Goodmans LLP Update

Pensions Law

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Federal Government Calls for Submissions on the Usefulness of the 30% Rule for Pension Investments

The Department of Finance Canada has issued a call for comments on the ongoing usefulness of the "30% Rule" for investments by federally regulated pension plans and considerations relating to its retention, relaxation or elimination. **Submissions are due by September 16, 2016**.

The federal Government is contemplating more than a simple elimination of the 30% Rule and is seeking views on whether other regulatory changes, including tax changes, should be introduced.

The 30% Rule

The 30% Rule restricts pension plans from directly or indirectly investing the moneys of the plan in the securities of a corporation to which are attached more than 30% of the votes that may be cast to elect the directors of a corporation. It is one of the most onerous quantitative limits on investments by pension plans contained in the federal pension regulations. It is also incorporated into most provincial pension legislation and investment standards of public pension plans.

As noted in our March 18, 2016 update, *Ontario Government Calls for Comments on Proposal to Eliminate the 30% Rule for Pension Investment*, Ontario has proposed to eliminate the 30% Rule for Ontario pension plans. In addition, last June, Quebec carved out investments by the Caisse de dépôt de placement de Québec in infrastructure corporations from the 30% Rule.

Discussion Paper

The discussion paper accompanying the call for comments, "*Pension Plan Investment in Canada: The 30% Percent Rule*", notes that the 30% Rule was intended to limit pension plans to a more passive role and to reduce the risk of exposure to business failure. It also points out that internationally, the majority of pension investments are not subject to an ownership contribution limit and that, according to the Organization for Economic Co-operation and Development, out of the seven member countries whose institutions hold 90% of pension assets, Canada is the only country with an ownership contribution limit.

The paper notes that as pension plans have sought better returns to fund increasingly costly pension benefits in a low interest rate environment and volatile global equity market, there has been a need to increase the investments in which they play an active role. Some large pension plans have circumvented the 30% Rule through the use of elaborate structures and have sought a repeal of the rule, arguing it increases costs and creates a barrier for making investments in foreign markets.

Policy Considerations

The discussion paper seeks comments on prudential, investment performance and tax policy considerations concerning the 30% Rule.

Prudential Considerations

The Government has posed questions aimed at determining whether removal of the 30% Rule would impact the obligations of a pension plan administrator to invest plan assets as a reasonable and prudent person. For example, the Government is seeking comment on whether a pension plan should be subject to additional requirements if its investment exceeds a certain threshold.

Investment Performance Considerations

Other questions explore how the 30% Rule affects a pension plan's investment returns, including whether it: (a) impedes appropriate investment returns; (b) imposes costs on plans seeking active investments; and (c) creates inequities between large and small plans or conversely, whether its removal could do so.

Tax Policy Considerations

The paper notes that a more active investment by a pension plan provides an opportunity to shift taxable income from tax paying business entities to tax exempt pension funds. This can be achieved through structures using earnings stripping via related party debt or private flow-through entities. The paper notes that most other G-7 countries either have rules that restrict corporate interest deductions in the case of domestic tax-exempt and foreign investors, or tax pension plans directly.

In this context, the Government is seeking responses to questions on whether such tax policy concerns are material in nature and what impact relaxation or elimination of the 30% Rule may have on these concerns.

In particular, the Government is seeking comment on whether it should consider implementing tax measures (such as thin capitalization restrictions or application of the Specified Investment Flow-Through tax to pension-controlled trusts and partnerships) to limit the ability of pension plans to undertake tax planning strategies to reduce or eliminate entity-level income tax on business earnings.

Interested parties may wish to review the questions posed in the discussion paper in more detail and make submissions to the Government before the September 16, 2016 deadline.

Please contact any member of our Pension, Benefits and Compensation Group for further information.

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