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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

May 19, 2004

The Right Honourable Paul Martin, P.C., M.P.
Prime Minister of Canada
Office of the Prime Minister
80 Wellington Street
Ottawa, ON
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Dear Prime Minister:

Re: Proposal to Limit Registered Pension Plan Investments in Business Income Trusts

The Association of Canadian Pension Management wishes to add its voice to critics of the March 23, 2004 federal budget proposal to limit the amount Canadian registered pension plans can invest in Business Income Trusts and commend the government for agreeing to suspend these measures pending further discussion.

The ACPM represents private and public sector pension plan sponsors, administrators and related stakeholders. The ACPM's 750 members across Canada represent plans with total assets of some $300 billion, covering over three million plan members. Our mission is to promote the health and growth of Canada's retirement income system. While the ACPM's membership includes some of the country's largest pension plans, many of our members represent smaller and medium-sized plans which may also be affected by the proposed measure, most significantly through its "look through" provisions.

Our opposition to the proposed measure should not be taken as a challenge to the government of Canada's legitimate right to develop tax policies. We do, however, strongly object to the discriminatory nature of the proposed investment restrictions on Canada's registered pension funds. The proposal appears motivated by a perception that the Canadian government would face a significant tax leakage problem if business income trusts expand their share of the Canadian investment market. If this is the perceived problem, then the government should address the issue directly and review how corporate earnings, trusts, dividends and capital gains and other investment earnings are taxed in Canada.

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We have the following comments on the proposed restriction:

1) **There is no clear rationale for the proposed measure**

The March 23, 2004 budget proposal would impose a cap of 1% of total assets for direct and indirect holdings of Business Income Trusts by Canadian pension plans and a 5% maximum on each individual Business Income Trust holding by Canadian pension plans. We have no indication to date that any econometric models have demonstrated that Canadian governments face levels of net tax leakage which would justify the restrictions proposed in the budget. Nor do we have any indication why the 1% and 5% caps were chosen.

We agree with the Pension Investment Association of Canada (PIAC) that, in the absence of any prior consultation it was "not possible for the pension investment industry to know what Finance's objectives are, to suggest appropriate means to achieve such objectives, or to highlight any unintended consequences" (PIAC Letter to Minister of Finance, April 23, 2004, p. 2).

2) **The proposal discriminates against Canadians who are saving for retirement in registered pension plans and against Canadians living in certain regions of the country**

The proposed restrictions do not target savings in RRSPs. They do, however, limit the ability of pension plan administrators to seek the appropriate risk adjusted returns which they need to ensure that they can meet their commitments to their plan members. Millions of Canadians belong to employer-sponsored, jointly-trusteed and union DB and DC pension plans. Because of Canada's low contribution limits, the majority of these plan members don't have the option of investing much tax-deferred savings in RRSPs, outside their registered employee plan. The budget proposal effectively shuts out pension plans and their members from any significant investment in the fastest growing segment of Canadian capital markets.

We also note that the Caisse de Dêpôt de Placement and foreign investors will not be subject to the Business Income Trust restrictions. This means that Québec plans whose investments are managed through the Caisse, as well as foreign pension plans, will not be fettered by these limits and their plan members will have the opportunity to benefit from investments which will be off-limits to all other Canadian pension plans. This is simply not fair and gives the Caisse and others an undue advantage over the other pension plans.

3) **The proposal worsens the funding crisis facing Canadian voluntary pension plans**

Even with a marked improvement in equity markets in 2003, many Canadian pension plans face funding deficits, on both a solvency and ongoing basis. Canadian plans are already forced to invest 70% of their assets in Canada, whose equity market represents less than 3% of global equity assets. The proposed budget would remove the fastest growing share of the limited domestic investment market from pension plan asset portfolios, further handicapping plan managers' efforts to earn optimal risk adjusted returns. As PIAC has pointed out, if business income trusts are declared off limits for pension plans, then plans will be obliged to purchase replacement assets which would have produced taxable returns in the hands of other investors.

4) **The proposed restriction is an open invitation to foreign investors, including pension plans, to take controlling stakes in Canadian business trusts and to become preferred private equity partners in new and expanding Canadian firms**

The proposed measure would remove Canada's pension plans as major investors in many new ventures or mezzanine private financings, where a business income trust was a possible or likely exit strategy. It is difficult to understand how this is good public policy. It reduces the amount of domestic Canadian capital available for investment in high-growth sectors. It also increases the possibility that growing businesses which require significant amounts of capital will be foreign-controlled.

5) **The "look through" provisions will exclude Canadian pension plans as investors in many investment vehicles**

Finally, while the ACPM concurs with the analysis of the negative impact the proposed measure will have on larger Canadian pension plans and their direct private equity and infrastructure investments, we are equally concerned with the impact of "look through" attribution rules. Canada's largest plans can attempt to track their direct investments in trusts, although the administrative obstacles are considerable. The attribution rules, if applied, would effectively shut out most smaller and mid-size plans from many investment vehicles which are the only cost efficient way they have to participate in higher-return non-traditional investments.

We are concerned about how the "look through" provisions could be administered or enforced in practice. It would be an administrative nightmare for all plans, and particularly for those trying to invest indirectly in private equity, venture capital pools, mutual, hedge and similar funds.

Summary

To conclude, the Association of Canadian Pension Management believes that the Proposal is an inappropriate and highly discriminatory response to a problem which has not yet been clearly defined and analyzed. We concur with PIAC and individual pension plan administrators who recommend that the implementation of the Proposal be deferred until the objective can be defined and the consequences, both intended and unintended, evaluated. We especially wish to emphasize that the issue of the treatment of business income trusts needs a thorough review so alternative solutions can receive the attention they deserve.

Sincerely,

The Association of Canadian Pension Management

Richard McAloney
President

Michael Beswick
Chair
Advocacy & Government Relations Committee