FTR Now

Changes to the Federal Pension Investment Rules

Date: May 20, 2015

In March 2015, the federal government published final regulations amending investment rules under the *Pension Benefits Standards Regulations, 1985* ("Regulations"). These reforms apply to federally registered pension plans and to pension plans registered in provincial jurisdictions that have adopted Schedule III of the Regulations, as amended (the "Federal Investment Rules" or "FIR").

As we previously reported, proposed amendments to the Regulations were released on September 19, 2014 for public comment. The final Regulations contain a number of important changes that address specific concerns raised by industry stakeholders during the consultation period.

In this *FTR Now*, we discuss these important pension investment changes.

BACKGROUND

Pension benefits standards legislation across Canada generally includes a requirement that pension fund assets be invested prudently. For pension plans subject to the federal *Pension Benefits Standards Act* ("PBSA"), the FIR also impose additional quantitative investment restrictions and specific investment rules. Pension plans registered in Ontario, Alberta, British Columbia, Manitoba, Newfoundland and Labrador or Saskatchewan ("Specified Jurisdictions") are also subject to the FIR because the FIR have been expressly adopted by reference into the pension benefits standards legislation in these jurisdictions.

FIR CHANGES

1. THE 10% LIMIT

Subject to enumerated exceptions, the Federal Investment Rules currently prohibit plan administrators from investing or lending more than 10% of a plan's assets in an entity or any associated or affiliated entities.

Effective July 1, 2016, a number of changes are being made to the "10% limit" rule. First, the 10% limit will change from a "book value" to a "market value" measurement of a plan's assets. The rule has also been revised to clarify that it applies to the total amount of a plan's debt and equity investment. Exemptions to the 10% limit will continue to be available, with some modification as noted below.

The new market value 10% limit test is to be measured when investments or loans of plan moneys are made. In other words, the new rules do not impose a duty to monitor compliance on a scheduled basis (e.g. at month end).

The 10% limit will also be applied to "member choice accounts," i.e. a defined contribution ("DC") account within a plan where the member directs the investment of his or her account. Exemptions to the 10% limit will apply to member choice accounts as well.

The exemptions to the 10% limit have been expanded to provide that the restriction does not apply to:

- investments in a fund that replicates the composition of a widely recognized index of a broad class of securities traded

at a “marketplace.” [1] This is an expansion from the current exemption that applies to a fund that replicates the composition of a widely recognized index of a broad class of securities traded on the public exchanges specifically listed in the FIR;
- investments that involve contracts or agreements in respect of which the return is based on the performance of a widely recognized index of a broad class of securities traded in a marketplace; or
- investment funds or segregated funds [2] that themselves comply with the FIR; or in respect of member choice accounts, investment funds or segregated funds that comply with the FIR “30% rule.” [3]

2. RELATED PARTY INVESTMENTS

The Federal Investment Rules currently restrict “related party” investments and transactions, except as specifically authorized under the FIR. [4]

The existing related party rules allow an administrator to invest the moneys of a plan in the securities of a related party if the securities are purchased on a public exchange listed in the FIR. This important exemption is being eliminated effective July 1, 2016. However, a new exemption will allow an administrator to invest in a related party indirectly thorough an investment fund or segregated fund in which investors other than the administrator and its affiliates may invest (i.e. a widely available investment fund) and that complies with the 10% rule and the 30% rule (or in respect of member choice accounts, an investment fund or segregated fund that complies with the FIR 30% rule).

The related party investment rules will be further amended as follows effective July 1, 2016:

- an exemption to the related party rules will apply to investments in a fund that replicates the composition of a widely recognized index of a broad class of securities traded at a marketplace (this is in addition to the widely available investment fund noted above); and
- currently the FIR permit an administrator to enter into a transaction with a related party if the transaction is required for the operation or administration of the plan and if it is under terms and conditions that are not less favourable to the plan than market terms and conditions. This exception will be revised such that there is no longer a requirement that the transaction be required for the operation or administration of the plan but it will prohibit the lending or investing of the plan’s money under this exemption.

The proposed Regulations released last Fall contemplated the elimination of the current exemption from the related party rules which permit an administrator to enter into a transaction with a related party if the value of the transaction is nominal or immaterial. However, in response to concerns that the proposed elimination would result in significant administration burdens, the final Regulations retained these exemptions.

Administrators will have until July 1, 2021 to comply with the new related party provisions (i.e. five (5) years from July 1, 2016). The FIR also provide a five (5) year compliance window in cases where the related party rules are contravened as a result of a transaction entered into by someone other than the administrator. This could occur in conjunction with a corporate transaction.

3. STATEMENTS OF INVESTMENT POLICIES AND PROCEDURES (“SIPP”)

Effective April 1, 2015, SIPPs for federally regulated plans are no longer required to address a plan’s investments relating to member choice accounts. Due to the structure of the FIR, this change does not apply to Ontario registered pension plans.

NEXT STEPS

These changes to the FIR will require administrators of plans registered under the PBSA or Specified Jurisdictions to review their plans’ investments for compliance with the new rules. Even if a plan is already compliant with the new rules, the plan’s

SIPP will likely need to be amended and changes to investment manager agreements may be required. The new rules relating to member choice accounts will require administrators of plans which hold DC accounts invested by members to put in place monitoring processes for the investments held in member choice accounts.

As a final note, the 2015 Federal Budget, "Strong Leadership: A Balanced-Budget, Low-Tax Plan for Jobs, Growth and Security," undertakes to hold public consultations on the "30% rule." This could lead to further reform of that investment rule.

If you have any questions regarding implementation of these significant reforms, please contact any member of Hicks Morley's Pension, Benefits and Executive Compensation group.

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[1] A new definition for "marketplace" includes all investment platforms in recognition that pension plan investments may be bought/sold not only on public exchanges, but also on quotation and trade-reporting systems and other platforms.

[2] A new definition of "investment fund" will replace the definitions of "mutual fund" and "pooled fund." As defined, an investment fund includes pooled funds and mutual funds whether created as corporations, trusts or limited partnerships and, in general terms, provides for the pooling of investments with unitholders holding a proportionate interest in the assets of the fund.

[3] The current 30% rule generally prohibits an administrator from investing in securities of a corporation to which are attached more than 30% of the votes that may be cast to elect the corporation's directors.

[4] Related parties include the plan administrator, a person responsible for holding or investing the assets of the plan, any employer who participates in the plan, any entity that holds a substantial investment in the employer, affiliate corporations, and corporations that are directly or indirectly controlled by a person who otherwise falls within the definition of related party, in addition to other listed persons.

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