



VIA WEB PORTAL

February 10, 2023

The Honourable Chrystia Freeland
Deputy Prime Minister and Minister of Finance
Department of Finance Canada
90 Elgin Street,
Ottawa, Ontario
K1A 0G5

Dear Minister:

Re: PMAC Pre-budget Submission 2023

Executive Summary

The issue

Many Canadian employers offer Defined Contribution (**DC**) pension plans and other savings programs to their employees; these plans are an effective means of encouraging them to save for retirement. According to Statistics Canada, membership in employer sponsored DC pension plans continues to rise, accounting for approximately 20% of all pension plan membership. The Canadian DC pension plan market is \$300b CAD.

These pension plans are subject to unfavourable tax treatment that results in unexpected double taxation and higher investment costs for over two million Canadians. Other retirement savings vehicles, including Defined Benefit (**DB**) pension plans and retail mutual funds, are not subject to this treatment.

Proposed solution

We are recommending an amendment to the *Income Tax Act* (**Act**) that would allow these pooled investment funds to merge on a tax-deferred basis and to invest internationally without restriction to the Designated Stock Exchange (**DSE**) list, subject to the condition that the majority of the pooled fund unitholders are DC plans and other registered plans as defined in the Act.

This solution will not involve any budget expenditure in Budget 2023.

Conclusion

Through a simple amendment to the Act, the government has the opportunity to encourage Canadians to save for retirement and help companies provide cost-effective savings vehicles for their employees. At a time when Canadians are experiencing the highest interest and inflation rates, the government should enact measures that strengthen – not weaken – the adequacy of Canadians' retirement savings. Our solution would help accomplish this goal.

PMAC Pre-budget Submission 2023 – Detailed Submission

Introduction

The Portfolio Management Association of Canada (**PMAC**) is writing with an urgent request to remedy a tax inequality that is harming Canadian retirees whose savings are invested as part of an employer-sponsored Defined Contribution (**DC**) pension plan.

PMAC represents over 310 asset management firm members that collectively manage \$3 trillion in assets for pension plans, endowments, individual and group RSPs, and other investments across Canada.

The issue

Many Canadian employers offer DC pension plans and other savings programs to their employees; these plans are an effective means of encouraging them to save for retirement. According to Statistics Canada, membership in employer sponsored DC pension plans continues to rise, accounting for approximately 20% of all pension plan membership. These pension plans are subject to unfavourable tax treatment that results in unexpected double taxation and higher investment costs for over two million Canadians. Other retirement savings vehicles, including Defined Benefit (**DB**) pension plans and retail mutual funds, are not subject to this treatment.

Employer sponsored DC plans and other employer sponsored saving plans (i.e., deferred profit-sharing plans) often use a type of pooled investment fund called Target Date Funds (**TDFs**) to invest employee savings. The Canadian DC pension plan market is \$300b CAD, with approximately \$75b CAD (25%) invested in TDFs. There is ample oversight of these plans by pension, insurance, and securities regulators.

The unfavourable treatment

We are asking you to address two tax rules that negatively impact DC pension plans:

- (i) The inability of these pooled investment funds to merge on a tax-deferred basis; and,
- (ii) The restriction of these pooled investment funds to invest only in securities traded on the Designated Stock Exchange (**DSE**) list.

The solution

A small amendment to the *Income Tax Act* (Canada) (the **Act**) will remedy the situation. This issue has been raised and supported by [the Pension Investment Association of Canada \(PIAC\)](#) and the [Investment Funds Institute of Canada \(IFIC\)](#).

We are recommending an amendment to the Act that would allow these pooled investment funds to merge on a tax-deferred basis and to invest internationally without restriction to the DSE list, subject to the condition that the majority of the pooled fund unitholders are DC plans and other registered plans as defined in the Act.

This amendment would eliminate the double taxation impacting employees after fund mergers and will allow more investment diversification at lower costs and potentially yield higher investment returns.¹

This solution will not involve any budget expenditure in Budget 2023.

