of risk that a plan administrator is willing to accept

Risk Tolerance – is the willingness of the plan administrator to accept a given level of risk

Risk Capacity – is the extent of risk that a plan administrator is able to support

To the extent that there is intended to be a difference between these aspects of the three concepts, it is not apparent to us. We would suggest that definitions that are more distinctive are preferable if the intent is to continue with this framework.

Specific Comments – Section 5: Risk Management Five Steps Process

In respect to the proposed five step process for risk management and the associated documents in the Appendices, a plan administrator and/or their third party provider(s) could require significant resources to execute the process as outlined. While the proposed process appears comprehensive, it is simply beyond the capability of smaller plans and would impose an administrative burden which would be challenging for them to fulfill given the required resources.

Many plans engage a third party provider to supply many of the reports that have been identified in this section. Since many of the suggested risk benchmarks have not been identified, a significant level of subjectivity will be needed for identification and development of measurements that support the risk management process.

Page 11 sets out an example of Risks and Controls for Smaller Plans Relying on third party Administrators. The text begins with "it is not uncommon.."; this is unnecessarily opaque. It is both very common, and indeed appropriate, for smaller plans to rely on third party administrators. We suggest this introductory language be revised to be consistent with the language at the beginning of Section 6 "Plan Administrators often rely upon the services of external parties…"

Specific Comments – Section 6: Special Considerations on Specific Topics

1. Third party (Outsourcing) Risk – Subcommittee members

The core principle underlying the discussion of third party (outsourcing) risk is the overarching fiduciary duty of the plan administrator to administer the plan directly or to supervise (and take full legal responsibility for) the work of administrative agents. ACPM believes that this aspect of the administrator's fiduciary duty is well understood by plan administrators. Beyond repeating this principle, the discussion of third party (outsourcing) risk in the Risk Management Guideline provides little practical additional guidance. That being said, ACPM is of the view that little additional guidance is needed.

We note that CAPSA Guideline 4 already suggests that plans document their governance processes, including identifying the different internal and external participants in those processes, ensuring that accountability, supervision, communication, transparency and contingency planning are present in the maintenance of those processes. A plan administrator that heeds the principles in Guideline 4 gains no additional assistance from the third party (outsourcing) risk discussion in the Risk Management Guideline.

Notwithstanding the above, we have seen some regulatory attempts to address third party (outsourcing) risk in a more substantive manner in other contexts. British Columbia's outsourcing guideline, while aimed more at provincially regulated financial institutions than pension plans, has, since its release, provoked efforts by B.C. registered pension plans to develop business interruption plans and to ask third-party agents to disclose and further develop their own plans. The B.C. guideline, while lengthy, better focuses the reader on the key components of outsourcing risk that face pension plans. These include the loss or breakdown of services provided by a third party, cyber incidents impacting a third party, fraud or negligence in the third party, and the over-reliance by the plan administrator on the institutional knowledge of a single service provider.

The better identification of these, and other, individual risks leads plan administrators to consider their business interruption plans, their access to backup technology, professional resources (including redundancies), their insurance, their procurement and contract negotiating abilities (ex.: contractually requiring service providers to provide their own business interruption plans, and higher limitations of liability), and other steps. The B.C. guidance does wade into prescription but, for the most part, focuses on principles, and leaves it to plan administrators to develop their own responses to the principles addressed in the guidance, which is preferable.

In the interests of reducing the length of the Risk Management Guideline, the third party (outsourcing) section could be distilled down to the key points, namely that plan administrators should apply the same standards to identifying, evaluating, managing and monitoring third party (outsourcing) risks as other kinds of risks. Examples of specific risks could be added to the Risk Table in Appendix A, or in a stand-alone self-assessment questionnaire if one were to be developed. Additionally, examples aren't needed in the body of the Risk Management Guideline, since they would take up a great deal of space and would not apply to all plans or to all plans in the same way.

ACPM would also like to address the third party (outsourcing) risk discussion in the context of small plans, and small defined contribution plans, in particular. These plans already contend with an increasing burden of regulatory guidance, including the coming release of a new Capital Accumulation Plan Guideline. The CAP Guideline already overlaps with, and duplicates a great deal of, the Defined Contribution Plans Guideline, but DC plan administrators will now need to contend with how the Risk Management Guideline will impact them. Many smaller DC plans are under-resourced as compared to larger defined benefit plans (or the smaller number of very large DC plans). Therefore, asking these plans to engage the Risk Management Guideline in a serious way may be a guidance step too far.

In terms of actually exempting smaller DC plans from this risk management framework, this would make sense when virtually all the relevant services are being provided by an insurance company. In this situation, we would expect that the insurance regulator would already be overseeing the risk management framework and operations of insurance companies. However, for the few, very large DC plans that do their own administration and investment internally, then this risk management framework may have applicability.

