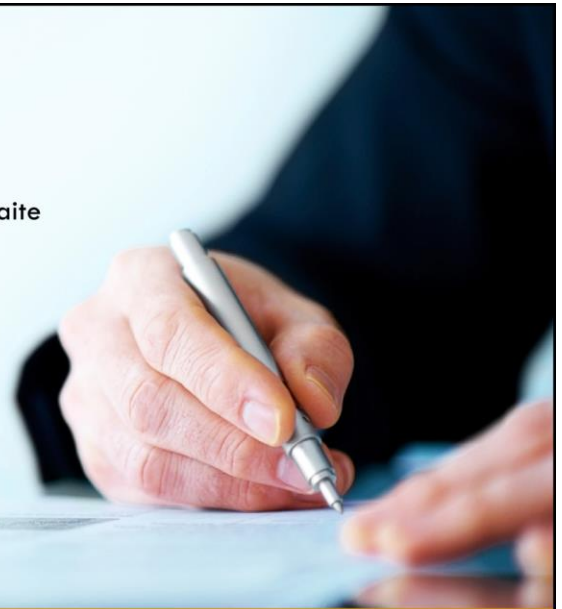




ACPM | ACARR

The Association of Canadian Pension Management

L'Association canadienne des administrateurs de régimes de retraite



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ACPM Response to the Proposed Amendments to the Pension Benefits Standards Regulations, *1985*

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TABLE OF CONTENTS

Foreword	3
Introduction	4
1. Modernizing the Pension Investment Rules.....	4
2. Regulatory Framework for DCPPs	6
3. Variable Benefits	6
4. Enhanced Disclosure	7
5. Electronic Communications	7
6. Conclusion.....	7

FOREWORD

THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT (ACPM)

ACPM is a national non-profit volunteer-based organization acting as the informed voice of plan sponsors, administrators and their service providers, advocating for improvement to the Canadian retirement income system. Our membership represents over 400 companies and retirement income plans consisting of more than 3 million plan members, with assets under management in excess of \$330 billion.

ACPM believes in the following principles as the basis for its policy development in support of an effective and sustainable Canadian retirement income system:

Diversification through Voluntary / Mandatory and Public / Private Options

Canada's retirement income system should be comprised of an appropriate mix of voluntary Third Pillar and mandatory First and Second Pillar components.

Third Pillar Coverage

Third Pillar retirement income plan coverage should be encouraged and play a meaningful ongoing role in Canada's retirement income system.

Adequacy and Security

The components of Canada's retirement income system should collectively enable Canadians to receive adequate and secure retirement incomes.

Affordability

The components of Canada's retirement income system should be affordable for both employers and employees.

Innovation in Plan Design

Canada's retirement income system should encourage and permit innovation in Third Pillar plan design.

Adaptability

Canada's retirement income system should be able to adapt to changing circumstances without the need for comprehensive legislative change.

Harmonization

Canada's pension legislation should be harmonized.

Introduction

We are pleased to provide ACPM's comments on the proposed amendments to the *Pension Benefits Standards Regulations, 1985* (the "Proposed Regulations"). We generally support the Government's efforts to modernize the pension investment rules, improve the regulatory framework for defined contribution pension plans ("DCPPs") and enhance disclosure to plan members and beneficiaries. However, we have a number of comments on the Proposed Regulations, which we have outlined below.

Modernizing the Pension Investment Rules: Schedule III

Changes to the Related Party Rules

Removal of the "nominal or immaterial" exemption (Subsection 17(3))

Our most significant concern with respect to the Proposed Regulations is the removal of the important "nominal or immaterial" exception to the related party rules. The ACPM is not aware of any abuses of the "nominal or immaterial" exemption and we believe that this exemption builds required flexibility into the related party rules.

The current definition of "related party" in Schedule III is problematic. It is imprecise and overly broad such that it captures situations where there is no personal financial interest of the "employer" (or other party) at stake. In addition to all participating employers, a "related party" transaction includes transactions with all plan members, their spouses, common law partners and children as well as the unions and associations that represent plan members. As such, it is very difficult for plan administrators to ensure compliance with the related party rules in making an investment. Without the "nominal or immaterial" exemption, plans may inadvertently violate the related party rules, especially large plans that have a significant number of members whose personal investments as well as those of their spouses and children are impossible for the plan administrator to ascertain. In other words, the "nominal or immaterial" exception is a critically important safety valve in light of the imprecise and overly broad nature of the current "related party" definition.