We provide additional detail on the two issues below:

(i) The inability of these pooled investment funds to merge on a tax-deferred basis

As is explained below, TDFs need to merge with existing Retirement Funds from time to time. Under current tax rules, this merger triggers a taxable event both at the investor level on the disposition of the shares, as well as within the fund on the deemed disposition of the investment property held. This taxable event will impact all individuals whose non-registered savings are invested in the TDF in the taxation year when the fund merges. These employees and retirees have no control over this taxable event, which may result in significant tax cost to them. Please see **Appendix A** for an example of this impact. While some retirees will be able to access tax planning advice to manage this outcome, others may not.

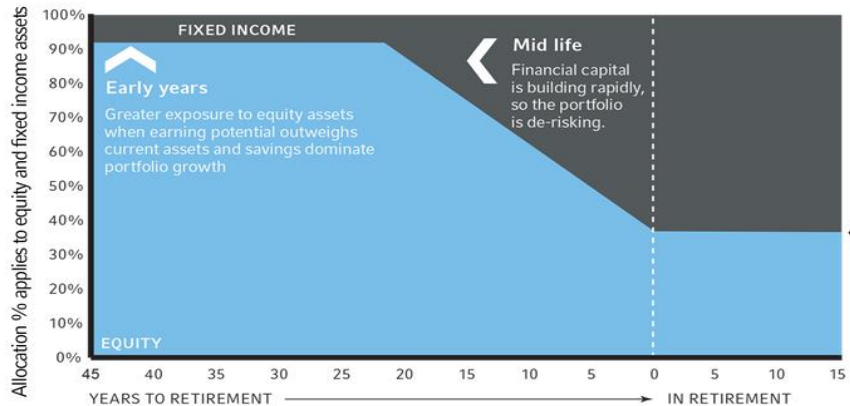
What are Target Date Funds?

Employer sponsored DC plans and other employer sponsored saving plans (e.g. deferred profit sharing plans) typically hire a plan administrator, which oversees these types of plans. A list of investment options is selected by the administrator. The investment options usually include pooled investment funds, due to their low cost and well-established investment managers. Similar to mutual funds and segregated funds, these pooled investment funds offer various investment strategies. TDFs are a popular and common type of pooled investment fund product offered to these employer-sponsored saving plans, and are the most common type of fund used to manage DC pension plan assets.

¹ A potential solution to give these pooled investment funds the ability to undertake a qualifying exchange could be accomplished by an amendment similar to that made for segregated funds – under s. 138.2 of the Act, effective January 1, 2018. Additionally, a definition of a pooled fund can be introduced in order to alleviate any concern that certain investment funds should not qualify for a tax-deferred merger. A definition could be introduced similar to that for segregated funds under s. 138.1 of the Act. For example, one such definition for an eligible pooled fund could be: an investment fund trust where greater than 50% of its investors are pension plan and/or other institutional employer saving plans (e.g. deferred profit sharing plan). If such a definition were introduced this would allow for such pooled funds, which are also registered investments under s. 204.4 of the Act, to be excluded from the requirement to hold only qualified investments that are listed on the DSE.

Given that the employee savings are intended to be available to the employees when they retire, the funds are managed in such a way as to “target” the retirement date. For this reason, the funds are called “Target Date Funds”. They are offered by employers in specific series based on the expected year of retirement (e.g., 2025, 2030, 2035). The asset mix, risk profile, and other attributes of the fund change over time to reflect the age and risk profile of the employees. See the following chart:

Target Date Fund example



In this example, when an employee is in their 20s and 30s, the TDF invests more heavily in equity securities (the blue portion). Towards retirement, the TDF de-risks by shifting its asset mix to provide income and moderate long-term growth of capital for retirees who are beginning to withdraw their money (the grey portion). At the target date (i.e., the retirement date – indicated by the dotted line), the assets in the fund are invested in a long-term fund with a conservative asset mix that remains static over time. This is referred to as a Retirement Fund.

Why do the funds need to merge?

