



**ACPM/ACARR**

**The Association of Canadian Pension Management**

**L'Association canadienne des administrateurs de régimes de retraite**

**BRIEF**  
**TO THE**  
**Government of Canada**  
**ON THE**  
**Consultation Paper Entitled**  
***“Strengthening the Legislative and  
Regulatory Framework for Private  
Pension Plans Subject to the Pension  
Benefits Standards Act, 1985”***

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**Prepared by the  
ACPM Advocacy & Government Relations Committee  
Federal Pension Review Task Force**

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## FOREWORD

### 1. Introduction

This brief contains comments by the Association of Canadian Pension Management (“ACPM”) in response to “Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the Pension Benefits Standards Act, 1985”, the consultation paper of the Department of Finance of Canada.

Both the changing economic environment and the maturing of pension plans provide a foundation for a complete review of current pension legislation. The ACPM is pleased that the Government of Canada is seeking feedback on the required evolution of the PBSA, 1985. The ACPM believes that it is possible for the government to create an environment in which both DB and DC pension plans can flourish and continue to be an important part of retirement income security. However, we also believe that, to bring this about, technical and administrative changes as well as more fundamental changes of principle and law are necessary. The federal government has provided temporary funding relief measures to deal with solvency deficit volatility to DB plan sponsors regulated by the PBSA, 1985 twice in the last three years. This is a strong indication that changes of a more permanent nature need to be made to the Act.

In many ways, the current system of federal pension regulation is strong. In other ways it is lopsided and unfair, and discourages plan sponsors from establishing new registered pension plans and funding existing plans beyond the minimum regulatory financing requirements. A greater sense of balance and fairness needs to be brought to the legal and regulatory context of federally-regulated pensions. That would be an excellent way for the government to encourage the growth and health of registered pension plans.

### 2. The Association of Canadian Pension Management (ACPM)

The Association of Canadian Pension Management is the informed voice of Canadian pension plan sponsors, plan administrators and their allied service providers. Established in 1976, ACPM has over the years gained a solid reputation as being an outspoken advocate for an effective and fully sustainable retirement income system in Canada. ACPM’s Individual Members and Institutional Members alike are drawn from all of the various industry sectors.

ACPM promotes its vision for the development of a world-leading retirement income system in Canada by championing the following principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders’ interests;
- Excellence in governance and administration.

The ACPM regularly advocates and participates in public dialogue on pension issues.

This brief was prepared by a Task Force of the ACPM Advocacy and Government Relations Committee (AGRC).

### **3. Structure of this Brief**

This brief consists of this Foreword and ACPM's position on each of the 16 questions contained in the consultation paper.

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## ACPM RESPONSES TO QUESTIONS POSED IN CONSULTATION PAPER

1. *The Government of Canada is interested in stakeholders' views regarding the rules for funding solvency deficiencies and the solvency calculation itself.*

The results produced by the current solvency deficit funding rules have proven throughout this decade to be onerous and volatile. The ACPM supports the Government of Canada's focus on solvency funding reform. The basis of this reform should focus on three concepts:

1. Extending Amortization Periods;
2. Letters of Credit; and
3. Solvency Accounts.

### **Extending Amortization Periods**

The current 5-year amortization period for solvency deficits has proven to be too short, leading to overly onerous and volatile contributions from plan sponsors. The ACPM supports lengthening the permissible solvency deficit amortization period to 10 years. The ACPM recommends that this change be made without requiring the approval of other stakeholders or the members' collective bargaining agent(s) and without requiring that any letters of credit be posted.

Since the commencement of the liquidity crisis in August 2007, letters of credit have ceased to be an inexpensive, readily accessible means of securing pension benefits. There appears to be little likelihood of reverting to pre-August 2007 credit conditions over the foreseeable future.

As well, member consent requirements for longer amortization periods transfer to the plan members and/or their collective bargaining agents the responsibility for addressing a policy issue – that being the overly onerous and volatile nature of the current solvency funding rules - that is more appropriately addressed by governments.

The ACPM believes that an appropriate balancing item to extending solvency deficit amortization would be to require surplus to be amortized over the same period as solvency deficits when determining the amount of surplus that could be used for contribution holiday purposes in any one year.

