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Via email: Lisa.Pezzack@fin.gc.ca

Ms. Lisa Pezzack
Director
Financial Sector Division
Finance Canada
90 Elgin Street, 13th Floor
Ottawa, Ontario K1A 0G5

Dear Ms. Pezzack:

Re: Regulations Amending Certain Regulations Relating to Pensions - Canada Gazette, Part I, September 27, 2014

I am writing on behalf of the Canadian Bar Association's National Pensions and Benefits Law Section (CBA Section) in response to the Regulations Amending Certain Regulations Relating to Pensions (Proposed Regulations) pre-published in the Canada Gazette, Part I on September 27, 2014. The Proposed Regulations amend the *Pension Benefits Standards Regulations, 1985* (PBSR) and the *Pooled Registered Pension Plans Regulations* (PRPP Regulations).

The Canadian Bar Association is a national association of over 37,000 lawyers, Quebec notaries, students and law teachers, with a mandate to promote improvements in the law and administration of justice. The CBA Section is comprised of lawyers from across Canada who practice in the pensions and benefits areas of law, including counsel to benefit administrators, employers, unions employees and employee groups, trust and insurance companies, pension and benefits consultants and investment managers and advisors.

Generally, the CBA Section supports the announced objectives of the Proposed Regulations: improving the regulatory framework for defined contribution pension plans (DC Plans), modernizing the federal investment rules, improving protection for plan members and beneficiaries, and requiring enhanced disclosure.

Improving Regulatory Framework for DC Plans

Investment Options Information

The CBA Section supports removing the requirement that a plan administrator establish a statement of investment policies and procedures (SIPP) pertaining to any member choice account.

500-865 Carling Avenue, Ottawa, ON, Canada K1S 5S8
tel/tél. : 613.237.2925 | **toll free/sans frais :** 1.800.267.8860 | **fax/téléc. :** 613.237.0185 | www.cba.org
Membership/Adhésion : memberservice@cba.org | **PD/DP :** pd@cba.org | **Sections :** cba.sections@cba.org | **General/Générale :** info@cba.org

We believe it is preferable to require a plan administrator to provide a statement of prescribed information to members and other individuals who are responsible for investment choices under their member choice accounts. However, the obligations of plan administrators for timing and frequency of the statement, as well as the requirements describing each investment option, are unclear. Specifically:

- When disclosing how a member's assets are invested, no frequency is given other than the word "currently". This is problematic as the value of each investment could change daily. We suggest that the statement required under section 7.3(1) be provided annually at the same time as the annual statement is provided to a member.
- No time period is specified for the "performance history". Using the "best" benchmark may impose a difficult standard to meet and the "degree of risk" may vary among individuals.
- The assets of the vast majority of DC Plans with member choice accounts are held in the general fund of insurance companies and not directly in the investment funds where the returns are mirrored or referenced in the assets held in the accounts of the members. We suggest that the obligations under section 7.3(1)(a) applying to these investment funds be specified.

Variable Benefits

The new section 21.1 provides for DC Plans establishing variable benefits options for members. The CBA Section supports the introduction of regulations related to variable benefits in principle. However, we have a number of practical concerns with the introduction of variable benefits and support them remaining optional rather than mandatory.

By introducing a variable benefit option and allowing members to remain in a DC Plan following termination of their employment, plan administrators will assume an increased administrative burden for communications and management of investment options, and additional liability for an expanded group of members.

In particular, under the Proposed Regulations, members of a DC Plan eligible to elect variable benefits could leave their DC account in the plan after they retire. They will also have the option to choose the amount to be drawn down from their account on an annual basis subject to a maximum prescribed in the PBSR and a minimum prescribed by the *Income Tax Regulations* (Canada). More importantly, plan administrators will continue to owe a fiduciary duty to and be liable for former members and retirees who elect the variable benefit option, not just active members. This creates an obligation for a group of beneficiaries who are not active members in the plan.

The CBA section supports the proposed new section 23.3 adopting Form 5.2 requiring the written consent of the spouse or common-law partner to the member's election for variable benefits.

Changes to investment rules applicable to DC Plans

The CBA Section supports the new section 9(1.1) of Schedule III which provides that a plan administrator cannot directly or indirectly lend or invest 10% or more of the total market value of the funds in a member choice account or in any one person, associated persons or affiliated corporations. However, it should be taken into account that for member choice accounts, the administrator does not make the investment choices (which are made by the members or others) pursuant to subsection 8(4.2) of the PBSA.

