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Brief to the House of Commons Standing Committee on Finance

Portfolio Management Association of Canada
August 2011

Mr. Guyanne L. Desforges, Clerk
Standing Committee on Finance
6-14 131 Queen Street
House of Commons Ottawa, Ontario
K1A 0A6

Dear Mr. Desforges:

Re: House of Commons Standing Committee on Finance - Pre-Budget Consultations

The Portfolio Management Association of Canada (formerly the Investment Counsel Association of Canada (ICAC)) is pleased to submit comments on recommended priorities for the **Federal 2012 Budget**.

As background, the Portfolio Management Association of Canada ("PMAC") represents over 150 investment management firms from across Canada. We invest the assets of individual Canadians who are saving for retirement and the assets of both traditional defined benefit pension plans and defined contribution pension plans. Many of Canada's largest pension plans and small employer pension plans hire our members to manage all or portions of their investment portfolios. In addition, individual Canadians who seek professional management of their savings, become clients of our members who set up custom portfolios for individuals based on their retirement goals, risk profile and financial objectives. Our members are from across Canada and manage retirement savings for Canadians in every province and territory. The PMAC was established in 1952 and its members manage in excess of $750 billion assets (excluding publicly offered mutual fund assets).

Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. This mission guides our advocacy objectives and focuses our government relations efforts on goals which ultimately benefit all Canadians.

We have 4 specific recommendations all focused on helping Canadians' build and maintain their retirement savings:

1) **Minimize and/or exempt discretionary investment management services provided to all retirement savings plans from additional taxation.**

2) **Encourage participation by employees & employers in the new proposed Pooled Registered Pension Plans (PRPPs) and other employer supported retirement vehicles through the introduction of specific tax incentives.**

3) **Minimize Taxation Impact on Pensions & RRSPs & Encourage Development of New Pooled Funds by Lowering 150 Unit Holder Rule for Mutual Fund Trust Status.**

4) **Expansion of Designated Stock Exchange List to Allow Canadians to Diversify their RRSP Investments.**

Each of the four issues below, if addressed, would greatly enhance Canadian's ability to save effectively for retirement.

1) Minimize And/Or Exempt Discretionary Investment Management Services Provided To All Retirement Savings Plans From Additional Taxation.

We are very supportive of the broad analysis and variety of options that the Government is considering to improve Canadian's retirement income system. Specifically, we are supportive of the proposed Pooled Registered Pension Plans. (PRPPs)

One of the most significant and immediate changes the government can make to assist Canadians saving for retirement, is to exempt investment portfolio management services provided to retirement savings plans (both pension plans, RRSPs and RRIFs) from consumption taxes on these savings. At the very least, recognizing the regional imbalance/inequity currently associated with the roll out of the HST (which is ultimately passed on to clients in the form of higher costs), the federal government should work with its provincial counterparts to avoid any additional tax being levied onto retirement savings by the provinces via its portion of the HST.

The recent implementation of the HST in Ontario and British Columbia represents a 160% increase in the taxes payable by Ontario residents on investment portfolio management services and a 140% increase in BC. As the government is well aware, the 1 year old implementation of HST in Ontario and BC on investment management services coincides with a period of extreme difficulty for firms and individuals saving for retirement. Pension funds are struggling with strict funding requirements and weak investment performance, and ordinary Canadians saving for retirement through RRSPs are still recovering from the financial meltdown of 2007 through 2009 and recent turmoil in the markets. While other areas of government are making good progress in alleviating the retirement funding challenges while financial markets recover, it is at best ironic that tax policy is, in effect, undermining those efforts. While there is a GST credit for pension plans, it is only partial and takes up huge amounts of resources to track and process the necessary forms. The Federal government's HST policy is working at cross purposes to the policy objectives of the Department of Finance - to ensure the strength and adequacy of Canadian's retirement savings. HST is, pure and simple, a tax on retirement savings. As such, it acts as a disincentive to the government's policy objectives of encouraging Canadians to take more responsibility for their retirement.

Although we continue to advocate that the government exempt investment management services from just the *provincial* portion of the HST, we recommend that, in the longer term, Canada take a broader policy view of how Value Added Taxes (VAT) are handled in other countries with a view to ultimately exempting investment management services from both the provincial *and* federal portions of the HST or GST (or making them zero-rated). In principle, VATs are meant to tax consumption of goods and services. If a Canadian hires a professional to manage their pool of savings, we would argue that there is no "consumption", within the definition of a consumption tax. Rather, the Canadian is growing his/her wealth to provide for greater consumption later in life. This is the policy position in Europe - investment

management of retirement assets is not consumption. There is also no such added tax on managing retirement savings in the United States.