Other stakeholders may be proposing that solvency valuations include a provision for adverse deviation (PfaD) that would, as a minimum, not permit sponsors to take any contribution holidays until that plan's assets exceed the plan's solvency liabilities by an amount equal to the PfaD. While ACPM believes that such a PfaD may worsen the asymmetry issue (i.e. sponsors are responsible for funding deficits, but have no ready access to excess funding that is not required for promised benefits), should the Government of Canada decide to introduce PfaDs, then the ACPM believes that these should not be funded by employer contributions, but simply be allowed to develop from experience gains.

### **Letters of Credit**

The ACPM supports the use of letters of credit to assist plan sponsors in meeting all or a part of its required solvency funding payments, subject to the ability to reduce or cancel the letters of credit if a solvency surplus later develops or if the sponsor chooses to remit cash contributions in lieu of previously-posted letters of credit. Letter of credit security should be an alternative source of funding that sponsors can voluntarily utilize, as opposed to a trade-off for lengthening solvency funding periods.

We believe that financing options made available through letters of credit would be an effective addition to a plan sponsor's funding toolkit, especially when plans' solvency funded status return to close-to-fully-funded positions.

### **Solvency Accounts**

The ACPM supports the concept of the solvency account to help alleviate the risk/reward asymmetry in the defined benefit ("DB") pension system. The notion of a solvency account was raised in our 2005 funding report entitled *Back from the Brink*. The solvency account has also been recommended in the recent report of the Alberta/British Columbia Joint Expert Panel on Pension Standards (JEPPS) in their discussion of "Pension Security Funds (PSFs)".

The solvency account would function as a separate account from the basic pension fund, but would be an asset of the pension fund in the event of a plan wind-up. However, the statutory rules governing solvency accounts would preclude the application of classic trust principles that might apply to the basic pension plan. Thus, subject to regulations regarding funding sufficiency or over-sufficiency, a plan sponsor would be able to withdraw or reallocate excess funds in the solvency account that are not required to protect the plan's solvency position. Solvency accounts would provide a net benefit to all pension stakeholders. Adoption of this concept is beneficial because it:

- preserves the security of the plan member benefits;
- would not entrap the plan sponsor's capital;

- may encourage plan sponsors to fund their pension plans beyond the statutory minimums; and
- may encourage plan sponsors who are considering establishing new DB plans.

2. *The Government of Canada is seeking views on whether to require that plan sponsors fully fund pension benefits when a plan is fully terminated, but provide that payments can be made over a period of five years, and treat the outstanding obligation as an unsecured debt of the company. In addition, the Government is seeking views on conditions, if any, where a plan could be terminated in an underfunded position by virtue of an agreement between the sponsor and plan members.*

The ACPM believes that the current ability of a plan sponsor to “walk away” from an underfunded pension debt obligation on plan wind-up is a threat to the security of plan members’ benefits. Plan sponsors should be required to fully fund pension benefits when a plan is fully terminated.

The ACPM believes that the deficiency identified on termination should be amortized over a maximum of five years.

Payments to amortize the deficiency on plan termination should be subject to the same rules and priorities as apply to special payments while the plan is ongoing. The ACPM believes that current service costs, and any special payments that are then due but unpaid (but not the entire amount of the deficiency) should have a special priority on the bankruptcy of the employer.

Regarding the termination of a plan in an underfunded position by agreement between the sponsor and the plan members, the ACPM generally supports the flexibility inherent in that proposal. The rules surrounding such a termination should ensure that each group affected by the proposal (in particular, pensioners and deferred vested members) approve the proposal that affects that particular group, as the interests of the various stakeholder groups may differ. In the interests of practicality, a high level of approval, but not unanimous approval, should be required.

3. *The Government of Canada is seeking views on whether to eliminate the concept of partial termination from the Act but require immediate vesting of pension benefits for all members.*

The concept of partial plan terminations creates unnecessary complexities in pension plans. Its main justification for existence is to provide immediate vesting to plan participants upon a partial wind-up. The ACPM supports the elimination of partial terminations from the Act.