We note too that the biggest risks faced by small DC plans is outsourcing risks and investment fund selection and monitoring risks. In most cases the former involves heavy reliance on the insurance and financial services delivery from life insurance companies that are themselves regulated by the same regulatory bodies that have combined in CAPSA to develop both the Risk Management Guidelines and the CAP Guidelines.

Thus, these regulators are using one set of guidelines to prompt regulated pension plans to monitor the regulated services of other regulated financial services governed by different guidelines of the same regulators. Canada's financial service regulators ought to investigate whether a more streamlined approach to regulation and financial markets guidance is warranted. The investment fund selection and monitoring risks that constitute the other outsized source of risk for small DC plans is dealt with quite comprehensively in the CAP Guidelines and should be housed there exclusively.

The objective of having a single Risk Management Guideline for all plans is laudable at one level, but ACPM takes the view that risk management for DC plans, particularly small DC plans, is an exercise of too much overlapping guidance. Pension plans that are CAPs should thus be exempted from the Risk Management Guidelines. If CAPSA is of the view that the CAP Guidelines would require additional attention to risk in order to warrant that exemption, ACPM would propose directing the Capital Accumulation Plans Guidelines Committee to address this before the new CAP Guidelines are released.

2. Cyber Security

In a previous ACPM submission to the CAPSA Secretariat on October 14, 2022, we highlighted three concerns related to the specificity of cyber security guidelines for pension plan administrators: finding the right balance between providing helpful examples and avoiding being too prescriptive, the appropriate sizing of mitigation plans for cyber events, and the overlap of cyber security responsibility with other aspects of organizational governance approaches that should already be in place to monitor privacy and confidentiality.

Within an organization, it cannot be assumed that the cyber security of personal information is a primary responsibility for a plan administrator; in reality, responsibility for cyber security, including protections for personal information, is often addressed by parties other than the plan administrator.

It is not reasonable to expect a plan administrator to have sufficient training, skills and expertise to manage cyber risk and evaluate critical technology assets or cyber insurance policies. Instead, this role is better served by individuals with the necessary background and expertise, either from the sponsoring organization or an outside third party.

To that end, an approach that places more emphasis on the plan administrator role vis-à-vis the internal or third party technological support would be more appropriate than placing the onus for cyber security on the plan administrator as the proposed risk management guideline implies.

3. Environmental, Social, Governance (ESG)

The issue of consistent, standardized reporting of ESG activities continues to evolve and ACPM is encouraged by the progress that has been made by the International Sustainability Standards Board. We look forward to the work of the recently populated Canadian Sustainability Standards Board and how their perspective will contribute to a predictable ESG regime for Canadian retirement income plans.

ACPM believes that ESG implementation and reporting can be a confusing challenge for many plan administrators. This is especially the case for smaller plans that do not have the resources to monitor and evaluate the various risk components associated with climate change, social issues, and governance practices. The addition of ESG examples in this draft paper such as deforestation, flooding, wildfires, forced labour and ethical supply chains simply add to the challenge as these examples are listed with no guidance other than stating that the examples "…can have economic significance...". There is no definitive context as to how any of these examples could be monitored, how they negatively affect economic performance on an ongoing basis, or even whether they are intended to fall within the "opportunities for new investment" identified in the footnote.

As mentioned in our October 14, 2022, response re: CAPSA ESG Considerations, we believe that an ESG guideline should consider proportionality as an accommodation for plans of all sizes as it would address multiple issues, including complexity, resources, a plan administrator's corporate sustainability strategy, governance structure and plan size.

We also propose the following suggestions to improve the clarity of the guidance:

- Further consolidation of the terms used in the section, such as replacing "ESG factors" with "ESG information" or providing a definition if the terms are meant to be distinct;
- Referring to a plan's "risk-return profile" instead of "investment performance" and "risk-adjusted expected returns" to highlight that both risk and return are important when making investment decisions.

4. Use of Leverage

Per our previous submission made to the CAPSA Secretariat on October 14, 2022, in respect to the CAPSA Guideline on Leverage and the Effective Management of Associated Risks, it is our belief that, prudently deployed, leverage is an important investment tool as it can expose different types of risk. Regulatory guidance on leverage should be structured to manage risks without unduly hindering the appropriate use of leverage.

In regard to the 2022 CAPSA guideline, our submission noted section 5 (Leverage Risk Management Practices for Pension Plan Administrators) had defined extensive oversight and risk management requirements that would typically be required for the more complex forms of leverage. We note with appreciation that the Leverage guidance in this Pension Plan Risk Management consultation has removed some of the more detailed guidance, particularly as it relates to metrics, which would place a burden on smaller pension plans using simple forms of leverage.

