

Breaking Barriers:
The Strategic Move
Towards Principles-Based
Pension Management





Pinciples-based pension management is revolutionizing our industry. Pension Plans need to be more holistic and transparent, drive up engagement and strategic value for organizations, to offer employees competitive pension benefits without over-burdening HR. In this paper, we explore the ways in which a principles-based approach can help build successful pension strategies for organizations, looking at the difference between principles-based plans and those that are based on standard pension rules. Starting with principles builds a better pension system from the ground up, and by aiming for principles tied to four objectives linked to adequacy, security, efficiency and sustainability, all pension managers can move their organizations in an innovative and strategic direction.

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Breaking Barriers: The Strategic Move Towards Principles-Based Pension Management

A recent paper by the CD Howe Institute¹ suggests that principles-based pension management is revolutionizing our industry.

By placing a focus on desired outcomes rather than processes, building a pension plan with principles in mind focuses organizations on the purpose behind creating pensions, rather than just on the details. As well, this approach can offer a framework to build better strategies and risk management for organizations, because it requires an integration of regulatory compliance and strategic planning process for today's businesses and organizations.

Stakeholders, under this model, are materially involved in the running of the plan. This means that managers, administrators, and members are all involved in making key decisions. This approach makes principles-based plans more holistic and transparent, driving up engagement, commitment and strategic value for organizations. The streamlining of rules and an emphasis on objectives promote compliance, and enhance the ability of regulators and organizations alike to achieve their desired outcomes.



This paper will explore the ways in which a principles-based approach can help build successful pension strategies for organizations.

We'll discuss how:

- Principles can offer employees competitive pension benefits without overburdening HR, building a better system from the ground up
 - Pension managers can begin to institute best practices in principles-based approaches to their work, and to serve management interests
 - Moving to this system can engage senior management in organizations and make decisions around pension that fit their organizational culture
 - Principles may enhance responsiveness to market innovation and other developments, increasing the sustainability of the pension
- This approach can lead to a decluttering of pension tactics, focusing attention on what is important for each organization

¹ <https://www.cdhowe.org/public-policy-research/room-thrive-why-principles-based-standards-make-sense-regulating-contingent-pension-plans>

Using principles means developing a discipline, not following rules

It's important, first of all, to delineate the difference between principles-based regulation and principles-based organizational plans for pensions. Bodies such as the Financial Services Regulatory Authority of Ontario and Alberta's Financial Services Act have revised their own regulations to be built on principles themselves, and this is because it has been found that principles-based statutory language is more equipped to deal with the changing circumstances of pensions at the present time, as the province of Ontario suggests. The precise reason is that one approach to pensions does not fit all pensions, and the nuance available to pension management using principles, allows clarity. As the Ontario Expert Commission on Pensions explains,

Understandings about policy goals or how best to achieve them may change; unforeseen contingencies may arise that cannot be dealt with under existing laws; and updating the law by substituting a new "clear" text for an old one may be a lengthy and difficult process. Consequently, legislators, regulators and decision-makers sometimes prefer broad language, with its potential for ambiguity rather than clarity. Breadth and ambiguity permit incremental changes in the law – adjustments at the margins to meet the changing needs of the pension system without the need for formal amendment.²

On the organizational side of things, the same nuanced ideas apply. The fundamental difference between principles-based plans and those that are based on standard pension rules, states the CD Howe Institute, is that they outline the reason behind the rule. Principles are just that: qualitative values that are often hard to define in the first place, but which create expected behavioural standards for everyone involved, such as integrity, ethics and care for stakeholders.

It is the process of stakeholders coming together to arrive at these defined principles that often makes the difference in pension plan outcomes. Principles management requires constant iterations and a focus on improvement, as pension managers aim to get

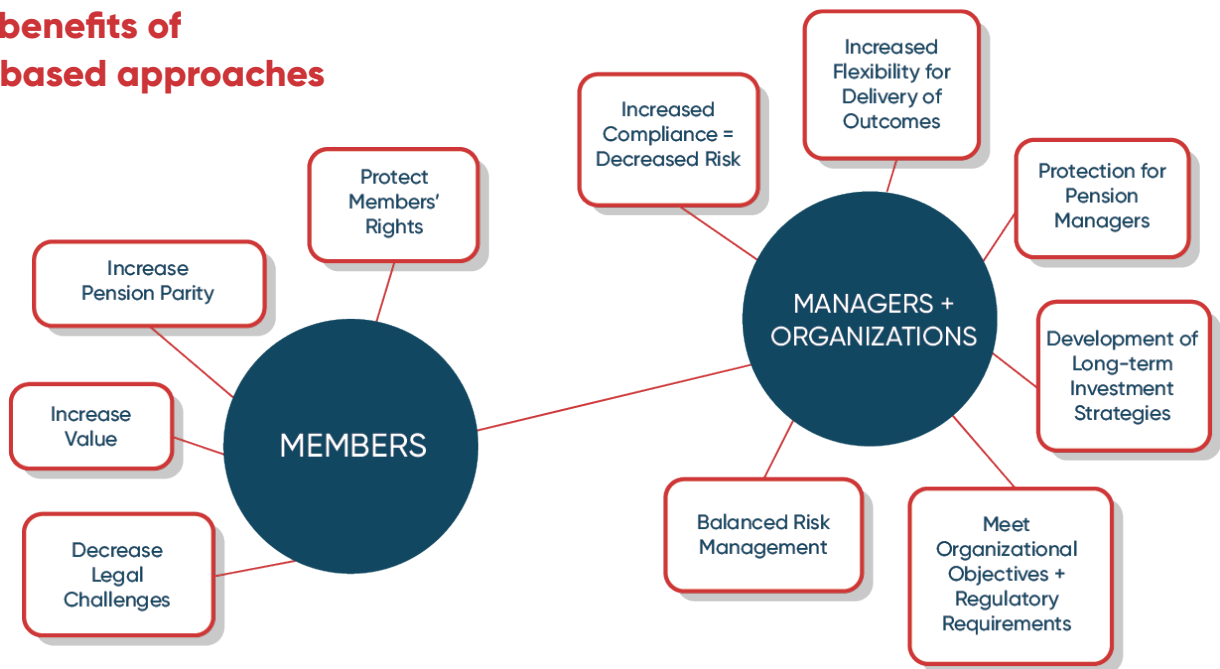
ever-closer to desired outcomes.

