ACPM | ACARR
The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

January 21, 2021

CAPSA Secretariat
5160 Yonge Street, 16th Floor
Toronto, ON M2N 6L9
Via email: capsa-acor@fsrao.ca

To Whom It May Concern:

Re: ACPM Response to the Updated CAPSA Guideline No. 7 on Funding Policies

NOTE: Proposed Changes

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 represent plan sponsors, administrators, trustees and service providers and our membership represents over 400 companies and retirement income plans that cover millions of plan members.

INITIAL COMMENTS

ACPM supports the use of Funding Policies, especially for jointly-sponsored plans or plans that have elements of contingent benefits that depend upon the funding status of the plan (e.g. target pension arrangements). We welcome CAPSA's review of its Guideline No. 7 and the opportunity to share our thoughts on the revisions.

Our understanding is that the primary reasons for the revisions are 1) the prevalence of target benefit arrangements and jointly-sponsored plans; and 2) the recent changes in pension funding models recently adopted in different jurisdictions. Overall, the suggested changes align well to these two objectives, but we offer the following suggestions (organized in each section of the updated document):

CONTEXT

The context portion should also reference the linkages with investment policy and any benefit adjustment policies. The last paragraph could be adjusted as follows:

> "The content of the funding policy will depend on the nature (characteristics and complexity) and documents of a pension plan, including the investment policy and any benefit adjustment policies. As the development of a funding policy involves a wide range of issues, CAPSA recognizes that some of the considerations described in this Guideline may not apply to all pension plans."

We also noted a typo in the second paragraph with the phrase "In the case of a multi-employer or target pension arrangement" being repeated.

Pension Plan Funding Principles and Objectives

The reference to target benefit arrangements could be made a little more general to reflect that many of these arrangements do allow for variance of contributions within a defined range. A better term may be "contingent pension plan" as defined in the recent CD Howe paper by Barry Gros and Barbara Saunders. The second paragraph could be adjusted as follows:

> "These same objectives also apply to target pension arrangements, recognizing that as a last resort these plans have the requirement to reduce benefit accruals or even accrued benefits if the assets and future contributions are insufficient to fund the benefits that are aimed for ~~as~~given that the contribution rates are either fixed ~~and do not have to be increased~~ or can only be increased up to a defined limit under the plan provisions, legislation, or policy.~~to cover the funding shortfall~~."

PURPOSE OF A FUNDING POLICY

The list here has been expanded substantially. It is not clear that the list needed to be expanded. For example, it is not clear that "Level of benefits" or "tax planning and impact on the plan sponsor's financial statement" belong on the list. While it may be important in some circumstances to consider the strength of the employer in a single-employer plan, actually addressing the "financial position of the sponsor" in writing may be problematic, especially in a public document. The item "Stability and/or affordability of contributions" does get at this issue without making a judgement call on whether the sponsors stability is at risk or whether it has competing demands on cash (likely always true).

We agree with the comment in the paragraph after the bullet list that the funding policy should be consistent with the purposes and goals of the pension plan. Including an outline of the plan purposes and goals in the funding policy may be helpful. At the very least, a reference should be included as to where these items can be found.

The last three paragraphs in this section were added, providing guidance on SIPPs and the incorporation of the plan's purpose and goals into the SIPPs. We believe they should be deleted from this guideline and, if necessary, update Guideline No. 6 accordingly.

DEVELOPING A FUNDING POLICY

Some of the language in the Guideline does not fit well for jointly-sponsored plans. For example, in this section, the phrase "could increase the plan sponsor's discipline" neglects the fact that in many plans, funding is not solely a sponsor decision. These instances could be modified by removing the terms "plan sponsor's", or replacing it with the "governing parties'", allowing the text to be interpreted as appropriately to either type of funding arrangement.

The last bullet point is new, but it is unclear what its role is in this section. These two statements are made elsewhere and do not add to the discussion in this section.

In addition, the paragraph following the bullet list has some inaccurate statements as there are single-employer pension plans for whom the funding decision is not the responsibility of the plan sponsor. Following are some potential revisions:

> "The party responsible for the adoption and maintenance of the funding policy may vary according to the circumstances of the plan. In plans where ~~For most single employer pension plans,~~ the employer is solely responsible for making funding decisions~~, it~~ and should ~~therefore~~ be responsible for the development of the funding policy. For plans where funding decisions do not solely rest with the employer (e.g.,~~most~~ target pension arrangements and jointly sponsored pension plans)~~, several plan~~ the administrator (typically a joint-board or committee) is responsible for ~~stakeholders may be involved in~~ the development of the funding policy. It would be reasonable in these circumstances to have a mechanism for both employees and employer(s) to have some input in the funding policy."

