

OSFI Publishes Guidance on Related Party Restriction Rules

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On November 18, 2016 the Office of the Superintendent of Financial Institutions Canada (OSFI) published guidance (Guidance) in relation to amendments to the related party restriction rules contained in Schedule III (Schedule III) to the *Pension Benefits Standards Regulations, 1985* (Canada) (PBSR) that came into force July 1, 2016. The guidance can be found at <http://www.osfi-bsif.gc.ca/Eng/pp-rr/ppa-rra/amd-mod/Pages/amdrltpr.aspx>. Plan administrators, investment managers of registered pension plan assets and other service providers should ensure that they have procedures in place to address these new requirements.

The Guidance is interesting for a number of reasons, not least of which is that OSFI rarely publishes feedback on the interaction of the investment restrictions contained in Schedule III. Among other items, OSFI emphasized that, in respect of employer stock purchase plans and dividend reinvestment programs for defined benefit and defined contribution pension plans including those DC plans that fit within the definition of a member choice account¹, absent an available exemption, registered plans would be prohibited from making new investments in related parties, such as securities of an employer who participates in the plan.

Removal of, and additions to, Available Exemptions

The Guidance highlights the fact that prior to the July 1, 2016 changes, plan administrators were able to purchase securities of a related party, as long as those securities were acquired at a “public exchange”. While this exemption did not act as a complete safe haven because the list of public exchanges was outdated, it did provide some flexibility for administrators and investment managers.

The public exchange exemption has now been removed but, happily, a number of new exemptions have been introduced. For example, an administrator may indirectly invest in the securities of a related party if the securities are held in an investment fund in which investors other than the administrator and its affiliates may invest and that complies with, in the case of member choice accounts the 30% corporate control restriction, and in the case of any other investments the 10% concentration limit and the 30% corporate control restriction.

Related party securities can now also be purchased through a fund that replicates the composition of a widely recognized index of a broad class of securities traded at a marketplace². This exemption will permit plans of companies whose securities are included in a

¹ “Member Choice Account” is defined to mean “an account in relation to which a member, former member or former spouse or former common-law partner of the member or former member is permitted to make investment choices [under an account maintained in respect of a defined contribution provision or additional voluntary contributions], s.2(1) of PBSR.

² “Marketplace” means: (a) an exchange; (b) a quotation and trade-reporting system; (c) any other entity that (i) constitutes, maintains or provides a market or facility for bringing together buyers and sellers of securities or

large number of indices to invest in investment funds that are benchmarked to an index in which their employer securities are included.

Transactions for the Operation or Administration of the Pension Plan

OSFI's Guidance makes it clear that the administrator of a plan may enter into a transaction with a related party for the operation or administration of the plan, if under terms and conditions not less favourable to the plan than market terms and conditions, and it does not involve the making of a loan to, or investment in, the related party. Prior to the July 1st changes it had not been clear that investments in a related party were excluded from this "transactions" exemption.

Nominal and Immaterial Transactions

The Guidance also reminds readers that in relation to the exemption permitting a plan administrator from entering into a transaction with a related party if the transaction is nominal or if the transaction is immaterial to the plan, the PBSR requires that the administrator set out in the plan's statement of investment policies and procedures (SIPP) the criteria to be used to establish whether a transaction is nominal or immaterial to the plan.

In relation to member choice accounts, OSFI states that it is its "opinion that the nominal or immaterial exemption in subsection 17(3) does not provide an exemption to the related party rule in section 16 to allow an administrator to offer a direct investment in securities of a related party as an investment option for a member choice account".

Compliance Deadlines

The new rules provide that a plan administrator who does not comply with the related party rules in section 16 of the PBSR on the day in which the regulations come into force has five years from July 1, 2016 (i.e. until July 1, 2021) to comply by divesting their plan of any non-compliant holdings. The Guidance states that this five year period for divestment is not intended to permit plan administrators that hold such non-compliant securities on July 1, 2016 to subsequently lend or invest moneys of the plan to obtain additional securities of a related party. The result is that any new investments or loans made after July 1, 2016 must comply with the new restrictions on related party transactions. The prohibition also applies to investment made through dividend reinvestment programs. In relation to member choice accounts, administrators of plans where plan members have been making contributions to related party securities are required as of July 1, 2016, to remove the related party securities investment option. Member contributions must be directed to a different investment option(s) and any dividend reinvestment programs must be discontinued.

derivatives, (ii) brings together the orders for securities or derivatives of multiple buyers and sellers, and (iii) uses established, non-discretionary methods under which the orders interact and with which the buyers and sellers entering the orders agree to the terms of a trade.