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Lynn Hemmings
Senior Chief, Pensions
Financial Sector Policy Branch
Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

Pascale Dugré-Sasseville
Chief, Financial Institutions Taxation
Tax Policy Branch
Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

Via email: FIN.Pensions-Pensions.FIN@canada.ca

Dear Lynn and Pascale:

Pension Plan Investment in Canada: The 30 Per Cent Rule

I am writing on behalf of Canada's life and health insurance companies in response to the June 3rd release of the captioned consultation paper. We greatly appreciated Finance Canada's outreach on this matter, which is of significant importance to our industry; we look forward to continuing, in-depth, consultation opportunities as these issues move forward.

Established in 1894, the Canadian Life and Health Insurance Association (CLHIA) is a voluntary association whose member companies account for 99 per cent of Canada's life and health insurance business. The industry provides a wide range of financial security products such as life insurance, annuities (including RRSPs, RRIFs and pensions) and supplementary health insurance to 28 million Canadians.

In the workplace retirement sphere, CLHIA member companies are major providers of record-keeping and investment management services to Canada's defined contribution pensions, and to capital accumulation plans more broadly, primarily for small- and medium-size employers. Life insurers also facilitate "de-risking" by defined benefit pension plans, whereby longevity and/or investment risks can be transferred from plan administrators to expert financial services

Canadian Life and Health Insurance Association
79 Wellington St. West, Suite 2300
P.O. Box 99, TD South Tower
Toronto, Ontario M5K 1G8
416-777-2221 www.clhia.ca

Association canadienne des compagnies d'assurances de personnes
79, rue Wellington Ouest, bureau 2300
CP 99, TD South Tower
Toronto (Ontario) M5K 1G8
416-777-2221 www.accap.ca

professionals. At the end of 2015, insurers held over \$350 billion in assets to support pension and other workplace retirement plan benefits for over 5.9 million Canadians.

Executive Summary

CLHIA supports the elimination of quantitative investment limits on pension plans, given the adoption of comprehensive prudential investment regimes¹ and the increasingly robust investment guidance and monitoring tools available to plan administrators, management teams and boards of directors of financial institutions, and their respective regulators. However, we strongly believe that corresponding investment rules for life and health insurers should also be relaxed as they compete with pension plans for long-term assets to support their liabilities. Elimination of these investment limits would also help level the playing field for domestic investors with international pension and sovereign wealth funds that are not subject to such ownership limits.

However, relaxation of quantitative investment limits may require some limitations based on the types of investment, such as broadly-defined infrastructure initiatives, as a means of reinforcing strong governance and prudent, principles-based, investment standards and practices. Such limitations would help mitigate concerns with regards to fairness and efficiency in capital markets and reduced tax revenues to government.

Our detailed submission below addresses the competitive and tax policy considerations raised in the consultation paper.

Competitive Balance and Investment Performance

As regulated financial institutions, life and health insurance companies compete directly with pension plans and other institutional investors for long-term, predictable, investment yields to support our long-term obligations. The factors that necessitate pension plans seeking alternative investments that provide strong returns, such as improving longevity, low interest rates and volatility in global equity markets, apply equally to life and health insurers.

Therefore, it is appropriate to only consider changes to the investment rules for pension plans in parallel with changes to the corresponding investment rules for other entities that compete directly with pension plans, so that any changes to such rules do not inadvertently bias the investment scope and flexibility of selected market participants, or prejudice pension plan members and/or other consumers of financial services who rely on the protections provided by such arrangements.

¹ See, for instance, subsection 8(4.1), *Pension Benefits Standards Act, 1985*, RSC 1985, c 32 (2nd Supp), and section 492, *Insurance Companies Act*, SC 1991, c 47.

If a review concludes that pension plan investment limits should not be relaxed, we believe that the ten per cent voting control and twenty-five per cent total equity limits that define a "substantial investment" for purposes of the *Insurance Companies Act* should be harmonized with the thirty per cent voting control standard applicable to pension plans.