As TDFs approach their “target” year, the weighting of the assets in the TDF end up matching the asset allocation of the Retirement Fund. The amount of money in the TDFs becomes smaller and smaller as retirees withdraw their savings. Maintaining many separate, small TDFs with virtually identical investment mix is duplicative, extremely costly, and inefficient; therefore, the TDFs need to merge into the Retirement Fund. This is similar to typical DB pension plans that have a single retirement fund. This provides for economies of scale and lowers the costs of investment for the employees, which ultimately provides them with more income in retirement.

Currently, TDFs cannot merge on a tax-deferred basis. As a result, employees are subject to tax twice: first, when their TDF rolls into the Retirement Fund and second, when they withdraw money in retirement. This double taxation means that these employees will have less money to fund their retirement.

We understand that most investment managers of TDFs have deferred merging their 2020 TDFs. This is to allow time for employer DC plan sponsors to communicate the pending taxable event to recent retirees. BlackRock Canada, for example, intends to merge its 2020 TDF in 2024.

This potential double taxation can be avoided if our recommended amendment to the Act is implemented.

(ii) The restriction of these pooled investment funds to the Designated Stock Exchange (DSE), which makes it costly for them to diversify their investments

The pooled investment funds that hold DC plan assets can only invest in securities offered on a set list of stock exchanges (the DSE). Otherwise, the funds and their individual investors are subject to a penalty tax, which can be significant and would erode the retirees' precious retirement savings. This limitation also prevents the funds from diversifying their investments in potentially lucrative overseas markets in a cost-effective manner.

As a result of this restriction, in order to access these markets, fund managers must use other investment vehicles, such as Exchange-Traded Funds (**ETFs**), which are more costly for the investment fund. This results in individual employees having less money in retirement. Please see the illustration in **Appendix B**, which compares the available markets on the DSE to the investments in the Canada Pension Plan, which is a DB plan not subject to these rules. It is clear that DC plans should have the ability to invest the fund assets in these additional markets, similar to the international investment opportunities afforded to DB plans and retail mutual funds.

DC pension plans landscape and regulation

The pooled investment vehicles that hold DC plan assets are structured such that the unitholders are the DC pension plan recordkeepers (large financial institutions such as Sun Life, Manulife, Canada Life/GWL, etc.) and other employer-sponsored DC plans and registered savings vehicles. These pooled investment funds are not distributed to the public and are not available through other investment channels. Individual investors only have access to these pooled investment funds through their employer-sponsored savings plans.

Employer-sponsored DC pension plans and other registered savings plans are strictly regulated in Canada. They are subject to provincial and federal pension and insurance legislation, and Canadian Association of Pension Supervisory Authorities (**CAPSA**) policies and guidelines. They are overseen by provincial and federal pension and insurance regulators. The investments are managed in accordance with "prudential principles of security and liquidity, using appropriate risk management concepts"² by investment fund managers regulated by provincial securities regulators. All of these

² Office of the Superintendent of Financial Institutions (OSFI) website, [Investment of Pension Funds \(Defined Contribution Plans\)](#) accessed 2023/02/10.

entities owe a fiduciary duty with respect to the management of the pension plan and its investments. DC pension plans are also subject to the Act.

Please see the diagram in **Appendix C** for an example that explains this structure and the responsibilities of the various entities.

As noted above, the Canadian DC pension plan market is \$300b, with approximately \$75b invested in TDFs as of June 30, 2022. There are approximately 2 million Canadian employees with TDFs. A small portion of these employees (approximately 1%) also have personal non-registered savings invested in the TDFs through their employer-sponsored savings plans.

According to the 2021 Fraser Group *Pension Universe Report*³, Sun Life is one of the largest pension service providers in Canada with 41.8% market share, followed by Manulife Financial, Canada Life, Desjardins Financial and Industrial Alliance; all are regulated by the federal Office of the Superintendent of Financial Institutions (**OSFI**) and provincial insurance regulators.

Using Sun Life as an example, it works with over 6,000 plan sponsors of Capital Accumulation Plans. Over 80% of these plans offer TDFs (i.e., over 5,300 plans). This represents a total of over 800,000 employees who invest in TDFs at Sun Life, totaling \$46b, with an average balance of \$42,000 per employee in TDFs (the average is \$72,000 for those aged 50 years and over).