Although the terms "nominal" and "immaterial" are not defined in the Proposed Regulations, each pension plan is required to include in its Statement of Investment Policies and Procedures the criteria to be used to establish whether a transaction is nominal or immaterial to the plan, having regard to all factors that may affect the funding and solvency of the plan and the ability of the plan to meet its financial obligations (section 7.1(1)(h) of the Regulations).

Further, pension plan administrators are subject to separate prudence and conflicts of interest standards when undertaking transactions on behalf of pension plans. As such, "related party" rules are not the only safeguards available to prevent improper self-dealing.

Large Public Sector Plans: Definition of "Related Party"

In addition, we recommend that the definition of "related party" in the *Canada Pension Plan Investment Board Regulations* apply to investments made on behalf of large public sector plans (as opposed to the current definition of "related party" currently in Schedule III).

Large public sector plans have robust governance frameworks and do not raise the public policy concerns relating to pension investment in employer securities that the current related party rules are

intended to address. As noted above, the definition of related party is imprecise and overly broad. Under the current definition of a “related party”, a related party to a plan can include an employer or employee who participates in the plan. Many large broader public sector plans have diverse and wide ranging investment portfolios. Many make many private market and infrastructure investments across Canada (either directly or indirectly through co-investment with other money managers or through fund of funds arrangements). Such transactions may touch upon employers in the broader public sector such as municipalities, school boards, museums, post-secondary institutions, hospitals, etc. Further, many such employers may not be agencies of the Crown (federal or provincial) and thus may not be carved-out of the definition of “related party”. As a result, if the “related party” definition and prohibitions are intended, or are interpreted so as, to restrict any transactions in respect of participating employers, it would severely restrict some broader public sector plans from making infrastructure investments in Canada. This is because it would be operationally impossible for such plans to track whether these investments touched upon a participating employer or employee directly or indirectly. In addition, the “administrator” of a pension plan is, on the face of the related party rules, a “related party”, and, as such, transactions with affiliates or entities in which the administrator holds a “substantial investment” would be prohibited, which would prevent further investment or even potentially require divestments.

For the avoidance of doubt and in order to avoid any possible interpretation that might cause plans to avoid making these types of Canadian infrastructure investments, we recommend that the current definition of “related party” should be replaced for large broader public sector plans with the “related party” definition in the *Canada Pension Plan Investment Board Regulations* (or something similar). That definition defines related parties with reference to directors, officers or employees of the Board or persons responsible for holding or investing the assets of the Board. We submit that the more narrow focus of this definition is much more appropriate for large public sector plans than the current “related party” definition in Schedule III, as such persons are more accurately the “related parties” of those plans and where there may be self-dealing concerns.

Furthermore, as submitted above, as is the case with the *Canada Pension Plan Investment Board Regulations*, there should continue to be an exception from the related party rules for transactions of nominal value.

Changes to the 10% Concentration Limit

The ACPM supports using a “market value” test rather than “book value” for the 10% concentration limit. We also agree with the clarification that the test applies to the aggregate of debt and equity.

Other Technical Comments on Proposed Amendments to Schedule III

In addition to our submissions above, we have the following technical comments on the proposed amendments to Schedule III:

- Regarding the 10% concentration limit exception for an investment in an “investment fund” in new subsection 9(3) of the Proposed Regulations. The proposed definition of “investment fund” requires that the fund be established “by” a corporation, partnership or trust. We submit that this proposed definition should be broadened to reflect the fact that sometimes the corporation, partnership or trust is the fund.
- The exception to the 10% concentration limit in new subsection 9(4) of the Proposed Regulations appears to only apply to index funds that are derivative based. This provision

should be amended to also extend to index funds that hold securities. We raise this same point in respect of the related party rules exception in new section 17(3) of the Proposed Regulations.

- Paragraph 9(3)(f) of the current version of Schedule III provides an exception to the 10% concentration limit for a fund that replicates the composition of a widely-recognized index of a broad class of securities traded at a public exchange. There are various indices which are not based on a single public exchange. Many index funds use broader indices covering multiple markets (e.g., EAFE). Accordingly, we recommend updating this provision (and the equivalent provision in new section 17 of the Proposed Regulations) to reflect current industry practice.

