



September 21, 2016

BY E-MAIL

Secretariat of the Financial Stability Board

c/o Bank of International Settlements
CH - 4002 Basel
Switzerland
Email: fsb@fsb.org

Dear Sirs/Mesdames:

Re: Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities dated June 22, 2016 (the “Consultative Document”)

The undersigned Canadian public sector pension funds, OMERS Administration Corporation, Ontario Teachers’ Pension Plan Board, and Healthcare of Ontario Pension Plan (collectively “**Canadian Pension Fund Managers**”, “**we**” or “**our**”), are grateful to have the opportunity to provide comments on the Consultative Document.

Our group represents some of the largest Canadian pension fund managers. We have common features and objectives, including that of maximizing the returns for our beneficiaries while satisfying our fiduciary duties. On an aggregate basis, we manage over \$ 300 billion in assets.

We are writing to you in response to the request of the Financial Stability Board (the “**FSB**”) for comments in respect of the Consultative Document. Our comments in this letter address our concerns with respect to the areas of structural vulnerabilities identified for further analysis, and specifically our comments are restricted to the fifth area of concern identified by the FSB related to “potential vulnerabilities of pension funds and sovereign wealth funds”, as well as the analysis relating to pension plans in Annex 2 of the Consultative Document.

The Canadian Pension Fund Managers agree with the FSB statement that pension plans generally have long-term investment horizons and make a positive contribution to financial stability.¹ We also agree with the statement that pension plans have relatively low levels of liquidity transformation and financial leverage.² Additionally, we would argue that pension plan activities do not create vulnerabilities within the financial system and do not pose financial stability risks.

¹ Consultative Document at 40.

² *Ibid.*



FSB Identified Potential Vulnerabilities related to Pension Plans

Within Annex 2 of the Consultative Document, the FSB outlines potential vulnerabilities of pension plans. The Canadian Pension Fund Managers disagree with the FSB's assertion that these situations are potential vulnerabilities, and we believe any perceived vulnerabilities have been dealt with through rules and regulations applicable to pension plans. As the Canadian Pension Fund Managers are all defined benefit arrangements, we have focused our comments on such arrangements.

The Canadian Pension Fund Managers would also like to address the comments found on page 40 of the Consultative Document, specifically "...some pension funds are moving into higher-risk assets or less-liquid alternative assets". The Canadian Pension Fund Managers include in their alternative investment portfolios real estate investments and infrastructure investments. It is our view that our alternative investment strategies actually reduce risks inherent in a pension plan, as such investments help contribute to portfolio diversification, have predictable and stable cash flows, and therefore actually reduce risk within a pension plan. Alternative investments are also a good match for payments due from our funds to the beneficiaries. While we acknowledge real estate and infrastructure investments are inherently less liquid investments, the Canadian Pension Fund Managers have dealt with this by board-approved governance frameworks to ensure the appropriate percentage of plan assets are held in sufficiently liquid investments.

(a) Potential Build-up of Leverage

The Canadian Pension Fund Managers are statutorily prohibited from borrowing, other than in certain limited circumstances, and so operate at a fraction of the level of leverage utilized by other market participants. Consequently, the Canadian Pension Fund Managers have little to no financial leverage.

The Consultative Document states "pension plans may invest in funds that take on leverage". The Canadian Pension Fund Managers would note that although pension plans may invest in funds that implement financial leverage strategies, such investments are structured to limit any potential future losses arising with respect to such investments to the amount of the investment itself. For Canadian Pension Fund Managers that employ leverage directly as part of investment strategies designed to more closely match fund assets and plan liabilities, the leverage is designed to reduce overall risk in their portfolios and is carefully managed, including through hedging.

(b) Use of Derivatives and Longevity Risks

The Canadian Pension Fund Managers, and pension plans generally, may engage in other investment strategies, including the use of derivatives. However, in contrast to almost all intermediaries and other end-users in the OTC derivatives market, pension plans are not driven by the desire for the highest possible returns at the lowest possible costs to satisfy investors, shareholders and other stakeholders. Rather, the Canadian Pension Fund Managers largely use derivatives to generate targeted returns to meet, or hedge against, their pension liabilities.

The mandate of the Canadian Pension Fund Managers dramatically impacts our derivatives strategy. The Canadian Pension Fund Managers use derivatives, together with their broader investment program, to achieve a targeted return within risk levels set by their respective board, with the ultimate goal of hedging their pension liabilities. Derivatives may be used in connection with other investments to hedge against volatility, inflation, interest rate risks, currency risks and other identified risks inherent in an investment, an asset class or across a portfolio. In addition, derivatives transactions allow the Canadian Pension Fund Managers to gain exposure to global markets on a cost-effective basis and may be used to obtain exposure to other investments and asset classes. However, the Canadian Pension Fund Managers note their derivatives programs require a prudent and robust governance framework providing appropriate oversight of such transactions as well as well-designed and effective operational and risk management systems and processes. The governance framework, in particular, helps set the context for risk appetite, investment beliefs and the risk management framework.

