

December 8, 2014

The Honourable Joe Oliver
Minister of Finance
Department of Finance, Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5
e-mail: commentonlegislation@ccmr-ocrmc.ca

Re: Capital Markets Stability Act (Canada) - Draft for Consultation

Dear Sir:

The undersigned public sector Canadian pension funds and pension fund managers, Healthcare of Ontario Pension Plan, OMERS Administration Corporation and Ontario Teachers' Pension Plan Board¹ (referred to below collectively as "**Canadian Pension Fund Investors**", "us" or "we") welcome the opportunity to comment on the consultation draft of the *Capital Markets Stability Act (Canada)* dated August, 2014 (the "**Draft CMSA**").

We appreciate the efforts by the Governments of Canada, Ontario, British Columbia, Saskatchewan and New Brunswick to harmonize securities regulation and to create a framework for a cooperative capital markets regulatory system (the "**Cooperative System**") under the oversight of a single regulatory authority and recognize that appropriate oversight and management of systemic risk is important to the stability of Canada's financial markets and the long-term growth of the Canadian economy. However, we are of the view that pension funds and pension fund managers (collectively, "**Pension Entities**") are qualitatively different from other market intermediaries and do not pose systemic risk. Moreover, Pension Entities are already prudentially regulated or subject to a comprehensive statutory framework, with the central requirement to be a prudent investor. Accordingly, we would urge you to consider excluding Pension Entities from the definition of a capital markets intermediary ("**CMI**") in section 2² and exempting Pension Entities from being subject to designation under section 27 of the Draft CMSA.

We are also concerned about the potentially onerous regulatory requirements for a Pension Entity designated as systemically important. We believe the regulations contemplated in section 28 and the powers of the Capital Markets Regulatory Authority (the "**Authority**") contemplated in section 29 need to be appropriately circumscribed and properly tailored to the policy objectives of the Draft CMSA. We also believe that the wind-up and management powers of a receiver or similar official under section 52(6) are not appropriate for Pension Entities and that the exercise of these powers could potentially be harmful to our plan members and pensioners. Furthermore, sections 30 to 33 permit sweeping regulation of the financial markets upon which Pension Entities depend and of the practices used by Pension Entities. These

¹ Please refer to Annex 1 for a detailed description of each of the Canadian Pension Fund Investors.

² Unless otherwise noted, all references in this letter to sections or paragraphs are references to the provisions of the Draft CMSA.

sections also need to be appropriately tailored to avoid unintended adverse consequences from such broad regulatory powers.

We also find that the Draft CMSA is unclear or deficient with respect to (i) the decision-making process leading to the designation of a CMI, and (ii) the due process safeguards afforded to a designated CMI to challenge any regulatory decision or order affecting it.

COMMENTS

Ancillary Legislation

As a practical matter, it is difficult for us as Canadian Pension Fund Investors, and will also be difficult for other Pension Entities and market participants, to assess the implications of the Draft CMSA without being able to review all ancillary legislation pertaining to the proposed new statute. To address this, we urge you to extend the comment period relating to the Draft CMSA until after the publication for review and comment of (i) the draft legislation establishing the Authority, and (ii) drafts of the initial regulations that will accompany the new statute.

CMI Definition and Exclusion of Pension Entities

a) CMI Definition: Introductory Language

The first three lines of the definition of CMI in section 2 are not appropriate for Pension Entities. Pension Entities are not in the "business" of trading securities or derivatives. Rather, the mandate of a pension fund is to pay pension benefits and the mandate of a pension fund manager is to manage the assets of a pension fund so that it may ensure pension benefits are paid. More generally, we believe that the first three lines of the definition are too open-ended and should be deleted. Paragraph (f) of the definition should be sufficient to provide any necessary flexibility to bring new types of intermediaries within the ambit of the new statute.

b) CMI Definition and Section 27: Unique Characteristics of Pension Entities

We strongly believe that paragraphs (c) and (d) of the definition of CMI should be deleted and that the Draft CMSA should expressly provide in section 27 that Pension Entities are not subject to designation by the Authority.

There is in fact a fundamental difference between Pension Entities and the other types of entities listed in the definition. In this regard, Pension Entities are motivated by the obligation to invest pension assets and/or pay pensions over the long-term in a safe manner and consistent with their statutory fiduciary duties. In addition, Pension Entities are not highly leveraged as some banks and other market participants are.