The ACPM recognizes that immediate vesting of pension benefits for all active members would increase plan liabilities and the burden on plan administrators. Notwithstanding this, immediate vesting provides an adequate solution to protecting accrued benefits under any type of termination from the plan including wind-ups while improving benefit levels for members with short service.

4. *The Government of Canada is seeking views on whether to:*
- *require administrators to establish a Statement of Funding Policy (SFP) in a similar fashion as the Statement of Investment Policies & Procedures (SIP&P). The SFP would be examinable upon request, like the SIP&P.*
  - *allow required disclosure items to be disseminated by electronic means, at the option of the receiving member or beneficiary.*
  - *expand the categories of members required to receive plan information to include former members and retirees, where it is appropriate.*

### **Require Administrators to Establish a SFP**

The ACPM believes that every DB plan should have a written funding policy. However, it would be the responsibility of the plan sponsors, not the administrator. A funding policy would be best dealt with in the same manner as a plan's SIP&P. That is:

- it would be mandated but without prescriptive rules regarding the content or administration of such policies;
- it would be reviewed on an annual basis;
- it would be filed with the Superintendent upon request;
- it would be given to the plan actuary;
- it would be available to plan members and other interested parties upon request;
- it would set out the plan sponsor's funding objectives, contribution strategy and general explanation of funding risk; and
- it would not address funding issues that are linked to the sponsor's management of its financial risks which are deemed confidential.

As in the development of the SIP&P, the forms and expressions of funding policies would evolve with time.

### **Allow Required Disclosure Items to be Disseminated by Electronic Means**

The ACPM supports the use of electronic means to disseminate required disclosure items to plan members and beneficiaries. The regulators should



ensure that electronic communication is seen as a viable alternative for plan sponsors to ensure members are informed. Electronic disclosure can be a cost-effective and efficient means of distributing required disclosures to members and beneficiaries.

In that vein, we would support the introduction of disclosure by electronic means on a broad basis, subject to appropriate privacy protections. Plan administrators should be required to provide notice to members and beneficiaries that ongoing disclosures will be satisfied through electronic means. Members or beneficiaries wishing to receive the required disclosures in hard copy would then be required to opt out of the electronic disclosure, by informing the plan administrator of their wishes. If a member or beneficiary does not opt out, he or she will be deemed to have consented to receive the required disclosures electronically.

### **Expand the Categories of Members Required to Receive Plan Information**

The ACPM believes strongly in transparency. Key policies related to the governance, investment and funding of a pension plan should be, as a matter of industry best practice, available to all stakeholders. However, we would not support the expansion of categories of members required to receive plan information to include former members and retirees for the purpose of disclosing individual-specific information, such as that contained in annual statements provided to active members given the cost-prohibitive nature of such an undertaking, and the fact that such information doesn't really change from year to year. Instead, we support the provision of plan-specific information to former members and retirees, such as the provision of financial and investment updates.

The ACPM also would not support the introduction of a requirement to inform plan members and beneficiaries each time a plan sponsor is late in remitting contributions to the trustee or fund holder. If the Act is amended to require such disclosure, we would support a requirement that the administrator must notify plan members and beneficiaries if the plan sponsor is more than three months late in making the required contributions. Plan administrators must first attempt to rectify the situation and provide the plan sponsor with a reasonable amount of time before a requirement to inform plan members and beneficiaries is triggered.

5. *The Government of Canada is seeking views on whether:*
- *plan sponsors be required to develop a formal policy on contribution holidays for inclusion in a Statement of Funding Policy; and*
  - *to the extent that employer contributions are permitted under the tax rules, plan sponsors only be permitted to take a contribution holiday in the year in which a valuation report, filed with OSFI, shows a surplus in the plan on a solvency basis.*

## Formal Policy On Contribution Holidays

As discussed above, the ACPM strongly supports that plan sponsors be required to establish a funding policy. A funding policy must, as a matter of good governance, set out the plan sponsor's formal policy with respect to its funding objectives and contribution strategy, including its policy on contribution holidays. As a funding policy would be available to plan members and beneficiaries, the inclusion of a formal policy with respect to contribution holidays would increase the transparency of such funding mechanisms.

