Proposed Amendments to Regulation 909: Eliminating the 30% Rule for Pension Investment

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Submitted to: Ministry of Finance, Pension Policy Branch

Submitted by: Ontario Bar Association, Pension & Benefits Law Section

ONTARIO BAR ASSOCIATION
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Introduction

The Ontario Bar Association ("the OBA") appreciates the opportunity to provide comments to the Ministry of Finance ("the Ministry") in response to its proposed amendments to Regulation 909 under the *Pension Benefits Act* ("the PBA") to eliminate the 30% rule for pension investment ("the Consultation Paper").

We support the Ministry's objective of opening up new investment opportunities and are pleased to provide our advice on achieving this objective from the perspective of practitioners of pension law.

The OBA

Established in 1907, the OBA is the largest voluntary legal organization in Ontario representing over 16,000 lawyers, law professors and students. In addition to providing legal education for its members, the OBA is pleased to analyze and assist government with dozens of legislative and policy initiatives each year – both in the interest of the profession and in the interest of the public.

This submission was formulated by a working group of our Pension & Benefits Law Section ("the Section"), which represents approximately 300 lawyers who serve as legal counsel to virtually every stakeholder in the pension and benefits industry, including pension and benefit plan administrators, employers, plan members, pension and benefit consultants, investment managers, actuarial firms and other advisors.

Over the years, our members have analyzed and provided assistance to the Ontario government on virtually every legislative and policy initiative in the pension field.

Background

In the 2015 Ontario Economic Outlook and Fiscal Review, the government announced its intention to eliminate the "30 per cent pension investment rule". The Consultation Paper describes and requests feedback on amendments being considered to Regulation 909 to implement this commitment.

The "30% rule" prohibits a pension administrator from holding, directly or indirectly, securities to which are attached more than 30% of the votes that may be cast to elect the directors of the corporation. There are exceptions to the 30% Rule for special purpose corporations, namely, investment, real estate and resource corporations. The Ministry has not suggested changing the rules for special purpose corporations, and the Section agrees with that approach.

The Ministry has asked whether it should introduce new disclosure requirements along with the elimination of the 30% Rule. The Ministry's main concern appears to be ensuring the continued protection of plan beneficiaries and the ability of the Superintendent of Financial Services ("the Superintendent") to oversee and regulate plans effectively.

Comments

The Section supports the Ministry's objective of opening up new investment opportunities by eliminating the 30% rule for pension investment. The primary aims of pension law include enhancing the security of members' benefits and promoting broader coverage of employees under workplace pension plans. The Section believes that a balanced approached is warranted, to provide sufficient disclosure for appropriate regulatory oversight while facilitating both the administration of the pension plan and the achievement of public policy goals. In the Section's view, these objectives can be achieved under the existing provisions of the PBA.

Relevant Existing Provisions of the PBA

Fiduciary Standard and Duty of Care

Section 22 of the PBA imposes a fiduciary standard and duty of care on the administrator of a pension plan, including, explicitly, in the investment of the pension fund. The fiduciary duty is the highest duty known to law.[1] Agents of the administrator, including third party investment managers, are held to the same rigorous standard. Moreover, subsection 22(4) clarifies that the administrator may not knowingly allow its interest to conflict with its duties to and powers over the pension fund. The Section does not believe that a specific undertaking from a corporation in which the administrator has invested can provide any greater protection than the administrator's freestanding fiduciary duty.

Specific Compliance and Reporting Mechanisms

Additionally, the PBA contains a number of specific compliance and reporting mechanisms that protect plan beneficiaries and provide supervisory tools to the Superintendent vis-à-vis plan investments. In the Sections' view, the chief *existing* protections in this regard are:

- The "10% Rule" in Section 9 of Schedule III under the Federal Investment Rules. This rule is a concentration limit that prevents an administrator from investing more than 10% of a plan's assets in any one person or affiliated or associated group. If the government eliminated the 30% Rule in its entirety, an administrator would still be prevented from over-concentrating a plan's investments in any one entity.