The following characteristics set Pension Entities apart from other market participants:

- *Pension plans are subject to a prudent portfolio investment standard.(...)*
- *Pension plans must establish and file with the appropriate regulators a detailed statement of investment policies and procedures, including with respect to the use of derivatives, options*

- and futures. Such document outlines the plans expectations with respect to diversification, asset mix, expected returns and other factors.*
- *Pension plans are generally prohibited from borrowing.*
 - *Funding shortfalls may be funded by the pension plan's corporate or government sponsor, by increasing contributions of pensioners or by lowering benefit payments, depending on the nature of the plan.*
 - *Pension plans must regularly file an actuarial valuation with the appropriate regulators.*
 - *Pension plans are transparent to members and regulators. Provincial legislation requires that pension plans file a detailed annual financial statement accompanied by an auditor's report.*
 - *Pension plans are not operating entities subject to business-line risks and competitive challenges.*
 - *There is no provision under any Canadian law for pension plans to file for bankruptcy or reorganization to avoid their financial obligations to counterparties or other creditors. Additionally, the voluntary termination of a plan does not relieve the plan of its financial obligations.³*

In a recent speech to the Pension Investment Association of Canada in Québec City on May 15, 2014, Mr. Lawrence Schembri, Deputy Governor of the Bank of Canada, noted that three main characteristics set pension funds apart from other market players, namely:

- *First, pension funds are market participants with long term horizons.*
- *Second, they are predominantly real-money investors; that is, they fund their investments primarily from contributions, rather than from borrowing.*
- *Third, employee and employer contributions are largely locked in.⁴*

Mr. Schembri also noted that "*(b)ecause pension funds are investing to help fund the retirements of members over a wide age distribution, they have the luxury of patience, of being able to withstand short-term market volatility or liquidity stresses to earn returns over the long term. They are the Warren Buffetts of the financial system. In other words, pension funds can more easily bear market and liquidity risk and earn the associated risk premiums because they can diversify these risks over time. Their long investment horizons are different from those of most other market participants, who are more focused on short-term returns. Thus pension funds have the capacity to smooth and absorb short-term volatility and act as a net provider of liquidity and collateral to the system, especially in times of stress.*"⁵

³ Excerpted from Exhibit B to the Global Pension Coalition's comment paper "Comments on Second Consultative Document: Margin Requirements for non-centrally cleared derivatives, issued by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions" dated March 15, 2013.

⁴ Please see remarks made by Lawrence Schembri, Deputy Governor of the Bank of Canada, to the Pension Investment Association of Canada in Quebec City on 15 May 2014.

⁵ *Id.*

Finally, we believe that there is no evidence showing that Pension Entities are potential sources of systemic risk. On the contrary, as demonstrated by the sources cited above, Pension Entities are typically seen as buffers against systemic risk.

c) Regulation under Draft CMSA is not Warranted

Pension Entities are already (a) prudentially regulated or (b) subject to a comprehensive statutory framework, with the central requirement to be a prudent investor. Moreover, the Pension Entities that would be large enough to be considered worthy of designation under the Draft CMSA would generally have professional management well aware of and focused on the applicable statutory and fiduciary duty of prudence. The regulations contemplated in section 28 appear to be designed to empower the Authority to promote prudent behavior on the part of CMIs. We strongly believe this statutory authority could be redundant to, and in certain cases conflict with, the regulatory or statutory regimes that already apply to Pension Entities in Canada, which would contribute to significant costs of compliance (which will ultimately be borne by pensioners) and market inefficiencies.

While we recognize that many large Pension Entities do trade in securities and derivatives at volumes that make their market participation significant, we do not believe that the Pension Entities themselves need to be directly regulated under the new statute in order to accomplish the Draft CMSA's policy objectives. We note that measures being taken by Canadian and foreign capital markets regulators are not aimed at Pension Entities directly but rather include new rules for mandating central clearing of derivatives, implementing margin requirements for uncleared derivatives and trade reporting. Rather than being aimed at Pension Entities directly, we believe the Draft CMSA should take the form of market-wide regulation that balances systemic risk concerns with the preservation of the essential functions of capital markets and market practices, such as risk transfer, price discovery and risk management. One of the objectives with the Draft CMSA should also be harmonization with capital market regulations in other jurisdictions.

For all these reasons, we believe that direct regulation of Pension Entities under the Draft CMSA is not warranted.

Administrative Law Concerns

a) Enabling Legislation for the Authority

We expect that the Authority will be constituted by dove-tailing legislation at the federal and provincial levels as part of the Cooperative System. However, we question whether the Authority can legitimately or effectively regulate entities which are subject to provincial jurisdiction and are based in provinces which have not opted into the Cooperative System.