A small percentage of these employees (approximately 1% or 10,000) have non-registered (taxable) assets invested in TDFs through their employer savings programs, totaling \$133 million. The average balance in these taxable plans is \$11,000 per employee (the average is \$20,000 for those aged 50 years and over), in addition to the amount invested in the registered (non-taxable) plans.

The assets in Canadian TDFs are managed by a small number of large Canadian asset managers, including Fidelity Investments, Blackrock Canada, RBC, Sun Life Global Investments, IA Clarington Investments and Manulife Financial. These are among the largest fund managers in Canada and all are regulated by provincial securities and insurance regulators.

Proposed solution

In summary, we are proposing an amendment to the Act that would allow these pooled investment funds to merge on a tax-deferred basis and to invest internationally without restriction to the DSE list, subject to the condition that the majority of the pooled fund unitholders are defined contribution plans and other registered plans as defined under the Act.

³ Fraser Group, [Pension Universe Report: Public Summary, Data Year 2021 - Canada](#). This survey included information from the following participants: Canada Life, Co-operators, Desjardins Financial, Industrial Alliance, Manulife Financial and Sun Life. The DC Pension assets administered collectively by these firms was \$118.4b in 2021.

This amendment would eliminate the double taxation impacting recent retirees after fund mergers, will allow more investment diversification at lower costs, and potentially yield higher investment returns.

Conclusion

Through a simple amendment to the Act, the government has the opportunity to encourage Canadians to save for retirement and help companies provide cost-effective savings vehicles for their employees. At a time when Canadians are experiencing the highest interest and inflation rates, the government should enact measures that strengthen – not weaken – the adequacy of Canadians’ retirement savings. Our solution would help accomplish this goal.

Thank you for the opportunity to participate in this Consultation. We would be pleased to continue the dialogue on this important issue and discuss the recommendations included in this submission in more detail.

If you have any questions regarding this submission, please do not hesitate to contact Katie Walmsley (kwalmsley@pmac.org) at (416) 560-9419 or Margaret Gunawan (Margaret.gunawan@blackrock.com) at (416) 643-4083.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

“Katie Walmsley”

Katie Walmsley
President

“Margaret Gunawan”

Margaret Gunawan
Director, Chair of Industry,
Regulation and Tax Committee,

Managing Director – General
Counsel, Americas (ex-US) &
Canada CCO, BlackRock Asset
Management Canada Limited