ELEMENTS OF A FUNDING POLICY

Plan Overview: This sub-section was significantly expanded without necessarily adding any additional value to the policy. Many of the items listed are disclosed elsewhere and will frequently change, increasing the risk that the funding policy becomes out of date with new information. In addition, some of the information as noted previously could be problematic to share in a public document. Instead, the original paragraph could be modified as follows:

> "The funding policy should include a~~n~~ high-level overview of the features of the plan, governance structure, who makes decisions on the funding of the Plan (e.g. employer or joint-board), and whether any other features of the plan are contingent on the funding level of the Plan.~~related financial information and characteristics of the plan sponsor that are relevant to the establishment of the funding policy.~~

Funding Objectives: We note the revisions that have been made, including the concepts of intergenerational equity and the concept or priority lists in the event there are multiple triggers available to address the funded status of the plan (contribution vs. benefit adjustment).

Key Risks Faced by the Plan: While the new bullet list includes some potential risks that could be addressed in the policy, not all will be relevant in all situations and some of these items may be problematic in disclosing in a public document. For example, under the bullet on the plan's funded status or required contributions, the text "on the plan sponsor's financial statements or cash flow" should be deleted. The comment on a deterioration of the "financial strength of the plan sponsor or employers" may also be problematic.

Risk Appetite: This new section is interesting and potentially helpful in considering how the investment policy and funding policy, and any potential benefit adjustment policy may fit together with a given "risk appetite". The word "stakeholder" may be too broad for the first sentence. Perhaps a better term would be "funding parties" to reflect both the situation where the employer is the sole decision-maker and the situation where both the employer and employees are joint decision makers. As noted earlier, you revise the first bullet to: "How much contribution volatility is tolerable to those who fund the Plan?".

Funding Volatility Factors and Management/Mitigation of Risks: While this element of the policy may be helpful to the administrator in periodically assessing the management/mitigation aspects of the policy, detailed financial data, scenario or stress analysis should not be included in the funding policy. The policy might suggest a particular approach and frequency to conduct the analysis. While we agree that the stochastic approach may be preferable, particularly with TPAs and jointly-sponsored plans, the method for the analysis needs to reflect the nature of the plan provisions and other aspects of the plan, and the context at the time the analysis is needed. It likely doesn't make sense to document a particular type of analysis in the policy, but leave it to the administrator to decide what level of analysis is appropriate at the time it is assessing the effectiveness of the risk management/mitigation levers. On page 11, there are a few instances where the term "plan sponsors" is used. The term "funding parties" could be used instead.

Funding Target Ranges: We note that this section has been updated to reflect situations where pension jurisdictions only require "partial solvency funding". It may be helpful to the users of the guide to more explicitly call this change in funding framework. Perhaps an additional sentence at the end of the second paragraph such as the following would be helpful:

> "In either case, if the minimum funding requirements under the legislation no longer require full solvency funding, it may be appropriate to consider the implications of that when creating or reviewing an existing funding policy."

For example, a previous funding policy might have previously stated that the funding targets included a 100% solvency ratio. While this may still be the administrator's / sponsor's desire, it may no longer be a requirement under the legislation. Depending on other policies and circumstances, additional steps may be required under some legislative frameworks in order to pursue a 100% solvency ratio goal (e.g., additional contributions or investment strategies that pursue higher returns).

SPECIAL CONSIDERATIONS FOR TARGET PENSION ARRANGEMENTS

We feel it is important to acknowledge the critical role of benefit adjustment provisions or policies for TPAs. A paragraph such as the following at the beginning of this section may be helpful to the users of the guideline:

> "For many Target Pension Arrangements, 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 Target Pension Arrangements 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."

The second paragraph should be adjusted to reflect the fact that some TPAs allow for variations in contributions.

> “For TPAs, benefit levels ~~rather than contribution levels,~~ will typically need to be adjusted to reflect the funding level of the plan. However, some TPAs allow for variance of contribution within a defined range, with benefit adjustments being required if a variance in contribution within the allowed range is not sufficient to remedy the funding situation.”

Under the heading “Funding Objectives”, this paragraph could be revised as follows:

> “Given the fixed contributions, or restricted range of contribution rates, and the ability to adjust benefit accruals or even accrued benefits to reflect the funding level, the funding objective of the TPAs can often be translated to either providing benefit stability or the highest level of benefit, with a potential consideration of intergenerational equity. In this regard, the funding policy should describe the approach followed in setting benefit levels, the associated risks and risk management protocols relating to the use of fixed or restricted range contributions.”

Under Actuarial Methods and Assumptions, we note that Provisions for Adverse Deviations (PfAD) could also be used for this stated purpose. The advantage of the PfAD is that they are more transparent than the (implicit) margin against adverse deviation (“MAD”) approach.

On page 17, the first paragraph could be revised as follows:

> “The funding policy should articulate how frequently the analysis should be performed assessing the effectiveness of the funding and benefit adjustment policies in attaining the objectives of the Plan and avoiding situations requiring drastic benefit reductions. Certain triggers or circumstances may, for example, necessitate an earlier evaluation than would normally be the case. While stochastic projections have definite advantages for this type of analysis, the administrator may use other approaches depending upon context for the Plan and other circumstances at the time the analysis is deemed to be necessary.~~the stress testing and projections to be performed, including their frequency and how these should be modeled~~.”

We welcome the opportunity to share our thoughts on this updated guideline and would be pleased to discuss any questions you may have on our submission.

Yours sincerely,

R Marrero

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ACPM