Guidance

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Amendments to the related party transaction rules in Schedule III to the Pension Benefits Standards Regulations, 1985 (PBSR) came into force on July 1, 2016.

Subsection 16(1) of Schedule III provides, that subject to certain exemptions that are described in more detail below, the administrator of a pension plan shall not, directly or indirectly

- lend the moneys of the plan to a related party or use those moneys to hold an investment in the securities of a related party; or
- enter into a transaction with a related party on behalf of the plan.

The term “related party” in respect of a plan is defined in section 1 of Schedule III to include, among others, a person who is the administrator of the plan, a person responsible for holding or investing the assets of the plan, an employer who participates in the plan, an entity that holds a substantial investment in the employer, an affiliate corporation of the employer, corporations that are directly or indirectly controlled by a person who otherwise falls within the definition of related party, employees of the employer, and members of the plan.

Exemptions to the Related Party Rule

Permitted Investments in Securities of a Related Party

Prior to July 1, 2016, the exemptions provided in section 17 to the broad prohibition against related party transactions permitted a plan administrator to purchase the securities of a related party if those securities were acquired at a public exchange. The July 1, 2016, amendments removed the public exchange exemption. The new rules do, however, provide exemptions that allow an administrator to indirectly invest in the securities of a related party if the securities are held in an investment fund or a segregated fund in which investors other than the administrator and its affiliates may invest and that complies with certain quantitative limits.

In addition to the investment fund and segregated fund exemptions, the related party rules in effect from July 1, 2016, provide exemptions for investments in related party securities in respect of investments

- in an unallocated general fund of a person authorized to carry on a life insurance business in Canada;
- in securities issued or fully guaranteed by the Government of Canada, the government of a province, or an agency of either one of them;
- in a fund composed of mortgage-backed securities that are fully guaranteed by the Government of Canada, the government of a province, or an agency of either one of them;
- in a fund that replicates the composition of a widely recognized index or a broad class of securities traded at a market place; or
- that involve the purchase of a contract or agreement in respect of which the return is based on the performance of a widely recognized index of a broad class of securities traded at a market place.

Transactions with a Related Party for the Operation or Administration of the Pension Plan

Prior to the amendments that came into effect on July 1, 2016, transactions involving a pension plan and a related party for the operation or administration of the pension plan were only permissible if the transactions were "required" for plan administration and on "market terms and conditions". As of July 1, 2016, the amended exemption does not require that such non-investment transactions be "required". The amendments are meant to clarify that a plan administrator may engage the services of a related party for the administration of the plan, such

as hiring a related party to act as a broker dealer. To qualify for this revised exemption, a related party transaction must be under terms and conditions that are not less favourable to the plan than market terms and conditions, and it must not involve the making of a loan to or investment in the related party.

Nominal and Immaterial Transactions

The amended rules retain the exemption for related party transactions that are nominal or immaterial. Specifically subsection 17(3) of Schedule III to the PBSR provides an exemption that permits a plan administrator to enter into a transaction with a related party if the value of the transaction is nominal or if the transaction is immaterial to the plan. While the PBSR does not define a threshold for a nominal or immaterial transaction, paragraph 7.1(1)(h) of the PBSR requires that a plan administrator set out in the plan's Statement of Investment Policies and Procedures the criteria to be used to establish whether a transaction is nominal or immaterial to the plan.

Existing Holdings of Related Party Securities

Section 17.1 of Schedule III to the PBSR, which came into force on July 1, 2016, provides 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 with section 16 by divesting their plan of any non-compliant holdings.

The five-year period provided by the regulations for divesting of existing holdings is not intended to permit administrators of plans 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. It is OSFI's opinion that any new investments or loans made after July 1, 2016, must comply with the new restrictions on related party transactions. This prohibition against making new investments in related parties after July 1, 2016, also applies to investments made through a dividend reinvestment program involving related party securities that would contravene subsection 16(1), as the reinvestment of dividends is considered to be an investment in securities of a related party.

Schedule III also provides a five-year compliance period where the related party rules are contravened as a result of a transaction entered into by someone other than the administrator. This could occur as a result of a corporate transaction, such as a take-over, and the five-year compliance period begins on the date of the contravention

resulting from the transaction.

Investment Options for Member Choice Accounts

With the removal of the public exchange exemption, a pension plan is no longer able to offer related party securities such as employer stock as an investment option for a member choice account. It is OSFI's 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. The Department of Finance Canada stated that the policy reason for removing the public exchange exemption is to prohibit plan administrators from directly investing any amount in the debt or shares of an employer who participates in the plan.[1] Therefore, the policy does not intend for plan administrators to continue to offer related party securities as an investment option by relying on the nominal or immaterial exemption.

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. Administrators will also need to ensure that, within five years after July 1, 2016, members divest of their existing holdings of related party securities, such as employer stock.

1 Visit the Department of Finance Canada 2009 Backgrounder and the Department of Finance Canada March 2015 Regulatory Impact Analysis Statement.