PENSION REGULATION SYMPOSIUM

Building a vision for the future of pension regulation

Rapporteur's synthesis of HOOPP-OPTrust pension regulation symposium

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HOOPP

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Introduction

What should the future of pension regulation look like? On November 24, 2017, two leading Ontario pension plans, HOOPP and OPTrust, convened a day-long symposium to address this question. Attendees at the symposium included pension plan CEOs, Chief Investment Officers, and other senior executives, as well as senior leaders from a variety of key policy making, regulatory, and other public bodies, including the Ontario Financial Services Regulatory Authority, the Ontario Ministry of Finance, the Financial Services Commission of Ontario, the Bank of Canada, the Ontario Securities Commission, and the World Bank Group. This report aims to synthesize the highlights from the symposium.

Context

Several factors set the stage for the symposium:

- The creation of a reformed financial services regulator in Ontario, the Financial Services Regulatory Authority of Ontario (FSRAO), to build on the existing Financial Services Commission of Ontario (FSCO).
- A period of unusually active pension reform in Canada over the past decade, including major reforms to pension benefits standards legislation and an enhancement to the Canada Pension Plan.
- An increasingly complex and uncertain global financial regulatory environment in the wake of the financial crisis of 2008-09, including the creation of new international standards and institutions.
- An increasing recognition that an opportunity exists to improve the situation for pension adequacy, coverage, and innovation for the benefit of the broader public.

Findings

The symposium focused on three topics:

- What are the **key questions** we need to answer to build a world-class regulatory regime for pensions?
- What are the key **risks and opportunities** facing the retirement system that should be prioritized by policy makers and regulators?
- What are some practical ways to **improve collaboration** on pension policy and regulation? What concrete next steps can interested stakeholders take to continue to strengthen pension regulation in Ontario and Canada?

The findings from the discussion are categorized below under headings that reflect these three questions.

SUMMARY

- Strengthening retirement security in Canada will require trust-based collaboration among diverse stakeholders, including federal and provincial policy makers, regulators, and regulated entities such as pension plans
- Independence, rulemaking authority, talent, and the ability to tap into a continuum of regulatory approaches – from education to enablement to enforcement – are among the key tools that a modern, 21st-century pension regulator should build
- International experience highlights the value of an outcomes-based, evidence-driven approach to retirement security and pension regulation, in which regulatory and public-policy resources are strategically focused on the problems and opportunities of greatest benefit

Actionable areas for potential collaboration

There was a strong consensus that further collaboration on retirement security would be of benefit. Among the priority areas identified were the following:

- **Outcomes.** Identify the key outcomes that pension policy and regulation should aim to achieve over the next 5-10 years.
- **Rethinking the PBA.** Develop a vision of what a Pension Benefits Act for the 21st century should look like.
- **Talent.** Promote talent exchange between regulators and pension plans through secondments and other forms of interchange.
- **Knowledge exchange.** Share information and best practices in areas such as stress testing, governance, risk management, data, and cybersecurity.

Key questions

Asking the right questions is arguably the most important first step in building a world-class pension regulator, as well as in shaping a vision for the future of pension regulation in Ontario and Canada. The following questions were among those that participants in the symposium identified.

- **Objectives and outcomes.** A number of participants stressed the importance of **focusing on outcomes.** Such an outcomes-based approach has been used in regulatory reform around the world, including with the UK Pensions Regulator and the U.S. Consumer Financial Protection Bureau, and through a framework developed by the World Bank. The regulator should have a clear answer to the question: What are the most important outcomes that pension regulation is trying to achieve over the medium term (e.g., next 10-20 years)? Should these outcomes be focused more narrowly around traditional regulatory objectives such as beneficiary protection and the efficient administration of plans? Or should they be broader, focused on issues of pension adequacy, coverage, and innovation? These desired outcomes should inform strategy and help triage the deployment of limited resources.

