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

May 18, 2022

Office of the Superintendent of Financial Institutions
255 Albert Street
12th Floor
Ottawa, Ontario
K1A 0H2
Via email: pensions@osfi-bsif.gc.ca

RE: ACPM response to OSFI Pension Investment Risk Management Consultation

Dear Superintendent:

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 retirement plan sponsors, administrators and trustees and our membership represents retirement income plans that cover millions of plan members.

ACPM appreciates the opportunity to comment on OSFI's Pension Investment Risk Management Consultation Paper (the "Paper"). We are in agreement that implementing appropriate risk management practices is consistent with prudently investing pension assets and encompassed in an administrator's fiduciary responsibilities. We note that the Paper focuses on investment risks in isolation. Risk management should be viewed holistically, particularly as asset-liability mismatch risk is the biggest risk most defined benefit plans face. The only mention of this risk is in the reference to asset/liability modelling where the survey findings showed widespread application.

In OSFI's view, the survey found that there were four areas where investment risk management practices could be strengthened and regulatory guidance enhanced. The Paper does not discuss the evidence on which those findings were constructed, nor does it outline what measures were taken, if shortcomings were identified for specific plans, using the current regulatory guidance. Without further background, it is unclear what problem the Paper is trying to solve. Having more background on the findings and their consequences could enhance our feedback.

The Paper draws on structures established by banks and insurance companies. The risks faced by pension plans are fundamentally different from these financial institutions, which are stand alone entities. The nature of federal regulation of pension plans including strict funding requirements necessitates that plans have robust governance and risk management practices. Plan sponsors are focused on providing sustainable plans over the long-term and guidance should leverage these practices.

As the consultation paper does not clearly identify any deficiencies, we are not of the view that supplemental guidance is required, but the industry would welcome sharing best practices. Should supplemental guidance prove necessary, we support that it be developed by the Canadian Association of Pension Supervisory Authorities ("CAPSA"). We encourage it to take a principles-based approach, considering the plan as a whole, including both investments and liabilities.

Section 2. Independent Risk Oversight Function

Question 1: How have independent risk oversight functions been successfully implemented by pension plans?

Risk oversight functions vary widely based on the size of the plan, complexity of both the liability and the investment structure, the degree of outsourcing of the investment function and the plan's overall governance structure.

At the highest level, many large plans have a sub-committee of the Board that oversees all aspects of the pension plan, hence this group serves as the independent oversight body for all matters including risk. This body normally approves the Statement of Investment Policies and Procedures ("SIPP"), which is the most important investment risk control document, and would consider the plan's risk profile as part of their fiduciary responsibilities. Such sub-committee would have the ability to engage independent risk management advisors, should they choose to do so.

At the operational level, how the risk oversight and operational management functions are carried out depends highly on the investment structure. Where funds are managed externally, independence is more readily achieved, with the monitoring independent from the investing. In addition, risk management of the selected managers would form part of the due diligence process. Plans that manage funds internally are more likely to have a separate component of the investment team dedicated to operational risk management.

In achieving effective risk oversight, the greater emphasis is on the segregation of duties rather than complete independence of the function.

Question 2: How do pension plans anticipate implementing an independent risk oversight function as outlined in this consultation paper?

While the principles of independent risk oversight are appealing, the prescriptive approach outlined in this consultation paper would not be anticipated to be implemented for most plans. Ultimately it is the Board of Directors that has independent oversight. Pension plans differ substantially from banks and insurance companies, who manage financial risks as part of their core business and should have dedicated risk professionals. Pension plans must consider their risks as a fundamental part of their fiduciary responsibilities, but the duplication of efforts required for complete independence is not practical, nor effective, and could potentially lead to worse outcomes without expert knowledge, given the complexity of issues. In practice, having the risk function liaise with the investment team allows decisions to be taken collaboratively integrating a risk perspective. It allows actions to be taken in a timely manner, which is less likely to occur with a separate entity for risk reporting directly to a Board of Directors. These reasons likely contribute to independent risk oversight functions not being common.

