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Daniel Jay Baum

Osgoode Hall Law School of York University

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Profit Sharing and Pension Plans in Canada: Profile in Action: A Melding of Interests*

BY
DANIEL J. BAUM**

1. MEANING OF THE CANADA PENSION PLAN

To provide security and a minimum level of living, the Canadian Government has entered the area of pensions; it has become a principal with a force and some of the same mixed goals as other financial institutions. There are only these differences: the Government does not have to compete for the savings dollar; that which goes into the Canada Pension Plan is a matter of compulsion; and the Government need not be as responsive as financial institutions to the contributor, the citizen, for making the savings dollar grow or for interest yield. Government takes from the individual a fixed amount and promises to return a set payment, nothing more.

In no small measure the Government has had a dramatic influence on the shape and direction of institutional investors. Partly, this may be due to the preferential treatment given qualified pension, retirement, or profit sharing schemes through tax deferred status. Yet, more important, perhaps, is the Government's own position as principal.

Consider the facts. As early as 1964, before the advent of the Canada Pension Plan, the *Financial Post* reported that *private* pensions then accounted for more than 30 percent of all personal savings.¹⁹² From 1965, the year of its enactment, to 1975 the fund for the Canada Pension Plan alone should grow to \$8 billion.¹⁹³ By 1969 it had reached nearly \$3 billion,¹⁹⁴ accounting for a very substantial portion of *all* trustee plans.¹⁹⁵ From the viewpoint of private industry, labour,

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** Professor, Faculties of Law and Administrative Studies, Osgoode Hall Law School, York University.

192. V. Nankivell, *How Much Is \$800 Million?*, *The Financial Post*, May 23, 1964, at 15, col. 1.

193. *Id.*

194. DOMINION BUREAU OF STATISTICS, *TRUSTEED PENSION PLAN FINANCIAL STATISTICS* 20 (1968).

195. Assets of trustee funds increased at yearend 1968 by \$904 million to a total of nearly \$9 billion at book value. These statistics include some of the funds in the public area. The figure of \$9 billion represents a growth from \$3.6 billion in 1960 averaging slightly greater growth rates before 1966 with the implementation of the Canada and Quebec Pension Plans. Over 72% of these funds

and financial institutions the way seemed open to concentrate on secondary, or back-up pensions, that would provide growth. But whether this course would be followed depended upon Government policy on the use of contributions to the Canada Pension Plan. There was nothing in the legislation to stop the Government from seeking maximum return on each contributed dollar. But to do so would have injected a powerful new and, to some extent, unpredictable force on the equity market.

Despite the few years of operation there is direction to the Canada Pension Plan. Administration is shared at the ministerial level between the Department of National Health and Welfare and the Department of National Revenue. Their roles are clear. The Department of National Revenue insures collection of the designated contributions while the Department of National Health and Welfare distributes what is necessary. But this division of authority hardly indicates how much *excess* money is received, how it is administered, and how it is used.

In the initial years of the Plan there has been a surplus. The amounts involved are of startling dimension. In fiscal 1968-69 contributions totalled \$697.6 million. For the first nine months of fiscal 1969-70 \$557 million was collected. *Other* revenue entered on the books of the plan was substantial. Itemized either as coming from "interest" or "other" sources, a total of \$87.4 million was received in fiscal 1968-69, and for the first nine months of fiscal 1969-70, \$106 million.

How much of the money received was paid out in benefits during the same periods? In fiscal 1968-69 benefits amounted to \$15.6 million, and administrative costs, \$14.5 million. For the first nine months of fiscal 1970 there was a measured increase. In that period \$32.3 million were paid as benefits while administrative costs stayed constant. As of December 31, 1969 the Plan balance was \$2,727.3 million. Interest and other income to the Plan, by themselves, more than doubled that needed to fund benefits.

There is a very large pool of money not immediately needed for benefits. It is this gathering of capital that brought about the support of so many of the Provinces for the Plan. Under the Plan's enabling legislation the way has been opened for the Provinces to *use* the capital pool, one of the largest in Canada. In

were administered by corporate trustees, with just over 25% by individual trustees. However, individual trustee funds administered over half of these assets by comparison to 36% as administered by corporate trustees. "Pooled funds" increased in value by \$70 million, while the proportion of pooled funds as part of the trustee area remained constant at 7.6%. The trustee fund area represents significant assets, and a grouping which is active and growing.