- **The legislative framework.** A pension regulator's ability to fulfill its goals depends heavily on the legislative environment in which it operates. A number of participants identified shortcomings in the structure and content of the Pension Benefits Act (PBA), suggesting that it may provide too little flexibility for the regulator and may be out of step with the current realities of financial and labour markets (one participant said that our pensions framework "fights the last war"; another said it was "written for DB single employer plans" and is "awkward" for other kinds of plans). A question that both policy makers and regulators should ask is what a modern pensions and retirement security legislative framework would look like. If we were to start over, and write a Retirement Security Act for the 21st century, what would that legislation look like? Even though the responsibility for pension legislation lies with policy makers, many participants felt that pension regulators had an important role to play in developing forward-looking legislative proposals and frameworks to support reform. Such long-term work may be especially important during periods when political will for pension reform is lacking.
- **Tools.** Participants urged broad and creative thinking about the kinds of tools that regulators could use to achieve the desired outcomes. One of the questions that a regulator should ask is: what tools should it have in its toolkit, and which of these tools is most effective in achieving different kinds of results? Examples of tools discussed included:
  - **Independence.** Just as independence has proven a key factor behind the success of Canada's top pension plans, independence was also identified as an important element of a strong regulator. Independence from government allows the regulator to take a longer-term perspective that is not constrained by short-term political cycles.
  - **Rulemaking** authority and processes, as is used in Canadian securities regulation, was identified as a critically important tool and one that would take time to evolve and get right. There was general support for independent rulemaking at the symposium, provided such rulemaking was principles-based, transparent, and based on collaboration with pension stakeholders.
  - **Pension Benefits Guarantee Fund** (PBGF). Unique to Ontario, the PBGF is an important source of influence for the pension regulator, particularly in an insolvency situation.
  - **Talent.** Participants strongly agreed that attracting and retaining talent was a key success factor for a modern pension regulator. Finding and keeping such talent, including actuarial, investment, governance, and accounting specialists, was widely acknowledged to be a challenge, especially given current pay restrictions.
  - **A continuum of tools.** Regulators need to have access to a range of tools, ranging from "softer" tools such as education, engagement, and enablement to more directive tools such as rulemaking and enforcement. One participant talked about the need to create a regulatory culture that tends to start with the softer tools and move towards more directive tools if the softer tools do not work. It is also important to be aware of new regulatory tools being pioneered around the world, such as the "reglab" or "sandbox" movement (which the OSC has applied to its LaunchPad initiative and which Ontario is looking to apply more broadly to fintech companies).
  - **Discount rate.** Participants discussed pension discount rates as an important proxy for the governance and management of a pension arrangement. Although Canadian pension plans tend to use a lower discount rate than their U.S. peers, Canadian pension regulation has tended not to prescribe a discount rate, instead leaving that determination to the actuarial profession and the governance structures of individual plans. Several participants warned of the dangers of moving towards a more prescriptive approach, as has been done in the Netherlands, with serious consequences for the Dutch pension system.

- **Data.** To evolve compliance approaches and better inform regulators, access to data has become a critical management lever. One participant noted that access includes an efficient data collection process, strong analytic tools and skilled resources.
- **De-regulation and inaction.** Several participants stressed that regulatory action and rules are not always the best way to achieve an outcome. Reducing the number and complexity of rules; moving towards a more flexible, principles-based approach; forms of inaction such as "no action" letters and forbearance -- these are also tools available to regulators and are sometimes effective, resource-efficient ways to achieve goals.

Risks and opportunities

Both pension plans and pension regulators have begun to focus more on risk in recent years, particularly in the wake of the financial crisis. Plans have integrated risk more deeply into their investment strategies and governance. Pension regulators have adopted risk-based approaches that allow them to focus on the organizations and parts of the market/system where the biggest problems exist.

The positive flip side of risk is opportunity. Global experience suggests that focusing regulatory resources on the biggest opportunities to improve the system/market, considering the "return on investment" for a regulatory intervention, can be an effective way to sharpen a regulator's strategic focus.

During the symposium, participants discussed

- **Governance.** There was strong support for placing greater emphasis on good governance within pension policy and regulation. Good governance is consistently identified as one of the most important drivers of positive pension outcomes. A recent World Bank report on the Canadian pension model identified governance as perhaps the most important factor in the evolution of some of Canada's most successful public pension plans, including OPTrust and HOOPP. Participants recognized that, outside the larger public sector plans, there is significant room for improvement in the governance of Canadian pension arrangements. Poor governance poses a major risk from both a solvency and a consumer protection point of view. And yet, several participants stressed that the PBA and the powers of the regulator say relatively little about what constitutes good governance. Governance has been used as an important lever for improving the efficiency of the pension system in the Netherlands, the UK, and Australia. The pension regulator should consider developing a strategy for improving governance, and one participant went as far as to say the governance should be the "biggest legislative priority" for both DB and DC plans. Several participants stressed alignment of interests as perhaps the key feature of governance: better pension arrangements align the incentives of plan stakeholders around serving the best interests of members. Similarly, strong retirement systems align incentives between regulators and regulated entities.