## Contribution Holidays In The Year In Which A Valuation Report Shows A Surplus

Plan sponsors should be allowed to continue taking a contribution holiday in the second and third year following an actuarial valuation if a brief actuarial update in the format of a certificate, as opposed to a full valuation, is provided to demonstrate that there is still sufficient surplus at the end of each year. This certificate should reflect the main relevant experience factors (e.g. asset return, change in discount rates, actual benefit payments, actual contributions if any, and current service cost), but not necessarily other experience items (e.g. demographic changes or salary changes). The methodology for such an actuarial certificate should be developed by the Canadian Institute of Actuaries.

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| <p>6. <i>The Government of Canada is seeking views on whether to amend the regulations to prescribe a solvency ratio level of 0.85 for the purpose of implementing the void amendment provision in the Act.</i></p> |
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ACPM does not support an absolute prohibition on plan amendments to provide benefit enhancements when a plan is underfunded. Such an approach would be too rigid for plan sponsors and punitive to plan members.

Instead, ACPM proposes the lowering of the priority for recent benefit improvements on plan wind up if the plan is in deficit and the sponsor is either bankrupt or not required to fund the deficit. This concept has been in place in Québec for many years. To the extent that a plan is underfunded, this risk of benefit loss should be clearly communicated to plan participants.

But if the void amendment provision is implemented, then pension plans should be permitted to make plan improvements provided that offsetting funding is provided at the time that the improvement comes into effect to maintain the plan's solvency ratio at the applicable threshold.

7. *The Government of Canada is seeking views on the practicality and desirability of safe harbour protection, and what considerations should be made in the determination of the qualified default investment options.*

The ACPM recommended in its policy paper *Delivering the Potential of DC Retirement Savings Plans* (May 2008) that the concept of safe harbour be adopted for certain design features of retirement savings plans that meet criteria prescribed by legislation/regulation. We further recommended that the criteria be at the level of broad-based principles, thereby allowing the flexibility needed for the myriad of existing and to be developed retirement savings plans.

We suggest that some of the factors involved in the selection of a default option are:

- the purpose of the plan (retirement savings is typically a long term effort);
- the management expense ratio of the option (as compared to other options made available);
- the turnover in the work force;
- the willingness of the sponsor to monitor the performance of the option selected and to switch out of it;
- the ability and cost for members who wish to switch out of the option;
- the level of required and optional member contributions;
- the ability of the member to stay invested in the option on termination of employment or retirement; and
- the cost to the member of moving out of the option if the CAP provider is replaced.

8. *The Government of Canada is seeking views on whether to allow the payment of variable retirement benefits directly from the defined contribution account.*

The ACPM endorses the concept that, in all jurisdictions, the payment of a variable benefit be permitted (at the sponsor's discretion) directly from a DC pension plan. This change would allow DC pension plans to pay pension benefits directly to their retired members, subject to an annual minimum payment after age 71 and subject to the same annual maximum withdrawal limit applicable to locked-in retirement accounts under applicable pension legislation. Where a plan sponsor offers a variable retirement income benefit, members are able to remain in their pension plan after retirement, without having to assume greater responsibility for investment decisions or to pay higher investment fees that are typically charged within individual plan arrangements. Plan sponsors and members alike also stand to benefit in situations where the retention of additional

assets within the DC pension plan results in a lower management expense ratio. It should be emphasized that this should be a benefit voluntarily offered by the plan sponsor.

9. *The Government of Canada is seeking views on whether it is appropriate to revise the standard of care for employers sponsoring defined contribution plans to 'good faith' rather than 'fiduciary'.*

The ACPM endorses the revision of the standard of care under the PBSA for employers administering defined contribution plans to require employers administering DC plans to act honestly and in a manner consistent with the purpose of the pension plan and industry best practices. This standard is more appropriate than the fiduciary standard as it better reflects the role employers play in the administration of DC plans where day to day administrative duties are generally delegated to professional third party administrators. To implement the revised standard of care in respect of DC plans, the PBSA must be amended to clearly dictate that the DC standard overrides the current standard of care provided in Subsections 8(4), 8(4.1), and 8(5), which would remain in effect in respect of the administration of defined benefit pension plans.