- The "related party" restrictions in Sections 15 through 17 of Schedule III. These restrictions, which will become even more robust with amendments becoming effective July 1, 2016,

[1] *Ben-Israel v. Vitacare Medical Products Inc.*, 1997 CanLII 12377 (ON SC).

prevent an administrator from lending the moneys of a plan to or investing those moneys in the securities of a related party. To the extent that there may be a concern that the elimination of the 30% Rule could allow administrators to take significant controlling stakes in a plan's participating employers, the related party rule offers full protection.

- The Annual Information Return, Investment Information Summary ("IIS"), pension fund financial statements and Statement of Investment Policies & Procedures ("SIP&P") (which must now be filed, along with any amendments, with the Superintendent) provide the Superintendent with a series of regular disclosures and reporting relating to a particular plan's investments. In some cases (such as the IIS), the Superintendent has authority to set the form and contents of the disclosure and may choose to make proportionate amendments in light of the elimination of the 30% Rule.

If the Regulator is of the view that it must have certain investment information that is not required to be provided under the current rules, the Section suggests that an appropriate avenue for obtaining this information is through the IIS.

Superintendent's Disclosure and Enforcement Powers

In addition to the foregoing reporting and disclosure requirements, the Superintendent also has general disclosure and enforcement powers under the PBA:

- For example, the Superintendent may order an employer, administrator or any other person to provide the Superintendent with information for the purpose of enabling the Superintendent to ascertain whether the PBA is being complied with.[2] This could include an order to require the administrator to secure an appraisal of any or all assets of the pension fund by an independent valuator and to provide the appraisal to the Superintendent or the Superintendent may obtain an appraisal at the administrator's expense.[3]

- The Superintendent also has broad examination and investigation powers to, among other things, make examinations, investigations and inquires and may require the production of any book, paper, document or thing related to a pension plan or pension fund.[4]

Practical Implications of the Proposed Additional Disclosure Requirements

The Section has concerns that the Ministry's proposed additional disclosure requirements may give rise to a number of practical issues, the chief of which can be summarized as follows: an administrator would have no freestanding ability to cause a corporation in which it held, say, 30% of the voting securities, to file the proposed undertaking, financial statements and other

[2] PBA subsection 98(1)
[3] PBA subsection 98(2)
[4] PBA section 106

information (except, perhaps, where the administrator actually controlled more than 50% of the voting securities). Therefore, an administrator would have to ensure that a corporation in which the administrator was proposing to take a stake agreed to provide this undertaking as a condition of the administrator's investment. This would put administrators at a disadvantage vis-à-vis other investors, who would not need to commit a target corporation to these requirements. Similar concerns apply in respect of the proposal to require any second corporation in which the first corporation holds voting securities above the threshold (again, assuming 30%) to provide the required undertaking and disclosure.

The Section believes that the majority of pension plans that will benefit and take advantage of the elimination of the 30% rule are large sophisticated plans with the capacity to make complex investment decisions, many of which are subject to a joint governance model. If the revised 30% rule requires additional disclosures and undertakings, the Section recommends that an exception be included to allow such plans to be exempt from those requirements. This is consistent with the recommendation of the Ontario Expert Commission on Pensions' report entitled *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules* to allow jointly governed plans with the requisite investment capabilities to be allowed to claim exemption from the 30% rule.

Conclusion

Once again, the Section supports the Ministry's objective of opening up new investment opportunities and appreciates the opportunity to provide input on the proposed regulatory changes. The Section does not believe that the elimination should, by itself, necessitate new disclosure requirements, since plan beneficiaries and the Superintendent are well protected and well served by the PBA's existing fiduciary standard, quantitative and related party investment limits and annual and *ad hoc* disclosure and filing requirements. We look forward to the opportunity to provide any further input as the Ministry moves forward with this commitment.