



Advancing Standards™

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Department of Finance Canada

House of Commons
Parliament Buildings
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Re: Pension Plan Investment in Canada: The 30 Per Cent Rule

The Portfolio Management Association of Canada (“PMAC”)¹, through its Industry, Regulation & Tax Committee, is writing to express our views on the ongoing usefulness of the 30 per cent rule and considerations relating to its elimination pursuant to the Federal government’s consultation on this matter (the “Consultation”).

PMAC applauds the Federal government in its pursuit of strengthening and modernizing pension legislation for the benefit of Canadians, including this Consultation and the agreement in principal reached on the Canada Pension Plan earlier this summer.

PMAC strongly advocates for measures that encourage and bolster the ability of Canadians to adequately save for retirement. We believe that any measures that promote the ease and returns of such savings are critical for a secure and prosperous Canadian economy.

The 30 per cent Rule

Similar to [our position on the recent Ontario government consultation](#) on the elimination of the 30 per cent rule in that province, PMAC supports the elimination of the current investment rule that restricts federally regulated pension plans from holding more than 30 per cent of the voting shares of a corporation. PMAC believes that this would be a welcome development for large federally regulated pension funds that engage in direct investing, as well as for Canadian investors.

Collectively, our member firms manage investment portfolios for most of Canada’s pension plans, and as such, have special experience with the issues faced by pension plans, their administrators, advisers and portfolio managers with regard to the investment of pension plan assets. We support a regulatory framework for pension plan fund managers that

¹ As background, PMAC was established in 1952 and currently represents over [220 investment management firms](#) that manage total assets in excess of \$1.4 trillion. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

provides greater flexibility to pursue investment strategies that mitigate risk, optimize return and allow appropriate diversification to meet plan liabilities. PMAC has previously advocated for the elimination of investment restriction rules, such as quantitative limits, on the basis that these types of rules are outdated and unnecessary in a modern pension investment environment.

In PMAC's view, reliance on the prudent person standard is sufficient to offset potential risks in pension plans acquiring a controlling stake in a corporation. This standard allows managers and plan administrators to use their expertise and discretion in constructing their portfolios. We note that government has gradually been moving in this direction with recent legislative changes.

For example, most recently, Ontario consulted on the elimination of the 30 per cent rule and there have been other recent changes made to Federal investment regulations which prohibit plan administrators from investing or lending more than 10 per cent of the total value of the plan's assets in a single entity. Additionally, recent amendments to the *Pension Benefits Standards Regulations, 1985* ("PBSR") amend a number of aspects of this concentration limit. The amendments modify the 10 percent limit so that it is based on the current value or "market value" of a pension plan's assets rather than the "book value".

In addition, the Federal government amended the investment rules in June of 2010 to eliminate the 5%, 15% and 25% quantitative investment limits in respect of resource and real property investments. In a prudent person environment, the quantitative limits in respect of real estate and resource property are considered cumbersome and no longer required. We applaud the government for moving toward this "prudence" environment and believe that the same course of action is appropriate in the context of the 30 per cent limit for pension plan investments.

Prudential Considerations

PMAC supports measures that are designed to protect pension plan beneficiaries and that ultimately ensure fiduciary obligations to members and beneficiaries are being met. As a result, we believe that, should a pension plan's investments exceed a certain threshold, the plan should not be subject to any additional requirements. Presuming that investment managers adopt prudent person standards in managing their portfolios, on-going monitoring and assessment of investments in the portfolios would preclude any undue risk being incurred without the necessity for further disclosure or other requirements.

PMAC's understanding is that the existence of the 30 per cent rule has not impeded pension plans' ability to achieve investment goals of greater than 30 per cent ownership in corporations but, rather, that the ways in which these goals have been achieved has been costly to the plans in terms of professional and advisory fees as well as internal compliance fees. We agree with the statement in the Consultation that the 30 per cent rule creates an additional barrier for Canadian pension plans making foreign investments as a result of the elaborate structures created to work around the 30 per cent limitation being viewed negatively by foreign stakeholders. We believe that Canadian pension plans should be on a level playing field with similar foreign plans in order to give Canadian investors access to returns derived from a wide variety of investments in their plans. We are in favour of measures that increase the competitiveness, fairness and efficiency of pension plans for the benefit of Canadians.