As a final note on this topic, we would point out the burden of the HST falls not just on Canadians living in BC and Ontario and Nova Scotia. As of July 1 2010, residents of non harmonized who have RRSPs in mutual funds are subject to HST indirectly. Residents of non-HST jurisdictions who invest in mutual funds together with Canadians in HST provinces will be paying HST indirectly on the investment management fees charged to the funds they own. Although the effective HST rate paid by mutual fund investors will be a "blended rate" that reflects the distribution of a fund's investors across Canada, given the populations of Ontario, BC and Atlantic Canada, the HST rate payable by many mutual fund investors will be much closer to the 13 % Ontario HST rate than the 5% GST rate that would otherwise apply in Manitoba, Saskatchewan and Alberta. Thus, the HST is doubly unfair. First it is being wrongly applied to tax Canadians' retirement savings. Secondly, the burden is being borne not just in HST provinces but by all those who are saving for retirement.

We recommend that the Federal Government agree with the provincial governments to adopt the policy positions taken elsewhere in the world and exempt consumption taxes on investment management services generally (i.e. on savings) or in the alternative, to work with the provincial governments to remove or mitigate the additional and uneven provincial portion of HST immediately.

2) Suggestions to Enhance Widespread Participation in Pooled Registered Pension Plans (PRPPs)

We have been very active in the Department of Finance's consultation process on Pooled Registered Pension Plans (PRPPs) and support them when compared to alternative solutions such as enhancements to CPP. As we raised in our August 12, 2011 submission, it is our contention that without a mandatory PRPP obligation on employers (i.e. other than employers already providing a RPP), the targeted objective of widespread participation by employer/employees may not be achieved. To improve participation in the absence of mandated obligations, we offer below a number of recommendations for the governments to review as potential tax incentives to spur employers to offer the plan:

- i) Introduce a temporary employer retirement savings tax credit akin to the Home Renovation Tax Credit. To ensure that the roll out of such a measure would not create an unfair advantage over those employers who were previously offering RPP's, this incentive should be offered to all participating employers in an RPP;
- ii) A transitional exemption for the first contributions into a PRPP to be included in calculating the RRSP limits;
- iii) Introduce an Employer/Employee Retirement Savings Grant - Similar to the RESP structure, provide a supplemental matching annual grant invested in the retirement savings vehicle.

Regardless of whether any additional incentives are contemplated, it would be recommended that the launch of the PRPP program is coordinated with a suitable

educational information on employer options for retirement savings and which helps employers evaluate the multitude of retirement savings program spins available (i.e. PRPP, RPP, group RRSPs, corporate contribution to employee RRSP of choice).

3) Minimize Taxation Impact on Pensions & RRSPs & Encourage Development of New Pooled Funds by Lowering 150 Unit Holder Rule for Mutual Fund Trust Status

Pooled Funds: Some individual Canadians and pension plans invest part of their investments with portfolio managers who offer "pooled funds" that are very similar to mutual funds but are offered pursuant to exemptions from the prospectus requirements under provincial securities legislation and are typically offered at substantially lower costs than traditional mutual funds. The *Income Tax Act (ITA)* was revised in the 1990s to attempt to provide certain tax rules for commercial trusts that meet specific requirements including that such funds have at least 150 unit holders (the "150 unit holder rule"). For example, if a Canadian had RRSPs in a fund that had 150 or more unit holders, it would be a qualified investment. If however, the fund dropped below the 150 level, the fund would no longer be a qualified investment for a Canadian's RRSP. This would also trigger a host of detrimental tax consequences including a 1% penalty tax per month to the RRSP annuitant on the book value of their investment in the fund simply due to the arbitrary event of dropping below 150 unit holders; before this drop, it was a qualified investment. A Canadian's RRSP would have lower returns, due to the tax the fund would be paying. Put simply, pooled funds established by portfolio managers registered with provincial securities commissions are commercial trusts and should be afforded the same treatment whether these funds have 149 clients or 150 clients.

Challenge of Maintaining Funds Above 150 Unit Holders: In recent years, meeting and surpassing this 150 limit however has become problematic due to two factors. Market volatility has caused some pooled funds to drop in volume and has challenged fund managers to maintain them above the 150 unit holder limit. This can happen very quickly, since most funds are redeemable by a unit holder on demand, therefore, managers of pooled funds have little or no control over the number of unit holders in the fund at any given time: in other words, if the number of unit holders is dropping to near or below 150, a pooled fund manager cannot compel new investors to come into the fund and it cannot prohibit existing investors from redeeming out of the fund. Secondly, there are over 46,000 Defined Contribution/Group RRSP clients that are now largely administered by insurance companies in Canada. The current method that these employer sponsored plans are structured results in large company DC Plans being counted as "one" in terms of the 150 unit holder rule. Large DC pension plans therefore can also find themselves in funds, below 150, resulting in detrimental tax treatment. This holds true for regular Defined Benefit Pension plans which may have 30,000 members but would be counted as "one" for unit holder count purposes.