Appendix A

Impact on Canadian seniors and retirees – An example

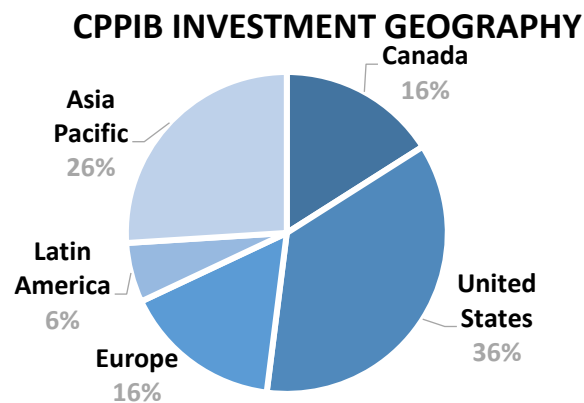
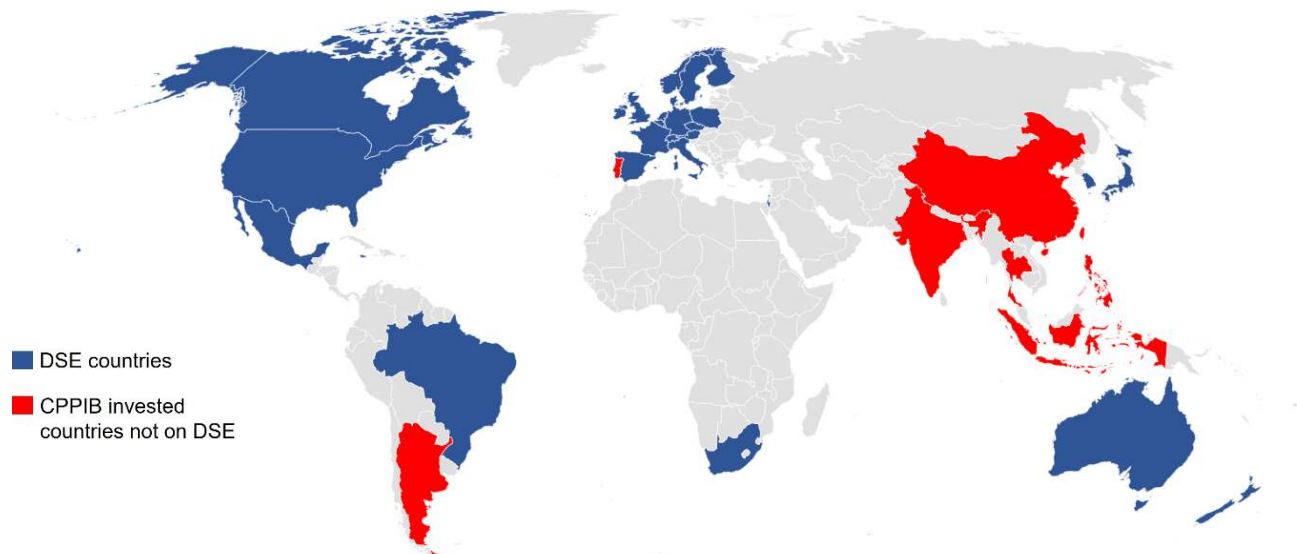
Miriam from Fredericton has worked her entire career at a Canadian forestry company, ABC Co. (**ABC**). ABC established a DC pension plan for its employees. The plan gives ABC employees the option of contributing additional personal retirement savings to the plan, which are invested alongside the pension assets, in a TDF. During her 32-year tenure, Miriam contributed \$38,800 to the plan. Combined with her employer's contributions, at age 64, Miriam has \$114,500 in her pension. Approximately 10% of Miriam's savings are in the non-registered employee savings program, separate from the pension. Unlike Canadians who are part of a DB pension plan or who have their savings in investment vehicles like mutual funds, by the time Miriam retires in 2023, she will be subject to tax twice. First, when her TDF rolls into a long-term retirement fund and second, when she withdraws money to support her living and health care costs in retirement. This double taxation means that Miriam will have less money to fund her retirement. In addition to these tax consequences, the health of Miriam's pension is negatively impacted by rules which restrict the TDF from investing in emerging economies around the world. DB plans are not subject to the same restriction. They are therefore better able to diversify the asset mix and incur fewer costs to access foreign investments.

Appendix B

Geographic Limitations of the Designated Stock Exchange (DSE) List

The asset management industry regularly invests internationally to optimize diversification and portfolio investment returns, including in many emerging markets. Defined Benefit (**DB**) pension plans and retail mutual funds have no limits on international investing. Defined Contribution (**DC**) plans, which often use pooled investment vehicles such as Target Date Funds (**TDFs**), are restricted to investing in stock exchanges on the DSE list, indicated in blue. This limits international exposure, particularly in the Asia-Pacific region.

Access to international and emerging markets, especially in the Asia-Pacific region, is common and desirable for Canadian pension plan investments. The example below uses the Canada Pension Plan (**CPP**) as an example of a typical DB pension plan whose assets are invested internationally, without restriction. Indicated in red are countries where CPP Investment Board (**CPPIB**) is investing, that are not on the DSE list (and therefore unavailable to DC pension plans). The current restrictions prevent DC pension plan diversification, or require costly work-arounds through the use of ETFs to access these markets.



This chart indicates the current asset breakdown by country of CPPIB, Canada's largest DB pension plan. Note the significant investment exposure in the Asia-Pacific region, which is very common for DB pension plans, but not available directly to DC pension plans, which are restricted to the DSE list.

Appendix C

Example: Company A Sponsored DC Plan in Target Date Funds (BlackRock 2025 Fund)