To the best of our knowledge, the internal audit function typically does not have the skills necessary to review the risk management processes for complex investments (exceptions could be for a bank or insurance company plan). The internal audit function would be effective in monitoring segregation of duties.

Question 3: OSFI believes that an independent assessment of pension plan investment risk is a sound principle. However, not all plans have the level of risk that would merit an internal independent pension risk expert. How should pension plans with less complex investment strategies achieve the benefits of this principle in an effective way?

ACPM's view is that defined benefit pension plan sponsors currently undertake rigorous investment risk management. It is not clearly articulated in the OSFI consultation how creation of an independent pension risk expert could be implemented or how it would improve outcomes.

Pension plans are best positioned to manage investment and other risks within their fiduciary obligations, assessing what risk oversight is merited. Plans already have an array of existing tools such as the SIPP to identify risks and set limits, governance to establish monitoring and reporting and independent review, such as through audited statements and actuarial reports. Note that less complex investment strategies are not necessarily indicative of less pension plan risk. Many plans have introduced more complex investment strategies to mitigate asset-liability risk.

Section 3. Articulated Risk Appetite Statement and Risk Limits

OSFI proposes to require plan administrators to establish a risk appetite and establish, monitor and review risk limits. Imposing further disclosures and statements on plan sponsors, or having too prescriptive requirements, will add further administrative burden on plan administrators.

Note that risks are considered and, where deemed appropriate, reflected in the SIPP. Additional risk analysis, whether qualitative or quantitative, is often conducted in the development of the SIPP, and while providing a foundation for the investment policy and use of portfolio limits, may not be disclosed in the SIPP itself.

Question 4: What do you consider to be the key risk limits for pension plans?

The key risk limits can be allocated into:

- funding and benefit security measures, such as going-concern or solvency ratios falling below certain levels, funding contributions or volatility exceeding certain levels or letter of credit limits being breached; and
- operational investment measures, such as asset mix limits, credit quality, leverage limits and liquidity risks.

Risk appetites and key risk limits may vary significantly between plans depending on their benefit and governance structures. As well, given the multiple types of risk, creating fixed limits for each individual identified risk may not be practical. Risk limits may be soft in that thresholds could be surpassed if an additional level of review is undertaken.

Question 5: How do pension plans anticipate implementing risk limits?

Pension plans are already incorporating risk management tools into their plan governance and operations. For example, asset/liability studies have become a frequent part of the risk management process and are performed regularly. This came about as a result of innovation in the pension industry and plan administrators seeking out better risk management frameworks.

The implementation of risk limits should be left at the discretion of plan sponsors, based on their risk appetite, liquidity needs, SIPP and applicable legislation.

Plans may analyze risk limits related to funding and benefit security measures through asset-liability modelling, often using 3-5 year timeframes given the long-term nature of pension plans. However, longer intervals may be appropriate. Other tools, such as stress testing or scenario testing, can also be beneficial. The results of such studies would impact the target asset allocation as disclosed in the SIPP, which must be reviewed annually per the *Pension Benefits Standards Regulations*. The risk levels would be monitored on at least an annual basis as part of the year-end reporting, but may be monitored more frequently by the plan administrator. Also, when a significant market stressor event occurs, additional monitoring may be warranted though the SIPP should have a long-term view.

Operational investment measures, while incorporated into the SIPP, are most responsive to the short-term or discrete risks. Investment managers would be responsible for respecting these limits within their mandates, with compliance monitoring being performed by the plan administrator.

Question 6: How will the implementation of risk limits impact the investment management activities of pension plans, if applicable?

As outlined above, the implementation of risk limits occurs both at the policy level, through the use of tools such as asset-liability modelling and the adoption of the SIPP, and the operational level, through the investment management activities and monitoring thereof. Individual limit monitoring may be done by staff or external advisors, along with reliance on compliance certificates.

Question 7: What are key tasks that a plan administrator should carry out to identify which risk limits should be in place and how often they should be monitored?

As noted in our introductory comments, OSFI usually takes a more principals-based approach to regulation. It is difficult to outline key tasks as it will depend on the plan. However, as noted above, the adoption of the SIPP should be emphasized, with the SIPP reviewed annually. As well, the plan administrator should determine the risk reporting requirements in terms of content and frequency. Risk reporting should deliver insight to the management of the plan, and not be solely compliance driven.

