

# NEW PENSION INVESTMENT AND DISCLOSURE RULES

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Pension plan sponsors should take notice of recent changes to the rules respecting investment of plan assets and new member disclosure requirements. Most of the changes described in this bulletin will become operative in 2016, though some amendments took effect on April 1, 2015.

## 1. New Federal Investment Rules ("FIR")

The FIR, [11](#) apply to federally regulated pension plans as well as provincially regulated plans in Ontario, British Columbia, Alberta, Saskatchewan, Manitoba, and Newfoundland and Labrador, the provinces that have adopted the federal rules by reference.

- **10% Diversification Rule**

To ensure that pension funds are prudently diversified, the FIR have, since 1994, prohibited more than 10% concentration of investment in any one person or affiliated or associated group. The maximum concentration test has been based on the total book value of the plans assets. Effective July 1, 2016, the test will be based on the total market value of the plan's assets at the time an investment is made. These changes will be welcomed, as they remove the previous uncertainty as to whether the test was one that required an ongoing monitoring requirement.

For defined contribution ("DC") pension plans, the new FIR language makes it clear that the 10% diversification test is to be applied at the member account level, not on a total plan basis. This eliminates another area of ambiguity in the former language of Schedule III.

The 10% diversification rule continues to be subject to exceptions that allow for concentration of plan assets in investments that can be characterized as "less risky" such as government issued securities, CDIC and Assuris guaranteed investments and investment funds that are themselves compliant with the FIR limitations. A new exception to the diversification rule will permit a pension plan to have more than 10% of its market value invested in a derivative contract with a return based on the performance of a widely recognized index of a broad class of securities traded at a marketplace.

- **Related Party Rules**

Generally, plan administrators are prohibited from investing in or entering into a transaction with a related party of the plan. Related parties are defined in the FIR to include an employer that participates in a pension plan, the administrator of a pension plan and a person that holds or invests assets of a pension plan. Under the existing FIR, a pension fund is permitted to hold securities of related parties if they are acquired on a stock exchange listed in Schedule III. Changes to the FIR that will become effective on July 1, 2016 will remove the stock market acquisition exemption for employers and other related party investments. After July 1, 2016, the limited exceptions for investments in related party securities will be confined to:

- Indirect investments through an investment fund in which the plan administrator and affiliates cannot invest.
- Investments in a fund that replicates the composition of an index of a broad class of publicly traded securities or a derivative contract based on such an index.
- Investments in insurance company general funds.
- Investments in securities issued or guaranteed by a Canadian government or government agency.

Plan administrators will have until July 1, 2021 to dispose of any off-side related party securities held on July 1, 2016. There will also be a five-year grace period for an administrator to divest a prohibited investment where the investment results from a transaction by a third party, such as a corporate take-over.

The FIR will retain the exception for related party transactions having nominal or immaterial value. It appears that this exception will apply to investments in related parties.

Previously, transactions involving a pension plan and related parties acting as service providers or lessors were only permissible if the transactions were "required" for plan administration and on "market terms and conditions". As of July 1, 2016, the exemption will no longer stipulate that such non-investment transactions be "required". This change makes it clear that all non-investment related party transactions are acceptable if they are on market terms.

#### • **Defined Contribution Plans and Disclosure**

Effective April 1, 2015, a new concept of "member choice account" ("**MCA**") is introduced to the FIR. A MCA is an account under a DC pension plan or an account under a defined benefit plan for additional voluntary contributions, where the member is permitted to make investment choices. After April 1, 2015, a Statement of Investment Policies and Procedures ("**SIP&P**") is no longer required for the MCA components of a federally regulated pension plan. It is important to note that the Financial Services Commission of Ontario ("**FSCO**") has taken the position that an Ontario pension plan with MCA components must continue to have a SIP&P. FSCO's position is based on Section 78 of the Ontario regulation that establishes the requirement to have a SIP&P.

FSCO has promised to provide further guidance on the required contents of a SIP&P for Ontario DC pension plans.