DC Regulatory Framework

The ACPM supports the removal of the requirement for DCPs to have a statement of investment policies and procedures (SIPP).

Regarding the new requirement to provide DCP members with a statement of prescribed information, we request that the Proposed Regulations provide clarity on the level of detail to be included in describing each investment option. The ACPM does not favour including an investment fund's top 10 holdings by market value. It is not useful information to the member in terms of assessing the risk/return profile of the fund and it will often be incorrect by the time the statement is received.

Variable Benefits

Minimum Payments

The ACPM supports the payment of variable benefits from a DCP, where the sponsor wishes to provide this option. However, the legislation should not provide that the minimum payment determined under subsection 8506(5) of the *Income Tax Regulations* must be paid for a calendar year where the member has not communicated a payment amount by the start of that year. Variable benefit minimums are not like LIF/RRIF minimums, as the minimum payment for a variable benefit payment determined under 8506(5) is subject to sub (7), which provides that the minimum until age 72 is zero. A variable benefit payment amount should continue at the amount previously set by the recipient, unless it must be increased to meet the minimum or decreased to meet the maximum for the coming year. We note that this same comment applies with respect to the Pooled Registered Pension Plans Regulations.

Spousal Consent

Section 16.2(1) of the *Pension Benefits Standards Act, 1985* ("PBSA, 1985") provides for spousal consent as a precondition to permitting a member to receive a variable benefit from a DCP. In our view, a variable benefit paid from a DCP is similar to a pension paid from a defined benefit (DB) pension plan, which does not require spousal consent. We understand the need to protect the interests of a spouse. However, we have concerns regarding the effect that this condition would have on a retiring DC member who requires retirement income, but is in the process of a marriage breakdown. The effect of requiring spousal consent to the payment of a variable benefit, in circumstances where the spouse is unavailable or unwilling to consent, would be to force the member to purchase an annuity from a life insurance company, potentially at a time when annuity purchase rates are unfavorable. The annuity purchase would be the only option available to such a DCP member that does not require spousal consent.

We do not see a policy reason to require spousal consent to receive a variable benefit from a DCP as opposed to a pension from a DB plan. As such, we recommend that the Proposed Regulations (including section 23.3) be amended to eliminate the spousal consent requirement referred to in Section 16.2(2)(a) of the PBA, 1985, as is expressly permitted by section 16.2(1). Section 16.2(1) provides, in part, as follows:

Variable benefit

16.2 (1) ***Subject to the regulations***, a pension plan may provide that a member or former member who is entitled to an immediate pension benefit under subsection 16(1) or eligible to receive an immediate pension benefit under subsection 16(2) may elect to receive a variable benefit payable under a defined contribution provision.

[emphasis added]

Enhanced Disclosure to Plan Members and Beneficiaries

The ACPM generally supports sections 3 and 12 of the Proposed Regulations which require a plan administrator to provide prescribed information and an annual statement to DCP members and former members.

However, with respect to Section 14(4) of the Proposed Regulations, we query how the disclosure of the top 10 asset holdings based on market value and the asset allocation assists in informing members of defined benefit plans. What does the description of the assets tell them about the security of their benefits? In the ACPM's view, the solvency ratio is the best indicator of the security of member benefits. We recommend that the requirement to disclose the top 10 asset holdings as well as the asset allocation be removed.

In addition, we note that former member address searches are very expensive for plan administrators to undertake, raising the costs of administering the plan. As such, we recommend that the Proposed Regulations be amended to clarify that plan administrators are only required to send statements to former members and retirees' last known addresses.

Electronic Communications

In ACPM's view, the provisions of the PBA, 1985 requiring paper copies of statements and other communications were enacted at a time when electronic communication systems were not widely used. Today, electronic communication is the predominant mode of communication in the workplace. We recommend that the electronic communications provisions in section 25 of the Proposed Regulations be revised to reflect this reality such that the electronic form of a document is the standard form where there is a designated information system. The Proposed Regulations would take priority over the default provision in section 31.1(1) of the PBA, 1985, as is expressly permitted by section 31.1(3)(c). If the plan member or beneficiary objects, plan-related documents shall then be provided to the individual in paper form.

Conclusion

We appreciate the opportunity to provide the ACPM's comments on the Proposed Regulations. We would be pleased to make ourselves available to discuss or expand upon our recommendations.