The total inflow into these funds continued to rise with \$1.3 billion added to the grouping. Of this inflow, almost two-thirds consisted of employer/employee contributions. Employee contributions have risen at moderate rates reflecting a change from higher contributions in the early 1960's, and attributable to the implementation of the public plans of 1966. Employer contributions have remained high as the public plan effect has been offset with the past service and solvency provisions of the provincial pension acts as implemented. *Id.* at 7, 8, 11.

brief, the law allows excess Plan funds, namely, those monies left over on a current basis after benefits have been paid, to be *made available* to the Provinces in proportion to the sums received by the Plan from each Province.¹⁹⁶

Under the Plan an investment fund has been established. It is the receptacle of all monies not used on a current basis for the payment of benefits and administrative costs. Proportionate to their residents' input into the Plan the Provinces may borrow from the fund at favourable or prime interest rates.¹⁹⁷

The heavily populated and heavily industrialized Provinces have received the greater sums from the fund. From 1968-69 Ontario took \$412 million and British Columbia, \$107.5 million, while the smaller provinces of Prince Edward Island and Newfoundland obtained only \$2.9 and \$14.2 million respectively.

The Canada Pension Plan Statistical Bulletin for December 1969, indicates that almost the entire excess of capital assets in the investment fund has been used to purchase Provincial bonds.¹⁹⁸ The rate of interest payable on the bonds has risen from 5.29 percent in March of 1966 to 7.83 percent for purchases made in December of 1969.¹⁹⁹ It should be pointed out that purchases are usually made on a monthly basis.

The remaining question to answer is what, if any, significant impact will this arrangement have on the Canadian equity capital market? Mr. V. Nankivell of the *Financial Post* offered these comments:²⁰⁰

1. There should be an obvious and substantial decrease in the volume of provincial borrowing that would otherwise take place in the open market.
2. One can expect to see increased interest by investors in common stocks and mortgages which may help push interest rates down and stock prices up.
3. There should be less dependence on borrowing funds from abroad.
4. One can expect a re-organization in the way provinces handle municipal borrowings.

2. THE METROPOLITAN TORONTO POLICE BENEFIT FUND

The investment fund of the Canada Pension Plan serves only as one dramatic example of government financing itself at favorable interest rates through the

196. *Id.* at 20.

197. The provinces may use the money at their own discretion. Provinces that do utilize these funds must guarantee the Canada Pension Fund a rate of return at least equal to the rate of return in long term government bonds. Funds that are not taken by the provinces may be used to purchase Government of Canada Bonds. The Canada Pension Plan, Stat. Can. 1964-1965, 13-14 Elizabeth II, c. 51 § 112(6).

198. Department of National Health and Welfare, I Canada Pension Plan, Statistical Bulletin, Dec. 1969 at 12.

199. *Id.* at 13.

200. V. Nankivell, *Big Pension Fund Could Reshape Capital Market*, The Financial Post, April 25, 1964, p. 7, col. 1.

use of government-operated pension funds. The Canada Pension Plan touches the citizenry generally, but what of the various pension schemes of Canada's largest employer, the government itself? How are the millions of dollars used that flow annually into the specialized pensions for employees of crown corporations, Federal and Provincial departments, and even of local, municipal agencies? Little is known of their precise mode of operations, and, more importantly, how their investment funds are used.

For purposes of this study only a single "government" fund will be viewed, The Metropolitan Toronto Police Benefit Fund. The rationale for doing so is twofold: (1) in depth data on all government funds simply is not available; (2) the Toronto fund may illustrate the range of government employee pensions.

Under The Municipal Employees' Act²⁰¹ the province of Ontario has permitted municipalities to establish pension funds for their employees. Acting under this authority Metropolitan Toronto ordered the formation of a police benefit fund.

In accordance with metropolitan by-law, contributions are made by the police and supplemented by the municipality. The police must pay into the fund 8 percent of their annual salary, though they may contribute more. The municipality must match individual compulsory contributions as well as make an annual grant of \$125,000.²⁰² If the fund is not fully funded additional amounts may be required of the Metropolitan Area Municipalities. Ordinarily, the policeman will receive on retirement an annual pension of 2.2 percent of his total earnings multiplied by the number of years of service.²⁰³

By December 31, 1967, the invested funds had a *book value* of \$34.4 million. The *market value*, however, was only \$29.6 million.²⁰⁴ The reason for this discrepancy lies in no small measure in the way funds are administered and invested.

