November 3, 2021

Andrew Donelle
Senior Director, Deferred Income Plans
Tax Legislation Division / Department of Finance
140 O'Connor Street
Ottawa, ON K1A 0G5

RE: Borrowing restrictions applicable to registered pension plans under paragraph 8502(i) of the Income Tax Regulations ("ITR").

Dear Mr. Donelle:

Thank you for the opportunity to comment on possible changes to the borrowing restrictions applicable to registered pension plans under paragraph 8502(i) of the Income Tax Regulations ("ITR").

ACPM is the leading advocacy organization for plan sponsors and administrators in the pursuit of a balanced, effective and sustainable retirement income system in Canada. We represent retirement plan sponsors, administrators and trustees and our membership represents retirement income plans that cover millions of plan members.

1) Background

We understand that the Department of Finance ("Finance Canada") is requesting comments from industry on the borrowing restrictions applicable to registered pension plans under paragraph 8502(i) of the ITR (the "borrowing rules"). Some in the industry, including ACPM, are of the view that the borrowing rules are out-of-date and ought to be amended or replaced. Below please find the ACPM's views regarding the borrowing rules and the changes that would be workable from our perspective and that of our members.

2) Meaning of "borrow"

ACPM strongly recommends that any amendments to the borrowing rules not contain a definition of "borrow money" or "borrow" for the purposes of the borrowing rules. The reasons for this are four-fold.

First, there is already a well-established definition of "borrowed money" that is consistently applied by the Courts. Terms such as "borrowed capital" and "borrowed money" in tax legislation have been interpreted to mean capital or money borrowed with a relationship of lender and borrower between the parties. Simply put, the words have meaning already and any attempt to distil the commonly understood meaning into a definition in the ITA risks changing that meaning.

Second, the definition from the case law is widely accepted and applied by the pension industry and is the one around which Canadian pension funds have arranged their affairs. In particular, pension fund administrators are very careful regarding how leveraged transactions are structured and documented such that they do not constitute "borrowing" per the accepted definition.

Third, any definition risks getting it wrong, either by casting too broad a net with the result that transactions into which pension funds regularly enter become caught by the new definition, or the evolution of capital markets moves in such a way so as to exclude pension funds from more efficient means of transacting. The cost and inefficiency associated with reordering investment structures, or worse, having to sell-off offending investments, should not be underestimated.

Fourth, any new definition would be accompanied by a period of uncertainty while legal practitioners and the industry coalesce around its meaning. Uncertainty necessarily results in increased cost and missed opportunity. We would, therefore, strongly recommend that revisions to the borrowing rules not contain a definition of "borrow money" in order to prevent the potential harms and inefficiencies noted above.

3) Purpose of the borrowing rules

Borrowing money is but one way in which leverage can be achieved and all other forms of leverage are permitted for pension plan administrators and explicitly regulated by pension minimum standards regulators through various policies and the general standards of prudence found in pension statutes across the country. For example, the Financial Services Regulatory Authority of Ontario Policy PE0144ORG, Prudent Investment Practices for Derivatives, which describes in detail the considerations pension plan administrators ought to be taking into account in entering into financial transactions that involve leverage, including the prudent taking of cash collateral.

In our view, it therefore behooves Finance Canada to ascertain what the purpose of the borrowing rules is (or was) and whether there remains valid tax policy to retain the rule for defined benefit pension plans in light of the prudential regulation of all other forms of leveraged transactions. If Finance Canada determines that the borrowing rules are born out of mid-century thinking regarding the "riskiness" of borrowing money, we urge Finance Canada to consider the following points:

- Canadian federal and provincial pension legislation and regulation includes general and specific standards and requirements for investing a pension plan's assets prudently, and in conformity with specified limits and restrictions.

- The role of the pension regulator is to supervise the prudent administration and investment of plan assets, taking into account that plan administrators must deploy assets into markets, and must manage the risk associated with doing so.

- Pension regulators are in fact regulating and guiding plan administrators on the appropriate use of leverage.

We therefore suggest that Finance Canada defer to the pension minimum standards regulators regarding the risk associated with borrowing money, if that is indeed the reason for the borrowing rules.

We understand that there may be another motivation for the borrowing rules: that of limiting the amount of plan assets and thus the amount of assets that are exempt from taxation. Although there is no clear legislative history or policy statement evidencing the intent of the borrowing rules, we can glean from the similar rules for capital accumulation plans, such as RRSPs and PRPPs, that the borrowing rules may be intended to limit the ability to artificially circumvent the money purchase limit.

In addition, we note that the CRA has interpreted the borrowing rules in this light stating[(1)]: “if the Plan is a money purchase plan, the concern about leveraged investing takes on greater importance as the borrowing would have served in effect to circumvent the RPP contribution limits.” The CRA contrasts this with a defined benefit plan, where leveraged investing is less of a concern as the tax rules provide for a self-adjusting mechanism: a higher rate of return resulting from leverage within the plan would result in lower employer contributions.

Given that Canadian minimum standards pension regulators (i) regulate, and (ii) are best positioned to regulate borrowing money from a prudential perspective, and that the “mischief” the borrowing rules are, according to the CRA, aimed at preventing is excess contributions to defined contribution plans, ACPM urges Finance Canada to consider limiting the borrowing rules in respect of defined contribution plans, and exclude defined benefit registered pension plans from their application.

4) Flexibility for “large” plans

In the event that the borrowing rules are not repealed entirely or, in the alternative, redirected at defined contribution plans, ACPM supports an exemption from the borrowing rules for “large plans”. It is our experience that “large plans” have sophisticated investment governance and risk management frameworks and need not be subject to such a rule.

We understand that others, including the Canadian Bar Association, have proposed an exemption for plans with at least 50,000 members and $10 billion in assets under management. ACPM would instead propose that Finance Canada grant exemptions in coordination with pension minimum standards regulators based on a demonstrated risk management framework, or if it is to be based on bright-line numbers, we would suggest that membership and asset value fluctuations not result in the loss of an exemption, or that an exemption once granted would not be lost in respect of transactions entered into prior to the exemption being lost.

Thank you for the opportunity for ACPM to provide comments on this issue and please contact us if we can be of further assistance.

Sincerely,

R Marrero

Ric Marrero
Chief Executive Officer
ACPM

cc: Maximilian.Baylor, Personal Income Tax Division, Tax Policy Branch, Dept. of Finance
Paul Taylor, Tax Legislation Officer, Deferred Income Plans, Tax Legislation Division, Dept. of Finance

(1) See Technical Interpretation 2016-0644761I7