Guidance

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This Guidance Note provides OSFI's interpretation and expectations relating to the requirements for the investment option selected by the administrator of a pooled registered pension plan (PRPP) as the default investment option.

The *Pooled Registered Pension Plans Act* (PRPP Act) states that a PRPP may permit a member to make investment choices from among the options offered by the administrator (subsection 23(1)). It also provides that where a PRPP permits a member to make investment choices and the member does not make a choice within the time prescribed in the regulations, the investment option chosen by the administrator as the default option will apply to the account of the member, and the PRPP administrator is responsible for making all decisions with respect to investing the funds in accounts to which the default option applies (subsection 23(3)). It is the PRPP administrator's duty, under subsection 22(4) of the PRPP Act, to invest the funds in members' accounts in a manner that a reasonable and prudent person would apply in respect of a portfolio of investments appropriate for retirement savings.

The Pooled Registered Pension Plans Regulations (PRPP Regulations) specify the period of time that members have to make their investment choice as being within 60 days after the day on which the member received their notice of plan membership. If no choice is made within that period, the investment option selected by the administrator as the default option will apply to the account of the member. The PRPP Regulations also provide that the default option must be a balanced fund or a portfolio of investments that takes into account a member's age.

The PRPP Regulations do not provide definitions of a balanced fund or a portfolio of investments that take into account a member's age. OSFI's expectations regarding the characteristics of these default options are set out below.

Characteristics of a balanced fund

A balanced fund is an investment fund that offers a mixture of safety, income and capital appreciation. In order to provide both income and capital appreciation while avoiding excessive risk, a balanced fund holds a combination of equity and fixed income investments. A balanced fund typically has a target allocation of between 40% and 60% of its assets to equities and the remainder to fixed income investments. A balanced fund does not materially change its allocation to equities and fixed income investments in response to market conditions. A balanced fund will, however, be automatically rebalanced to maintain its target allocation to equities and fixed income.

The return earned by a balanced fund is not guaranteed. Investment returns will depend on the performance of the underlying securities held in the balanced fund. There may be periods of time in which the balanced fund has a negative rate of return.

Characteristics of a portfolio of investments that takes into account a member's age (e.g. target date funds)

An example of a portfolio of investments that takes into account a member's age is a target date fund[1]. When a member of a PRPP does not make an investment choice, the administrator is expected to invest the member's funds in a target date fund that reflects the member's age or expected retirement date. A target date fund, like a balanced fund, invests in a mix of asset classes, including equities and fixed income. Unlike a balanced fund, the overall asset allocation of a target date fund will gradually adjust over time to reduce risk as the target date (generally the investor's expected retirement date) approaches.

A target date fund includes a schedule or "glide path" according to which the target date fund's asset allocation is adjusted. The glide path reflects a typical investor's changing risk tolerance as they get closer to retirement, with adjustments made to the fund to limit risk over time by reducing the funds sensitivity to capital market fluctuations.

Implementing the glide path results in a gradual reduction in equity exposure and increased allocation to fixed income investments. While glide paths differ between target date funds all glide paths provide for more exposure to equities for younger investors and more exposure to fixed income for investors closer to retirement. A target date fund, however, does not take into account the individual risk tolerance of any particular investor or any investor's individual circumstances, including whether the investor holds investments outside of the default fund.

The return earned by a target date fund is not guaranteed. Investment returns will depend on the performance of the underlying securities held in the fund. There may be periods of time in which the target date fund has a negative rate of return.

Costs

Costs are important for PRPPs, as they reduce investment returns and therefore the amount of funds that a member can accumulate in their PRPP account. As such, they must be taken into account by a plan administrator when selecting a default investment option. This option is subject to the requirement of the PRPP Regulations which provides that costs are to be at or below those incurred by members of defined contribution plans that provide investment options to groups of 500 or more members.[2] The PRPP Regulations defined "costs" to mean "all fees, levies and other charges that reduce a member's return on investment other than those that are triggered by the member's actions."[3] Costs that fall within this category may include an investment management fee and other administrative fees.

Communicating the Default Investment Option

The PRPP Act and the PRPP Regulations[4] provide that as soon as feasible after an employer enters into a contract with an administrator to provide a PRPP to its employees, either the administrator or the employer must send a notice to each employee that includes a description of the default option that indicates:

- its investment objective;
- the type of investment and the degree of risk associated with it;
- its top ten holdings by market value;
- its performance history;

- that its past performance is not necessarily an indication of its future performance;
- the name and a description of the benchmark that best reflects the composition of the investment option;
- the cost associated with the investment option, expressed as a percentage or a fixed amount; and
- its target asset allocation.

If the default option is a target date fund, OSFI expects that an explanation of the target date fund and an illustration of the glide path be included in this notice.

Reviewing the Default Investment Option

The administrator should review the design, performance and continued suitability of the default investment option on an ongoing basis. A review is especially important when certain events occur that could reasonably be expected to have an impact on the appropriateness of the default investment option. Such events could include:

- consistent overperformance or underperformance of the underlying funds used in the investment strategy;
- a change to the cost of the default investment option;
- a change in the manager of the fund; or
- significant changes in financial markets or the economy.

1 Target-date funds are also referred to as "lifecycle funds," "retirement date funds" and "age-based funds".

2 Section 20 of the PRPP Regulations.

3 Section 1 of the PRPP Regulations.

4 Subsection 41(2) of the PRPP Act and section 23 of the PRPP Regulations.