In addition, as noted above, market participants should have the ability to review and comment on this fundamental legislation in tandem with the Draft CMSA.

b) Relevant Factors

The factors which the Authority must consider under section 27(2) in designating a CMI are open-ended. We strongly believe that more granularity is required in this regard. In order to minimize duplicative regulatory regimes, which create confusion, added costs and inefficiencies, we believe that the Authority should also be required to consider whether the existing regulatory regime and governance structures of a CMI are adequate to mitigate any potential systemic risk that may be posed by a CMI.

c) Due Process

The Draft CMSA does not appear to provide a designated CMI with any due process protections in respect of such designation except the "opportunity to make representations" pursuant to section 27(3). There is no indication that the CMI will be given a hearing, the right to make oral arguments, the right to disclosure of any expert evidence or the reasons for the ultimate decision of the Authority. Given the significant implications of being designated, we believe that the due process protections in the Draft CMSA are not extensive enough and should be enhanced.

d) Judicial Review

The applicable standard of judicial review relating to a decision of the Authority to designate a CMI will be whether the decision being reviewed is reasonable. Given the open-ended factors listed in section 27(2) and the low level of due process protections provided by the Draft CMSA (including no duty upon the Authority to provide detailed reasons for a decision), we believe that it will be unreasonably difficult for an aggrieved CMI to mount a challenge to such a decision. We believe that this is inappropriate given the implications of being designated under the new statute.

e) Appeal Process

The appeal process for the designation of a CMI is also not clear. The term "decision" is defined to include an order of the Authority but such a decision is not subject to the review under section 103 since that section is only for decisions of the Chief Regulator. Conversely, section 99 suggests that the designation of a CMI by the Authority is subject to judicial review under sections 18 and 18.1 of the *Federal Courts Act* (Canada). It is not clear why this distinction has been made.

Concerns Relating to Over-reach of the Draft CMSA

The power to designate a CMI comes with the possibility of the Authority imposing various, broadly described and onerous regulatory requirements for designated entities (section 28) and imposing upon them various, broadly described and onerous obligations (section 29(1)). Furthermore, both the financial instruments and the practices used by Pension Entities are made subject to the broad discretion of the Authority, as described in sections 30 to 33. We strongly believe that these powers are far too broad and vague and go well beyond what is necessary to protect capital markets. In addition, the wind-up and management powers of a

receiver or similar official pursuant to section 52(6) are not appropriate for Pension Entities and the exercise of these powers could be harmful to pension plan members and pensioners.

CONCLUSION

We hope that the comments in this letter are helpful to you and we would welcome the opportunity to discuss our views with representatives from the Department of Finance Canada.

**Healthcare of Ontario Pension Plan
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board**

ANNEX 1

DESCRIPTION OF CANADIAN PENSION FUND INVESTORS

ONTARIO TEACHERS' PENSION PLAN BOARD

Ontario Teachers' Pension Plan ("OTPP") is Canada's largest single-profession pension plan with \$140.8 billion in net assets, as at December 31, 2013. It was created by its two sponsors, the Ontario government and the Ontario Teachers' Federation, and is an independent organization. In carrying out its mandate, OTPP administers the pension benefits of 180,000 current elementary and secondary school teachers in addition to 127,000 pensioners, as at December 31, 2013. OTPP operates in a highly regulated environment and is governed by the *Teachers' Pension Act* (Ontario) and complies with the *Pension Benefits Act* (Ontario) and the *Income Tax Act* (Canada).

HEALTHCARE OF ONTARIO PENSION PLAN

The Healthcare of Ontario Pension Plan ("HOOPP") is a multi-employer contributory defined benefit plan serving more than 286,000 working and retired healthcare workers. HOOPP was originally established by the Ontario Hospital Association (the OHA) in 1960. The Plan is registered under, and regulated by, the *Pension Benefits Act* (Ontario) and the *Income Tax Act* (Canada). As at December 31st, 2013, it had \$51.6 billion in net assets. HOOPP's ability to meet its pension promise, measured by the ratio of the net assets to the present value of its promised benefits (funded ratio), is strong at 124%.

OMERS ADMINISTRATION CORPORATION

Under the *Ontario Municipal Employees Retirement System* ("OMERS") Act (Ontario), OMERS Administration Corporation ("OAC") is the administrator of the OMERS pension plan, one of Canada's largest multi-employer defined benefit pension plans, and trustee of the OMERS pension funds. As of December 31, 2013, OMERS had more than \$65 billion in net assets and serves 982 participating employers and over 440,000 employees and former employees of municipalities, school boards, libraries, police, and fire departments, children's aid societies, and other local agencies across Ontario. OAC manages a diversified global portfolio of stocks, bonds, derivatives, real estate, infrastructure and private equity investments.