10. *The Government of Canada is seeking views on whether it is appropriate to clarify that defined benefit surplus can be used to offset employer's defined contribution current service costs for hybrid plans.*

The ACPM endorses the concept that with a hybrid plan in surplus, a contribution holiday may be taken in respect of required contributions for the defined contribution component of the plan. Access to the hybrid plan surplus for this purpose and in these circumstances should be subject to the same limitations applicable to the funding of new benefits. The ACPM believes that this clarification should not expose the balances of DC plan members to claims to compensate the overall plan in the event of an overall plan deficit. Conversely, DC plan members should not have access to any surplus upon plan wind-up. Such a result would be beyond the reasonable expectations of all plan members.

11. *The Government of Canada is seeking views on required administrative practices that may impede the proper and efficient administration of defined contribution plans.*

The ACPM encourages the Government to consider the following improvements to administrative practices affecting defined contribution plans.

- Simpler laws. Pension benefits statutes are generally more focused on DB pension plans than DC pension plans causing them to be unnecessarily

complex for DC plans. The laws applicable to DC pension plans should be simplified so that they can operate on a level playing field with Group RRSPs, increasing plan sponsors' flexibility;

- Uniform laws. The laws applicable to retirement savings plans should be harmonized across Canadian jurisdictions;
- Administrative simplicity. Legislation should facilitate administrative efficiencies, such as e-commerce. In addition, simplifying and harmonizing the rules around locking-in, vesting, membership and marriage breakdown should be a top priority;
- Need for flexibility and options in retirement. The regulatory system should allow flexibility in product design to accommodate the need for retirement income alternatives;
- Terminated members. Sponsors of DC pension plans should be able to require terminated members to leave the plan;
- Automatic enrolment. Plan sponsors should be permitted to enroll members in the plan without their consent, subject to the right of the member to opt out of the plan;
- Automatic escalation of contributions. Sponsors should be allowed to increase contribution levels without express member consent, subject to the right of the plan member to opt out;
- Default funds. Default funds that are more appropriate to long term investing should be supported;
- Investment advice. Provision of investment advice should generally be at the discretion of the plan sponsor, although there is a greater need for advice in the period just prior to retirement.

12. *The Government of Canada is seeking views on whether there is interest in alternative plan designs that may not currently be accommodated by the legislative framework.*

As has been recommended in the Alberta and British-Columbia report of the Joint Expert Panel on Pension Standards (JEPPS), the ACPM believes that the next generation of pension standards legislation should contain principles of general application and provide sufficient flexibility to accommodate any type of plan design. Which types of alternative plan designs may gain favour is difficult to anticipate but this type of flexibility would allow for potential innovations in plan design.

Rules relating to specific existing and future plan types should be housed in regulation and / or regulatory policy.

The JEPPS report recommends that the role of pension standards legislation, and of the regulator, should be to ensure that reasonable protections are in place to ensure that the deal made is actually delivered. The ACPM agrees with this principle.

13. *The Government of Canada is seeking views on whether there are legislative impediments to the creation or operation of multi-employer pension plans, and if there are improvements that could usefully be made to the legislative framework for these arrangements.*

We suggest that multi-employer pension plans (MEPPs) need to be encouraged as they provide increased flexibility to plan sponsors. Increased flexibility for plan sponsors could lead to greater retirement savings coverage for Canadians. MEPPs offer several benefits to sponsors including removing pension liabilities from the sponsor's books, fixed contribution rates and the ability to reduce benefits. They could be structured on national, regional or industry lines or under a particular financial institution. Legislation should ensure that there are not disincentives to establishing such plans. In particular, the administrator of such a plan should be shielded from legal liability provided it followed specific requirements.

However, one area of concern has been the application of solvency rules to MEPPs. Solvency rules are a very blunt instrument for dealing with negotiated MEPPs and should be eliminated. The funding issues that solvency tries to address for these plans should be dealt with in a more direct fashion. Instead of solvency rules for MEPPs, we first encourage government to introduce legislation specifically addressing areas of potential abuse, such as inappropriate benefit improvements. In addition, there should be legislation concerning the treatment of the withdrawal of individual employers from MEPPs.