PMAC believes that, since the existence of the 30 per cent rule is currently not a commercial impediment for larger plans seeking active management, there will be a minimal impact on smaller plans as a consequence of eliminating this limit.

Tax Policy Considerations

With respect to the tax implications of increased active investments by pension plans, PMAC believes that any measures implemented by the Federal government to address the tax planning opportunities that would accrue to plans with a controlling interest in a corporation should be forward-looking and not impact the structure and taxation of any investments already in existence. We believe that to impose tax measures that would impact already existing investments would harm the pensioners relying on the returns generated by investments in those plans and do a disservice to the investing public.

PMAC does not view the tax policy concerns relating to the ability of tax-exempt pension plans to acquire operating businesses as being material in nature. We also do not believe that the elimination of the 30 per cent rule would have any material impact with respect to exacerbating the tax policy concerns set out in the Consultation.

Moreover, PMAC believes that past amendments to tax legislation have already effectively eliminated many of the structures that would be the targets of the proposed tax measures in the Consultation. In particular, the change to the “bump” of non-depreciable capital property contained in paragraph 88(1)(d) of the *Income Tax Act* (Canada) (the “Tax Act”) has eliminated the ability of pension plans to buy the shares of a taxable Canadian corporation from a vendor and to extract the underlying business on a tax-deferred basis. Pension plans acquiring substantial interests in private corporations now continue to conduct those acquired business through taxable corporations.

Additionally, the significant expansion of subsection 100(1) of the Tax Act, which causes a vendor selling a partnership interest to a pension plan to realize double the amount of taxable income compared to a sale to a taxable buyer, has effectively rendered the sale of partnership interests in operating partnerships to be too expensive for vendors. In practice, we see vendors requiring as a condition of sale that the buyer be, or form, a taxable Canadian corporation to acquire the partnership interests.

As a result, we believe that the possible imposition of a specified investment flow-through (“SIFT”) tax on pension plans would not effectively address the issues of concern highlighted in the Consultation. Should such a tax be imposed, we urge the Federal government to impose the tax only on structures and flow-through entities formed or implemented after the effective date of the legislative amendments and not retroactively because, to do so would impose a tax on already-established entities, formed or acquired prior to the introduction of the amendments to the Act noted above, to the detriment of pensioners.

With respect to the proposed thin capitalization restrictions, we do not believe these to be necessary to guard against the concerns set out in the Consultation, since pension plans already govern themselves in a way that respects the requirements in the Act regarding limits on the amount of interest that may be deducted. Should the thin capitalization restrictions be introduced, however, careful consideration should be given to tailoring these requirements for pension plans. For example, the existing rules (relevant in the cross-border context) do not consider the equity of lower-tiered subsidiaries. It would be inappropriate to remove the 30% limitation for the purpose of reducing costs associated with pension investment, only to create additional impediments in the Tax Act that do not achieve the desired policy objectives.

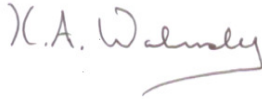
Harmonization across Canada

PMAC is in favour of the removal of all quantitative limits and investment restrictions on pension plans on a harmonized basis across all Canadian jurisdictions. In our view, investment rules should be set out as broad principles and most of the prescriptive quantitative restrictions should be abandoned as they do not address all of the portfolio diversification issues nor risks inherent in investments included in a pension plan (i.e. derivative exposure, geographical risks, etc.). As set out in our response to the Ontario government's consultation on the elimination of the 30% rule, we believe that this Federal Consultation process should be the cornerstone of national reform on this issue of quantitative limits on pension plan investments. Since the PBSR, containing the 30 per cent rule, have been adopted by many Canadian provinces, we believe that it is essential that the Federal government complete its consultative process and legislative amendments prior to the amendments of other provinces being finalized in order to ensure national harmonized. This is vital to ensuring that federal, provincial and territorial differences do not impede the efficiency and coordination of pension regulation in Canada.

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We would be please to answer any questions you may have and would be happy to meet in person to discuss our recommendations.

Yours truly;  
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



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