Negative Implications of 150 Unit Holder Rule: There are two problems with this rule: taxation impact on retirement savings when funds drop below 150 unit holders and the barrier to starting new innovative funds due to the very high threshold.

i)Taxation Impact: We believe this rule is unfair to Canadians and pension plans who invest in pooled funds and unbeknownst to them, the fund drops below the 150 limit. The Canadian with the RRSPs in the fund would not be aware that part of their lower returns were due to tax implications of the fund dropping below 150. If pooled fund (MFT) drops below 150 unit holders, the impact could be significantly detrimental on the remaining investors. Once an MFT drops below 150 unit holders, it loses its qualification as an investment for an RRIF, RRSP, DPSP, or RESP. This would immediately trigger a 1% penalty tax per month on an RRSP or RRIF holder that continues to hold the units.

If pension plans were counted as multiple units (based on underlying plan participants) instead of one unit, which they are today, the 150 unit holder target would be easier to achieve. We suggest that the government could meet its original policy objective of this rule, by simply providing a look-through to pension plans and retirement savings plans generally, including those serviced by insurance companies.

ii) Barrier to New Fund Innovation: Canadian's continue to seek investment opportunities to meet their needs, risk profiles and retirement objectives. Small innovative investment ideas are being kept on the shelf or not launched as pooled funds because of the requirement to have 150 unit holders, which can not include RRSPs. Lowering the limit to 50 unit holders, would encourage firms large and small to set up new, innovative funds which offer good growth potential and optimum value for the investor. The current threshold of 150 makes it difficult for firms to launch pooled funds and limits competition in the industry.

iii) Barrier to Investment in Canadian Funds by Non- Residents*:* Non residents are unable to invest in our funds with less than 150 unit holders without detrimental tax implications on the non resident and remaining unit holders. This has detrimental effects on our industry and ultimately the government tax base.

In summary, we feel the current threshold is too high and results in unfair and unintended tax consequences on retirement savings that should be corrected. In addition, the rule limits new fund innovation, and reduces opportunities for Canadians and non-residents to invest in new funds which meet their needs. Lowering the 150 unit holder rule to 50 would ensure the developments of new pooled funds and would allow international equity funds to accept RRSP unit holders given smaller international funds would meet the new target threshold of 50.

We recommend that the 150 unit holder rule to qualify for "mutual fund trust" status be modified to (a) only require 50 unit holders, and (b) provide a "look through" for pension plans and group RRSPs such that each participant in the pension/group RRSP is counted as 1 unit holder, regardless if they invest in fund directly or via an insurance segregated fund.

4) Expansion of Designated Stock Exchange List to Allow Canadians to Diversify Their RRSP Investments

The 2005 Federal budget took the important step of eliminating the foreign content limit for RRSPs and other tax-deferred plans. However, seniors and Canadians saving

for retirement are still unable to optimize and/or diversify the foreign content portion of their investment portfolio due to the fact that certain countries exchanges are not on the designated stock exchange list maintained by the Department of Finance.

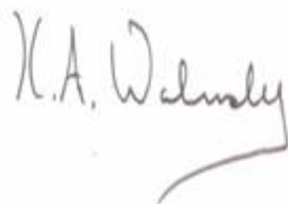
There are many investments which can be held in an RRSP, however a Canadian may not hold shares listed on an exchange which is not on the Department of Finance's list of Designated Stock Exchanges. (http://www.fin.gc.ca/act/fim-imf/dse-bvd-eng.asp) Given the turmoil in the markets in the last few years, diversification of capital is even more critical. The current list of approximately 38 exchanges primarily consists of exchanges in North America (40%; 28% of which are in the United States) and Europe (40%). We would suggest that given the impact on the sovereign debt issue on both the European and US markets, it is critical this list be expanded and diversified to include other very well regulated, well known, and established exchanges which are commonly used as part of pension plan portfolios and other non - RRSP portfolios. For example, India (BSE), and all South American stock exchanges are not on the Designated Stock Exchange list, to name a few.

It should be noted that our second recommendation regarding the lowering of the 150 unit-holder rule for Mutual Fund Trust status is very related to this recommendation. If a fund contains RRSP unit holders, it is limited to the Designated Stock Exchange list when the fund has less than 150 unit holders and as noted, is very restricted from other investment opportunities. As noted due to the massive structural changes in the servicing of the 46,000 RRSP and capital accumulation plans in Canada, now concentrated in the hands of the largest insurance companies, many pooled funds, even those with billions of dollars in them often struggle to meet the 150 unitholder requirement for MFT status and thus have to restrict themselves to accepting no RRSP money (denying Canadians the opportunity to participate in these low cost vehicles) We would suggest this is unfair to Canadians and propose the lowering of the 150 Unit Holder rule for MFT status with the expansion of the Designated Stock Exchange list as a way to help Canadians, save more and pay less for their retirement savings.

We recommend the current list of designated stock exchanges be expanded and updated to allow Canadians to adequately diversify their savings in different economies around the world.

We would be happy to present our submission to the House of Commons Standing Committee on Finance.

Sincerely,



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