One-size-fits-all legislation is neither adequate nor appropriate. ACPM feels there should be different rules for plans with different risk-sharing arrangements and risk/reward characteristics. We would refer to the analysis of MEPPs in the Report of the Ontario Expert Commission on Pensions, which suggests that MEPPs should in fact be exempt from solvency funding requirements.

We believe that MEPPs are more like DC pension plans than DB – contributions are usually set at fixed levels through collective bargaining and target benefits established by a Board of Trustees. MEPPs are typically over-funded on a going concern basis and underfunded on a solvency basis. Unable to meet these minimum solvency funding standards, many MEPPs have been forced to reduce benefits. This also creates intergenerational inequities as contributions that have previously been earmarked for benefit improvements are used to fund the solvency deficiencies.

The liability of members of Boards of Trustees of MEPPs needs to be addressed. One way to do this may be to allow members of Boards to pay the cost of liability insurance out of the pension fund, but make it specific that the insurance covers members only when they act in good faith. This way, a balancing of prudent investment behaviour while covering the liability of trustees could be achieved. This could also reduce the viability of plan sponsors who generally indemnify their



nominees to a Board of Trustees, but have no control over the actions of the Board, particularly the investment decisions made by the Board.

Finally an aspect of MEPPs that should be considered is the expectation that competitors will band together to form such a plan. One solution to do this is to remove the requirement for MEPPs to be governed by a Board of Trustees and allow third party administration of the MEPP, say from an insurance company, so that the legacy, liability and competitive issues are potentially removed.

14. *The Government of Canada is seeking views on the relevance of Simplified Pension Plans, and whether there are any impediments in the legislation to the adoption of such arrangements.*

Although there has not been much take up on Simplified Pension Plans (SPP), the ACPM supports the flexibility that is injected into the retirement system by their existence. We do not see impediments in the legislation to the formation of SPP's but would observe that the awareness level of these vehicles is low. The Department of Finance might consider a campaign to raise awareness of their features and would direct you to the efforts of the Government of Québec in recent years.

15. *The Government of Canada is seeking views on the appropriateness of reorganizing the Act to provide greater clarity on the differing legislative provisions applicable to defined benefit and defined contribution plans. Specific examples of legislative impediments and uncertainties are particularly desired.*

The administrative burden for sponsors of DB and DC plans acts as an obstacle to their maintenance and to the creation of new such plans.

- The laws applicable to pension plans are more complex than needed;
- There is a lack of uniformity among federal and provincial rules applicable to pension plans; and
- There is a need to modernize the administration of retirement savings plans through the use of e-commerce.

To address these issues, we suggest the following options, in descending order of desirability:

- (i) Create a single, simple statute applicable in all jurisdictions that applies to all retirement savings plans, that codifies only what is necessary and relies on guidelines, such as the CAP Guidelines, and regulations or the application of best practices and flexibility;

- (ii) Amend the pension benefits statute of each jurisdiction to provide regulators with rule-making powers, together with a mandate to pursue uniform national rules. This might follow the model of national instruments under securities laws;
- (iii) Expand uniform national guidelines, such as the CAP Guidelines.

16. *The Government of Canada is seeking views on ways to improve the regulatory framework governing pension investment.*

We recommend holding pension investments to the standard of a prudent person and eliminating all quantitative limits on investing. Canada is the only developed country that uses quantitative limits, instead of the more universally applied prudent person standards for investing. Such restrictions, by limiting the pool of available assets, can have a negative impact on pension fund performance.

Capital markets are global – Canadian dollar denominated assets can readily be substituted for any other asset in a global pool of liquidity. A greater opportunity set of investments leads to a higher probability of increased risk-adjusted returns. The greater range of investment options and strategies available, the more diversification can reduce risk, and the greater the opportunity pension funds have to obtain higher returns.

Governments have influenced these strategies in the past by, for example, limiting the foreign content in pension plans. ACPM believes that the industry has evolved to the point that pension funds should be governed by the prudent person rule, which enables pension plan administrators to make the best investment choices for their plan.

The Department of Finance may wish to emulate both Québec regulations and the US ERISA legislation by adding the need for diversification in order to avoid significant losses. Regulators could introduce guidelines to supplement the prudent person rule along the lines of the guidelines for the composition of the Statement of Investment Policies and Procedures.