Section 4. Comprehensive Portfolio and Risk Reporting

Question 8: What controls do plan administrators have in place to ensure that portfolio and risk reporting is comprehensive?

There is a wide range of controls in place as they are heavily dependent on the size and complexity of the plan, its investments and how constraining the risk limits are. The plan administrator is responsible for understanding the controls in place and ensuring they are appropriate to enable their fiduciary obligations to be fulfilled. Typically, internal controls are defined and audited extensively.

Question 9: How do plan administrators manage data limitations relating to investment funds?

Often custodians, have the capacity to aggregate data, including segregated positions, enabling the production of quality portfolio reporting on asset class / manager allocation and performance, either internally or by a third party. Alternative asset classes have a greater reliance on investment manager reporting, backed up by audited statements, which give a higher level of scrutiny to controls, processes and individual limits established in pooled fund policy statements.

Section 5. Enhanced Valuation Policies and Processes

Question 10: How do plan administrators evaluate third-party valuation processes and procedures?

Plan administrators access third-party valuation processes and procedures as part of the due diligence process prior to engaging third parties. Frequently, external consultants are used, and methods are evaluated versus established standards by asset class. Investment monitoring would identify any changes in process, considering industry practice continues to evolve. In addition, plans may be represented on Limited Partnership Advisory Committees providing oversight on the processes and their application. Finally, valuations are subject to annual audits, both at the investment fund level and the plan level, including the application of benchmarking measures by auditors.

Question 11: During periods of market stress, how do plan administrators ensure that third-party valuations (e.g., investment funds) reflect fair market value?

Plan administrators would be conscious that the valuations may lag markets. During times of stress, plan administrators would communicate with investment managers and refer to market indices to estimate the effect on valuations. However, given the long-term nature of pension plans and illiquid assets are not expected to be used to meet ongoing liquidity requirements, the implications of lagged valuations are moderate, and often restricted to timing differences. As contribution requirements are typically determined annually, as part of the actuarial valuation, this effect may be minimal. The plan's financial statements would be subject to an external audit at year end, as well.

Section 6. Proportionality Considerations

Question 12: Please describe examples of successful implementation by smaller plans that pursue less complex investment strategies of one or more of the risk management principles described in this consultation paper. What challenges were encountered, if any, and how did plan administrators adapt their approach?

Question 13: How should smaller plans that pursue less complex investment strategies implement the risk management principles described in this consultation paper?

Question 14: What controls or practices can be put in place to ensure that plan administrators of smaller and less complex pension plans are kept informed when their pension plan is approaching levels that are outside of their risk tolerance?

Smaller plans have the same fiduciary responsibilities as larger plans, therefore the comments above are equally applicable from a principles perspective. However, they do tend to have less complex investment strategies and make greater use of external resources for expertise and oversight, so risk oversight may be less complex. Note that the biggest risk, being asset-liability mismatch, is not proportional to plan size, and should also take into consideration the company's ability to make up funding shortfalls.

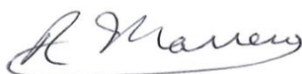
Question 15: What are examples of risk management strategies implemented for defined contribution plans that address the principles described in this consultation paper?

While the risk management principles for defined contribution are important, the concepts in the Paper generally do not apply. One exception is that for defined contribution plans that offer alternative investments, timely valuations are more important as members may transact on them. However, few plans offer such options.

Risk management principles which are more important for defined contribution plans when members have investment choices revolve around ensuring members are taking an appropriate amount of risk for their circumstances and have the necessary understanding of the risks involved, through appropriate communication and education by plan administrators and their delegates. When plan administrators select the asset mix, other principles may also apply.

We thank OSFI for engaging the pension industry in its reflection around risk management practices and giving us the chance to comment on this consultation. We can provide additional guidance as required. This submission was prepared in conjunction with the ACPM Federal Council and the ACPM National Policy Committee.

Thank you for the opportunity to comment on this consultation. Please feel free to contact us if we can be of further assistance.



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