- **Financial stability.** Since the financial crisis, policy makers, regulators, and central banks have taken measures to improve the stability of the global financial system. While these efforts have focused mainly on banks and insurers, symposium participants discussed the role of pensions in the stability of the financial system. The Bank of Canada's recent review of some of Canada's largest pension funds, which focused on issues such as the use of leverage, concluded that such funds could have a stabilizing effect on the financial system provided they were well governed with strong risk-management systems in place. The heterogeneity of investment and risk-management approaches among Canada's leading plans was seen as a positive, stabilizing factor. A number of the pension fund participants discussed their strategies for managing funded status and liquidity within their plans.
- **Retirement insecurity / inadequacy.** Several participants identified the level of retirement anxiety and insecurity, especially among Canadians in the private sector, as a central risk facing the retirement system. Canadians without pensions, particularly those with lower and moderate incomes, have saved little for retirement. Pension coverage continues to decline and is particularly low among precarious, non-standard workers. Conversions from DB directly to DC continue to be common in the private sector, and some participants raised concerns about the quality of these DC plans, which often have lower contribution rates, are not benchmarked to a particular level of retirement security, lack strong governance, and do not share risks between members and employers. Several participants called for more of a "middle ground" in our regulatory system between pure DB plans, and lower-quality DC plans and Group RRSPs (which one participant called "under-regulated"). Several participants felt the regulator should have greater flexibility to encourage innovative, high-quality arrangements that combine the characteristics of DB with the characteristics of DC, without exposing the sponsor to undue liability. Legislative attempts to create new product and plan categories to date, including the Pooled Registered Pension Plan (PRPP), have seen relatively little take-up. A number of participants said that a less prescriptive approach -- one more focused on outcomes and giving pension stakeholders and the regulators more flexibility to work out their own arrangements -- could be more effective.

Collaboration

Trust and confidence are hallmarks of a successful pension system. Many symposium participants stressed the importance of building trust and confidence in FSRAO, and in putting in place a process of continuous trust building between regulatory authorities and regulated entities, including pension plans. A strong consensus emerged from the symposium that greater collaboration is both desirable and a critical part of building trust and strengthening the system. Participants also recognized the fragmented nature of the regulatory system for retirement security in Canada, and the number of policy makers and regulators involved in shaping that system. Collaboration should be thought of broadly, and needs to include collaboration (a) among regulators; (b) between regulators and policy makers; (c) between industry and regulatory authorities; and, (d) between pension stakeholders across borders (because the regulatory environment has grown more complex and more global).

Participants proposed a number of ideas for strengthening such collaboration:

- **More collaborative fora.** There was strong support among participants for holding further collaborative fora, similar to the symposium, in the future. Unlike traditional pension conferences and typical stakeholder consultations, the symposium aimed to take a broader view, and participants expressed support for the strategic focus, candor, and openness of the discussion. Some participants felt that that future collaborations should go “one level down,” focusing on specific issues within the retirement system. Others felt that future collaborations should involve other stakeholders, including in parts of the retirement system where there are more significant gaps, weaknesses, and risks.
- **Talent exchange.** There was strong interest among participants in collaboration between public pension plans and pension regulators around talent exchange. Several participants felt exchanges, secondments, or other arrangements to allow people to move between the regulator and a pension organization would be of mutual benefit. Participants stressed that such an exchange should be two-way, and could go beyond one-off secondments to a broader “talent collaboration strategy,” as one participant put it.
- **Stress testing.** Regulators, pension plans, and the Bank of Canada all use stress tests as a tool to measure and manage risks to financial stability. Several participants expressed that the financial system as a whole would benefit from greater collaboration around such stress testing, including the sharing of stress testing results and methodologies between pension plans and public entities.
- **Public plans as a source of ideas/analysis in addressing big strategic and policy questions.** Several participants from the public plans expressed a willingness to contribute to helping pension regulators and policy makers address some of the unanswered macro questions facing the retirement system, including: (1) what should the retirement security legislation of the future look like? (2) what is the right approach to rulemaking authority? (3) what are the biggest risks and opportunities facing our retirement system? (4) what is the right way for the regulator to think about risk management? (5) what is the best way for regulators and policy makers to think about discount rates? (6) how should regulators “segment” the retirement system so they are focused on the areas of biggest risk / impact?
- **Shared tools and best practice guides.** Some participants presented ideas for collaboration and resource pooling around tools and best-practices. One participant felt that large public sector plans could help create educational tools for DC plans. Another suggested repurposing pension education sessions used for plan board members to assist the regulator with education and capacity-building efforts.