In lieu of a SIP&P, administrators of federally regulated MCA type plans must provide members with an annual statement that provides prescribed information, including:

- (a) the investment objective, degree of risk, largest investments, performance history, fees and benchmark for each investment option that a member can select;
- (b) a description of how the member's funds are currently invested; and
- (c) any timing requirements that apply to the making of an investment choice.

- **30% Rule Review**

In the 2015 federal budget tabled April 21, 2015, the government promised that it would review the current provision of the FIR that limits pension investments in voting shares of a corporation to 30%. Changes to this rule will be of particular interest to very large pension plans, many of which have employed complicated holding structures to get economic exposure to an investment that cannot be directly made as a result of the 30% rule.

## **2. New Ontario Filing Disclosure Requirements**

Sponsors and administrators of Ontario registered pension plans should take note of important changes to member disclosure obligations.

- **SIP&P for Ontario Plans to be filed with FSCO**

Before Ontario's adoption of the FIR in 2000, Ontario pension plans were required to file their SIP&P with FSCO. In a "Back to the Future" type of development, Ontario plans will once again be required to file a SIP&P with the regulator. Pension plans that are registered before January 1, 2016 must file a SIP&P no later than February 29, 2016. Amendments to a SIP&P after 2015 will also be required to be filed within sixty (60) days of the date of the amendment. With these changes, Ontario will join New Brunswick as the only jurisdictions in Canada requiring the filing documents.

- **Disclosure of Environmental, Social and Governance Factors**

Effective January 1, 2016, the SIP&P of an Ontario pension plan must include information about whether environmental, social and governance factors (the "**Factors**") are incorporated into the plan's investment policies and procedures and if so, how the Factors are addressed. The Factors are not defined in the regulation

and FSCO has yet to provide guidance on what it considers relevant factors.

At a high level, this regulation simply requires disclosure of whether and how the Factors are made part of a plan's investment process. When considered more closely, the requirement will place a specific area of fiduciary decision making in the spotlight. Plan administrators will be obliged to give careful consideration to the interplay between the integration of the Factors in the investment of a plan's assets and the best interests of the plan members. This can involve analysis of the complex interplay between maximizing return at an acceptable risk and the softer "moral" issues of environmental, social and governance considerations.

For the large group of plans that invest through managed investment funds, the issue will be straightforward. The factors will be employed, if at all, at the investment fund level. The issues will be more complex for plans that have large funds invested in individually managed corporate securities. In all cases, the administrator's process of deciding whether or not to incorporate the Factors must be clearly documented.

Plan administrators can anticipate increased member interest and engagement in plan investment issues after July 1, 2016. All member, former member and retiree statements issued after that date must include information respecting the plan's SIP&P. This information includes statements that alert the plan participants to the fact that a SIP&P is required, and that the individual is entitled to access the SIP&P through the employer or through FSCO.

- **Pension Statements for Former and Retired Members**

Plan administrators have long been required to provide plan members with an annual pension statement. New regulations now stipulate that biennial statements must be provided to former members and retirees. New Sections 40.1 and 40.2 of the *Ontario Pension Benefits Act* regulations set out the information that must be included in these new statements, which substantially parallels the current requirements for annual member statements.

For existing pension plans, the first biennial statement must be provided to former and retired members no later than July 1, 2017. For plans registered after January 1, 2015, the first statement must be provided to former and retired members within 18 months after the plan's first year end. In either case, plan administrators must continue to provide statements every two years thereafter, within six months following the plan's fiscal year end.

### **3. Administrator Take-Aways**

Plan administrators should become familiar with the new federal and provincial investment and disclosure rules to ensure their pension plans comply with the amended requirements by the applicable coming-into-force dates. Plan administrators should also start collecting the data necessary to prepare the new biennial

disclosure statements and statements to former and retired members. In light of the new disclosure requirements, plan administrators should consider revising existing disclosure statement templates or preparing new templates for statements to former and retired members.

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<sup>1</sup> The FIR are found in sections 6 to 7.2 of the regulations under the Pension Benefits Standards Act, 1985, Schedule III to the regulations.

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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