By way of example, many Canadian pension plans hedge the currency risk in non-Canadian dollar denominated investments, as payments made to plan beneficiaries are in Canadian dollars. Rather than increasing risks to the plan, or the market as a whole, such foreign exchange hedging transactions actually decrease risk in pension plans.

Regulatory requirements also impact a pension plans' use of derivatives. The Canadian Pension Fund Managers are subject to the *Pension Benefits Act* (Ontario)³, which imposes a fiduciary duty on our employees when managing and investing the assets of their respective pension plan, which maximizes beneficiaries' pension security. The Canadian Pension Fund Managers investment decisions and actions in the capital and financial markets are based on the near-and long-term needs of their respective pension plan and reflect the best interest of all beneficiaries. This naturally provides pension plans with a long-term orientation when investing with the added benefit that their investment approach is often countercyclical.

In addition, as a matter of internal policy or upcoming regulatory mandates, pension plans generally post variation margin in respect of outstanding exposure and either currently post or in the future will be required to post initial margin as well. In addition, for many pension plans including the Canadian Pension Fund Managers, the claims of creditors rank ahead of beneficiaries in the event of a pension plan wind-up. This, together with limitations on leverage,

³ *Pension Benefits Act*, RSO 1990, c P.8 ("*PBA*").



result in pension plans having a very low to no risk of defaulting as a result of an inability to pay their counterparties.

The Canadian Pension Fund Managers agree with the conclusion reached by the FSB within the Consultative Document that defined benefit plans are not subject to run risk, and, in fact, we would suggest that due to our long-term investment horizon, our investments in less liquid alternatives provide an increase in our portfolio's resilience to market turbulence. The Bank of Canada has also suggested this fact in a recent paper, stating large Canadian pension plans "may be better able than other financial market participants to invest counter-cyclically and therefore act as a stabilizing force in the Canadian financial system"⁴.

Conclusion

While we are strongly in favour of regulation that reduces potential vulnerabilities to the financial markets, we do not believe pension plans create systemic risk, and in fact we believe the long-term investment horizons, little to no leverage and general management of pension plans contribute to financial stability. Consequently, we believe that pension plans are not appropriate entities to consider for purposes of the global systemically important financial institutions methodologies.

The Canadian Pension Fund Managers appreciate the opportunity to comment on the Consultative Document. Thank you in advance for consideration of our views. Please do not hesitate to contact us should you have any questions or wish to discuss in further detail.

Yours very truly,

OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
Healthcare of Ontario Pension Plan


⁴ G. Bedard-Page, A. Demers, E. Tuer and M. Tremblay, *Bank of Canada. Large Canadian Public Pension Funds: A Financial System Perspective*, *Bank of Canada Financial System Review*, June 2016, online <<http://www.bankofcanada.ca/wp-content/uploads/2016/06/fsr-june2016-bedard-page.pdf>> (the "BoC Paper"), at 37.




OMERS Administration Corporation

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APPENDIX 1

DESCRIPTION OF CANADIAN PENSION FUND MANAGERS

OMERS ADMINISTRATION CORPORATION

Under the Ontario Municipal Employees Retirement System (“OMERS”) Act (Ontario), OMERS Administration Corporation (“OAC”) is the administrator of the OMERS pension plan, one of Canada’s largest multi-employer defined benefit pension plans, and trustee of the OMERS pension fund. As of December 31, 2015, OMERS has more than \$77 billion in net assets and serves approximately 1,000 participating employers and approximately 460,000 employees and former employees of municipalities, school boards, libraries, police, and fire departments, children’s aid societies, and other local agencies across Ontario. OAC manages a diversified global portfolio of stocks, bonds, real estate, infrastructure and private equity investments.

ONTARIO TEACHERS’ PENSION PLAN BOARD

Ontario Teachers' Pension Plan Board ("OTPP") is Canada’s largest single-profession pension with \$171.4 billion in net assets as at December 31, 2015. It was created by its two sponsors, the Ontario government and the Ontario Teachers' Federation, and is an independent organization. In carrying out its mandate, OTPP administers the pension benefits of 316,000 active and retired elementary and secondary school teachers. OTPP operates in a highly regulated environment and is governed by the *Teachers' Pension Act* (Ontario) and complies with the *Pension Benefits Act* (Ontario) and the *Income Tax Act* (Canada).

HEALTHCARE OF ONTARIO PENSION PLAN

Healthcare of Ontario Pension Plan ("HOOPP") is a multi-employer contributory defined benefit plan serving more than 309,000 working and retired healthcare workers. HOOPP was originally established by the Ontario Hospital Association (the OHA) in 1960. The Plan is registered under, and regulated by, the Pension Benefits Act (Ontario) and the Income Tax Act (Canada). As at December 31st, 2015, it had over \$63 billion in net assets.