For DC Plans with investments held in the general fund of insurance companies, the Proposed Regulations should clarify whether the 10% rule is meant to apply to the investment funds held in each member choice account. We suggest a transition period to allow plans to comply with this

requirement as the plan administrator will need time to verify the funds it offers for compliance and to communicate with all members to explain any changes.

Modernizing Federal Investment Rules

Schedule III - Subsection 9(1)

One of the revisions to subsection 9(1) is the change from "book value" to "market value" in the test used under the 10% rule. The intent seems to be that the test be applied at the time the investment or loan is made and not on an ongoing basis. We suggest that for clarification, the intent be made explicit. For example, subsection 9(1) could be revised to read:

> *The administrator of a plan shall not, directly or indirectly, lend or invest, in total, 10% or more of the total market value of the plan's assets on the date the loan or investment is made, to or in,*

We have concerns with the definition of "market value". The change in the test in subsection 9(1) means that plan administrators will need to determine the market value of all plan assets. Market value is defined in subsection 2(1) of the PBSR as "in respect of an asset, means the price that would be obtained in the purchase or sale of the asset in *an open market* under conditions requisite to a fair transaction between parties who are at arm's length and acting prudently, knowledgeably and willingly". Under paragraph 7.1(1)(g) of the PBSR, plans may hold assets that are not traded in an open market. This is becoming common in both large and small plans as more allocations are made to private equity, real estate and infrastructure assets. Having a test for market value based on the price obtained in an open market will add unnecessary complexity to the determination. We recommend removing the words "in an open market" from the definition. The requirement that the price be determined on the basis that the transaction is "fair" and "at arm's length" should be sufficient for the purposes of the test.

Additionally, no transition period is provided for the change from "book value" to "market value". While this change will apply prospectively, it will require the plan administrator and its service providers to make numerous administrative changes, including changes to the plan's SIPP, changes to investment management agreements, systems changes, etc. We recommend a transition period of at least one year from the enactment of the new regulations.

Schedule III – Subsection 9(3)

In new paragraph 9(3)(a)(i) it is not clear why investment funds or segregated funds applicable to a member choice account must only comply with section 11 of Schedule III (the 30% rule). We believe it would be more appropriate to require these funds to comply with the 10% rule.

Schedule III - Subsection 9(4)

The intent of new subsection 9(4) seems to be to broaden the exemption for indexed funds. However, the reference to "the purchase of a contract or agreement" is unclear. For example, investments in mutual funds made through subscription agreements would not normally involve the purchase of a contract or agreement.

Schedule III - Subsection 17(1)

Subsection 17(1) has been revised to remove the ability of a plan administrator to enter into a transaction with a related party on behalf of the plan where the transaction is required for the operation or administration of the plan and is on terms and conditions not less favourable to the plan than market terms and conditions. New subsection 17(1) allows a plan administrator to

"engage the services of any related party for the operation or administration of the plan by means of a transaction under market terms and conditions". The Regulatory Impact Analysis Statement cites hiring a related party to act as a broker or dealer as an example of the application of new subsection 17(1) of Schedule III.

If the intent in revising subsection 17(1) is to prohibit pension plan assets from being invested in a related party, specifically the employer and its affiliates, even where the investment is required for the operation or administration of the plan and is on market terms (except for related party investments that are otherwise permitted under new subsections 17(2) or (3)), we recommend that new subsection 17(1) be revised to make that intent clear. Subsection 17(1) could be revised to read:

> *The administrator of a plan may enter into a transaction, other than a transaction involving a loan to or an investment in the securities of the employer and its affiliates, with a related party for the operation or administration of the plan under market terms and conditions.*

This change would avoid any ambiguity in the interpretation of the phrase "engage the services of". For example, consider where a pension plan administrator leases office equipment from a related party. Provided the lease is on market terms, it would be permitted under current subsection 17(1). However, it is less clear that the arrangement would constitute the plan administrator "engaging the services of" the related party for purposes of new subsection 17(1).

If current subsection 17(1) is amended, it should be limited to carving out investments in a related party especially if, as proposed, the nominal or immaterial transaction exemption under current subsection 17(3) of Schedule III (which could also apply in some cases where subsection 17(1) applies) is eliminated.

Schedule III – Subsection 17(2)

We do not believe it is necessary to require compliance with the 10% and 30% rules to fit into the exception in subsection 17(2) as these requirements are directed at different policy concerns, unrelated to potential conflicts of interest. It adds unnecessary uncertainty since diversification and control requirements are dealt with elsewhere in Schedule III.