But the reality is that a principles-based approach means that key values have to be quite broad, so that the actual day-to-day work can flex to ever-changing external regulations, but still remain true to organizational stakeholder needs.³ Organizations are able to develop their own internal policies for addressing any issues that arise. This requires managers to, ultimately, develop their own discipline and keep themselves in check in order to meet internal and external expectations. This builds a better system from the ground up.

² <https://www.fin.gov.on.ca/en/consultations/pension/report/>

³ Black, J., Hopper, M., & Band, C. (2007). Making a success of principles-based regulation. *Law and Financial Markets Review*, 1(3), 191-206.

Strategic benefits of principle-based approaches



Why do we want to move towards principles as a foundation for pension management? Because it's strategic, because it reduces risks, and, because, despite its nuances, actually makes decision making easier. The same can be said to be true for the individuals who create and manage these plans, and for member stakeholders.

Here's why principles-based approaches make sense, according to the most recent findings in the field.⁴

For members, principles-based pensions:

- Are more likely to increase pension parity
- End up protecting the vested rights of members and use a vetted entitlement process
- Can provide a basis for open dialogue that includes members, facilitating a co-operative and educative approach that allows members to make informed choices about their retirement
- Increase the value of pension products, in that they are more likely to perform as organizations have led members to expect
- Decrease legal challenges between members and organizations, such as disputes over value, supervision and choice

For pension managers and their organization, principles-based pensions:

- Create a platform for increased flexibility in how they deliver expected outcomes, in terms of guaranteeing commitments to members while still generating income
- Develop investment strategies that reflect more prudence, based on pension expertise rather than on short term wins
- May be able to offer a more balanced risk management process that allows organizational risk and personal member risk to be assessed
- Allow them to develop a closer fit between meeting their organizational objectives and meeting regulatory requirements
- More opportunity and protection for pension managers driving the changes necessary for their firms to meet the principles
- Increase substantive compliance with regulations, and thus decrease risks for organizations

⁴ OECD, from <https://www.oecd.org/finance/private-pensions/2403207.pdf>; Gros, B. (2020). Room to Thrive: Why Principles-based Standards Make Sense for Regulating Contingent Pension Plans. Exchange Magazine.

Building a better system: Best practices in principles-based approaches

So, now that we know what we're aiming for, how do we create principles that work in practice?

The Organization for Economic Co-operation and Development (OECD) suggests that pension principles have to consider four primary objectives: **adequacy, security, efficiency and sustainability.**⁵

Adequacy, according to the OECD, means creating principles that recognize that pension coverage and pension benefits are now an essential means by which people can eventually retire, and that most employees do not have separate investments because they cannot usually afford to purchase them. This is a realist approach, and therefore a more ethical stance to planning. Members do count on this income, and decisions made have to respect the gravity of this responsibility. Plan members and beneficiaries should have access to information regarding the benefits they are likely to obtain at retirement under specific assumptions.

Security means that principles are needed to create an effective supervision plan for pension funds. These plans must be set up and focus on legal compliance, financial control, actuarial examination and supervision of those with the responsibility of operating or managing the plan.

Efficiency suggests that pension managers should operate in framework in which they can make expedient decisions, and draw on resources as they see fit.



⁵ <https://www.oecd.org/finance/principles-private-pension-regulation.htm>

Principles behind governance, pension management roles, and checks and balances need to be established. Even so, transparency principles and practices also have to be established.

Finally, **sustainability** needs to incorporate principles that govern the long term role of the pension, risk management and regulatory engagement. Funding requirements and rules are a part of this responsibility. These principles may enhance responsiveness to market innovation and other developments, increasing the sustainability of the pension.

Considering the Four Primary Objectives in Pension Principles*

*According to The Organisation for Economic Co-operation and Development (OECD)



In order to determine what principles should stand behind these primary objectives, the OECD recommends starting with national and regional regulations and standards, and using these as a point of inquiry. Then, pension managers in organizations need to make decisions around pension principles that fit their organizational culture, and how to engage a qualitative review of proposed principles. This approach can lead to a decluttering of pension tactics, focusing attention on what is important for each organization.



Delivering an innovative future

Strategic thinking in pension management means looking at pensions with a business eye in order to truly deliver value and serve our clients' best interests. What we need and hope for, on top of this, is that creating a principles-based approach will help organizations break the barriers that prevent employers offering a meaningful and fair retirement program, to create safe, productive, enjoyable jobs and quality of life for employees.

We know that changes in the labour market, demographic, financial and economic environment have affected the operation of workplace pension plans in recent years, but, through principles, how we can weather these changes more effectively.

But a principles-based approach offers key tools, to ensure that these changes do not overly affect pension outcomes. Through attention to principles, pension managers can build flexibility, balance, decreased risk and increased parity into day-to-day pension operations.

We can deliver a better retirement to all pension members this way, while simultaneously meeting organizations' strategic needs. A new approach, using principles, can enable present and future pension innovations through its naturally iterative process, and it can do so in a way that is transparent, ethical and valuable to all stakeholders.

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