We continue to recommend that CAPSA support the simpler Liquidity Coverage Ratio (LCR) per an article from the Investment Innovation Institute on "The Impact of Liquidity on Pension Funds". ACPM believes that easier-to-calculate risk metrics would be produced on a regular basis within the risk management process.

As previously communicated, a "One size fits all" guideline is not appropriate for plan administrators who already have a fiduciary duty to identify and manage investment. By improving the alignment of oversight expectations with the level of leverage risk, we can avoid the situation where smaller pension plans avoid using certain forms of beneficial leverage for fear that they are not compliant with CAPSA expectations. This could adversely affect plan members due to increased investment risk and pension benefit funding costs.

5. Target Pension Arrangements

Under "Special Considerations for Target Pension Arrangements" in CAPSA's Guideline No. 7, we noted the inclusion of this paragraph which we had recommended to CAPSA in our January 21, 2021, ACPM submission on the updated CAPSA Guideline No. 7 on Funding Policies:

"For many TPAs, future or accrued benefits may be adjusted depending on the financial status and the contribution requirements of the plan. As such, it would be expected that most TPAs would have formal benefit adjustment provisions or policies and that there is strong linkage between the funding and benefit policies. For plans where both contributions and benefits may be adjusted based on the financial position of the plan (and the associated interaction and priority between contribution and benefit adjustment policies), it may make sense for the funding and benefit policies to be in a combined document. In either case, the funding policy should reflect the key features of the benefits adjustment policy."

We recommend that this paragraph be duplicated in the Risk Management guideline to provide a high degree of clarity in terms of the intrinsic relationship between funding and benefits policies. We also strongly urge that our other suggested wording changes from our January 21, 2021, submission be included in this guideline.

6. Investment Risk Governance

From a structural perspective, we note that the Investment Risk Governance section is separate from sections on ESG and the Use of Leverage and is included last in the document. ACPM views the management of ESG and leverage risks as components of investment risk governance. In addition, the placement of the Investment Risk Governance section at the end of the document may inadvertently send a message that CAPSA views this topic as being of less importance than other sections such as third-party risk, cyber security, ESG risk etc.

We note that section 6.6 appears to relate strictly to the administration of a DB pension plan, but this is not stated explicitly in the section. As we have discussed previously, administrators of DC pension plans may struggle to determine if CAPSA expects them to follow the guidelines in this section.

ACPM questions the feasibility of some of the recommendations in section 6.6.2 which outlines "Considerations for plan Administrators with less sophisticated investment strategies". Specifically, it recommends that plan administrators complete "more frequent governance self-assessments.."; in a footnote, it defines this assessment as at least annually. Given the nature of these pension plans as smaller plans with relatively static governance processes, we question the value of reassessing this annually. An alternative approach would be to conduct a governance self-assessment every 2 to 3 years or after any change in the governance process.

Section 6.6.2 goes on to recommend separate governance oversight for the operational and risk management functions. Given that this section applies to smaller pension plans that may follow less sophisticated investment strategies, ACPM feels that expecting them to have multiple risk governance processes is onerous and not realistic.

Section 6.6.3 recommends "portfolio" limits as part of the recommended investment governance process. The guideline states that while these portfolio limits are separate from the SIP&P, they still appear to be limits defined in policy. The guideline is not realistic in stating that "a policy limit breach does not necessarily require that action be taken to rebalance the portfolio...". If it is defined in policy, Boards will implement actions to ensure compliance.

It should also be noted that the word "Portfolio" is not defined in the glossary. For most ACPM members, a portfolio is typically the lowest level at which they allocate capital (i.e. to an individual investment manager who oversees a specific portfolio of assets). Portfolios are assessed against their compliance with the limits defined in their portfolio mandate and not against a SIP&P defined policy limit. It should be noted that individual portfolios are typically in breach of the SIP&P policy requirements, but collectively all portfolios within an asset class would be compliant.

For example, a single small cap equity portfolio would be in breach of the SIP&P limits on the maximum exposure to small cap public equities. However, when all public equity portfolios are assessed, there is no breach.

ACPM feels that caution needs to be used in the creation and setting of sensitivity limits at a policy level. Sensitivity limits that are defined in policy and require immediate action for the plan to remain compliant are highly problematic. Breaches are typically associated with market extremes and so they can force pension plans to liquidate risk assets at market lows. Sensitivity limits that are defined in policy are therefore value destroying over the long term and impede a pension plan's ability to earn strong risk adjusted returns.

Instead, sensitivity limits should be defined at an operational level and breaches should be tracked over time and then used to help a pension plan assess the overall level of risk that they are taking in their SIP&P. Constant breaches of sensitivity limits are an indication the pension plan is taking more risk than they anticipated when setting their strategic asset allocation.

Thank you for the opportunity to provide our comments and please contact us if we can be of assistance.

Sincerely,

Ric Marrero
Chief Executive Officer
ric.marrero@acpm.com
ACPM