If, however, these requirements are retained, it is not clear why in new paragraph 17(2)(a)(i) the investment fund or segregated fund applicable to a member choice account should be required to comply with section 11 (the 30% limit). It would be more appropriate to require the investment fund or segregated fund to comply with subsection 9(1) (the 10% limit) instead of section 11.

Schedule III – Subsection 17(3)

The Proposed Regulations remove the "nominal or immaterial" transaction exemption from the general prohibition on related party transactions currently in subsection 17(3). We recommend that the nominal or immaterial transaction exemption be maintained in its current form. While the PBSR does not define "nominal or immaterial", we believe that the determination of what is nominal or immaterial depends on the circumstances of the particular pension plan and should be left to the plan administrator to decide in its fiduciary capacity. An administrator has a statutory obligation to review the plan's threshold for nominal or immaterial transactions on an annual basis. Specifically, paragraph 7.1(1)(h) of the PBSR requires the administrator to set out in the plan's SIPP the criteria used to establish whether a transaction is nominal or immaterial to the plan.

Given the broad definition of "related party" in Schedule III (which is not amended under the Proposed Regulations), the nominal or immaterial transaction exemption is particularly important for large pension plans to address situations of inadvertent related party transactions which are nominal or immaterial in nature. For example, in a large multi-employer pension plan with hundreds of participating employers, it is difficult for the plan administrator to ensure that it does not transact with (i) any employee, officer or director of any employer that participates in the plan or the spouse, common-law partner or child of any that person; or (ii) any person who directly or indirectly holds, or together with their spouse, common-law partner or child holds, more than 10% of the voting shares of a corporate employer that participates in the plan.

Enhanced Disclosure

The CBA Section supports section 3 of the Proposed Regulations which requires a plan administrator to provide prescribed information to members who are responsible for investment choice under their defined contribution or additional voluntary contribution accounts.

The CBA Section supports section 12 of the Proposed Regulations which requires the annual statement to include prescribed information for members and former members who elect to receive variable benefits.

Subsection 14(4) of the Proposed Regulations provides that for assets of a plan not held in respect of member choice accounts, a list of the 10 largest asset holdings based on market value and the asset allocation be included in the annual statement. The CBA Section questions whether including this information is desirable as it may be too detailed to effectively inform members about the well-being of their plan. In our view, including the solvency ratio is the best indicator of the security and sustainability of a plan. Should this information be included, the CBA Section recommends clarifying the effective date of the asset valuations to be included in the annual statement.

Subsection 14(5) of the Proposed Regulations requires plan administrators to provide retirees and other former pension plan members with an annual statement, as currently required for active members. This may be difficult for a plan administrator to administer since locating former members may be challenging.

Improving Protection for Plan Members

Spousal Consent

The Proposed Regulations state that the consent referred to in section 26(2.1) of the PBSA shall be as prescribed in Form 3.1 of Schedule I of the PBSR.

Generally, Form 3.1 of Schedule I sets out the member's right to transfer their pension benefit credit from the plan fund and describes situations in which a transfer may result in a reduced pension income for a surviving spouse. Form 3.1 then permits the surviving spouse to consent to the transfer and certify their understanding of a number of facts.

The CBA Section agrees with the format and overall content of Form 3.1. However, we suggest some revisions to the form:

- it should clearly identify the name and registration number of the pension plan to which the consent to the transfer applies;
- it should include an acknowledgement of having the opportunity to obtain independent legal advice.

It is not clear why bullet point (c) in the certification requiring the spouse to certify that "[my] spouse or common-law partner is not present while I am signing this form" is required. Spousal consent should be given of the spouse's own volition, as certified in bullet point (b). Requiring that the member be absent while the spouse signs the consent overlaps with the requirement that spouse sign of their own volition and seems unnecessary. If the requirement that the spouse sign in the absence of the member is removed, the corresponding witness certification respecting the signing of the waiver in the absence of the member should be deleted.

Distribution of Surplus

The CBA Section supports the extension of time in section 16(2)(e) to allow interested parties to prepare an application for judicial review of the Superintendent's decision on refund of surplus.

Technical Amendments

The CBA Section supports the attempts to harmonize, in the specified circumstances, the treatment of monies held in a Pooled Registered Pension Plan, and a pension plan to which the PBSR applies.

We trust these comments are helpful. We would be pleased to further assist Finance Canada in any way possible.

Yours truly,

(original signed by Noah Arshinoff for Lyne Duhaime)

Lyne Duhaime
Chair, National Pensions and Benefits Law Section