Moreover, given the long-term nature of pension and insurance obligations, we recommend eliminating the thirteen year limit on insurers' holdings under the Specialized Financing (Life Companies) Regulations. That limit is fundamentally inconsistent with long-term investments that best match assets to liabilities for life insurers, and does not mirror the broader public policy objective of supporting long-term infrastructure investment in Canada.

Tax Policy Considerations (Fairness and Efficiency)

Tax preferences accruing to businesses controlled by tax-exempt pension plans could create competitive imbalances with other taxable businesses, either through preferential pricing or corporate expansion financed through such tax-preferred earnings. This has implications beyond the pension context, particularly with regards to capital market efficiency.

Differences in scale and the tax status of competing investors create potential competitive imbalances. Minimizing differential treatment among domestic entities that compete globally with foreign entities would be the best way to address such imbalances. For small pension plans, many of which now invest through regulated financial institutions, such pooling leverages investment efficiency and reduces systemic biases in favour of large pension plans.

Relaxation of investment limits can make investment via self-directed RRSPs and RRIFs less competitive, although individuals using such structures would be able to mitigate such risk by altering their investment approaches to incorporate professional management, either within a self-directed plan or via alternate vehicles. Changing the investment rules for pensions and regulated financial institutions should not be curtailed due to potential adverse impact on self-directed investment arrangements.

The consultation paper notes the potential application of thin-capitalization or similar rules to pension plans in order to mitigate any tax loss to government arising from less restrictive investment rules. Eliminating the thirty per cent rule, at least with respect to investment in defined asset classes, such as broadly defined infrastructure initiatives, would minimize any tax loss to the government.

Further, the bias to maximize distribution to pension plans as owners rather than reinvest would likely jeopardize the controlled business's sustainability, innovation and growth potential over the longer term. These potentially negative impacts can again be mitigated by restricting

defined assets classes in which pension plans and financial institutions may be controlling investors.

The June 2015 Benefits Canada Survey of the top 100 pension plans² (reflecting December 31, 2014 data), indicated that the top ten "pillar 3" plans, coupled with the Canada and Quebec Pension Plans, accounted for \$842 billion, or almost forty per cent of pension assets in Canada³. Excluding the Canada and Quebec Pension Plans, the top ten "pillar 3" plans represent 77% of the assets of the top 100 pillar 3 plans, but members of such plans represent a comparatively small proportion of Canadians.

The plans most likely to benefit from eliminating the thirty per cent rule represent a substantial portion of pension assets in Canada. Accordingly, the tax benefits of eliminating the 30% rule on tax-exempt pension plans would significantly distort markets. Such distortions can be mitigated by restricting the investment classes to which the thirty per cent rule would not apply.

Foreign pension plans and sovereign wealth funds are subject to thin-capitalization rules - which limit their ability to reduce a Canadian corporation's taxable earnings through related-party interest payments. Many foreign jurisdictions also limit interest deductions to businesses controlled by pension plans or apply a tax directly on pension plans. It would be reasonable to consider some tax restrictions in Canada. Absent such parity, elimination of the thirty per cent rule would materially distort capital markets between taxable and non-taxable entities.

Canada's life insurance companies greatly appreciate the ongoing opportunity to engage with the government as it considers this matter. Should you or other officials have any questions regarding the concerns identified above, we would be pleased to discuss these matters in more detail. Please feel free to contact me at your convenience in this regard, by telephone at 416-359-2047 or by email at nsimon@clhia.ca.

Yours sincerely,

Original signed by

Noeline Simon,
Vice President, Taxation and Industry Analytics

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² <http://www.benefitscanada.com/wp-content/uploads/2015/06/Top-100-Pension-Plans.pdf>

³ Total assets based on Statistics Canada's Pension Satellite Account, <http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=3780117>