The by-law vests the administration of the policemen's fund in three trustees appointed by the Metropolitan council. One of these trustees must be the Treasurer for Metropolitan Toronto. As administrators of the fund, they not only exercise power over collection, payment of benefits and record keeping, but also over every investment decision. Their discretionary sweep has not been severely restricted by Metropolitan legislation that investments "shall conform with the requirements of the Pension Benefits Act and the regulations thereunder, however, that no investments shall be made which are not authorized investments for a trustee under the Trustee Act, as amended from time to time."²⁰⁵

201. REV. STAT. ONT. 1960, c. 249. The Act provides for the passage of by-laws to set up pension funds.

202. THE MUNICIPALITY OF TORONTO, By-law 1288, §§ 9-11.

203. *Id.*

204. The report on the audit of the books and accounts is for the year ended 1967. *The Metropolitan Toronto Police Benefit Fund* at 3.

205. See Part A of this paper, 6 Texas Int'l L.F. 10 (1970).

They could invest fully in high-paying corporate bonds and common stocks. They could move to give the police fund a measure of flexibility, to provide the highest possible income at the lowest possible price or contribution. They could act as corporate trustees. But they have not, much to the consternation of the police.²⁰⁶ Representing 3,800 officers, The Metropolitan Toronto Police Association has sought representation on the board of administrators. The association wants better use of its contributed monies.²⁰⁷ The police find little justification for investing *all* of the fund in low-paying government obligations which cannot even be traded on the open market at their stated worth. How, they ask, is the trustee relationship of the board of administrators carried forward with 80 percent of the fund, \$27.6 million, invested in Metropolitan Toronto debt issues? The police point to the official audit of investments of their fund for year-end 1967:²⁰⁸

Government of Canada bonds ..	\$.7 million	1.5%
Provincial Government	\$ 2.8 million	8 %
Metropolitan Toronto	\$27.6 million	80%
Other Municipalities	\$ 3.2 million	10%
Separate School Boards	\$.05 million5%
 Total Book Value	 \$34.4 million	 100 %

The market value of these investments is some five million dollars less than the reported book value.

The investment policy of the trustees seemed clear. They take the position that the funds should be directed toward financing government programmes and local works. The rationale for this position develops from that fact that policemen are public servants remunerated from public funds. They should show their appreciation and allow these monies to be plowed back into public projects at a nominal return.²⁰⁹ In this regard, the question of market as against book value, so the City argues, has no significance. Fund assets are almost always held to full maturity. Therefore it is the periodic interest which is the material factor, and not the market value at any given time. Moreover, if the fund were ever short of cash the City would not hesitate to make up the difference. Finally, fund cash flow usually is more than enough to cover expenditures. At yearend 1967, total expenditures were \$1.6 million while investment income was \$1.8 million.²¹⁰ Rough calculations put the overall return on investment at approximately 5.3 percent.

206. Interviews conducted March 5, 1969, by A. Young, M. Jacobson, and P. Mullins, research assistants, with officials of the Toronto Police Association.

207. *Id.*

208. Audit, *supra* note 204, at 4.

209. Interviews conducted in April 1969 by A. Young, M. Jacobson, and P. Mullins, research assistants, with Donald Bryon, solicitor for Metropolitan Toronto.

210. Note 204, *supra*, Schedule 3.

The Metropolitan Toronto Police Association, however, compares its pension investment programme with private industry and finds it lacking. To the association capital growth is important. The association can look to the larger trust companies and see clear evidence of heavy equity investment. Indeed, Canada Permanent Trust Company placed nearly half of all its trustee pension assets in equities during 1968.²¹¹ Performance has been its guiding factor and because of this it has been expanding its research department and hiring specialized analysts in order to keep abreast of market trends. The company is not interested in dividends but in growth. Canada Permanent's estimated true rate of return on equities in 1969 was between 23 and 30 percent. The company may increase the equity portion of its portfolio to 60 percent by 1971 to seek diversity and to maintain flexibility in poor market conditions.

Toronto police do not see their pension fund as general tax revenue, to be used in the best interests of general government. They seem to be saying, if taxes are needed, let them be levied, but use the police pension monies efficiently to bring maximum return. Should the police association prevail, should other "government" pensions accept even in part the same view, not only might those new tax levies be forthcoming, but the effect on the equity market could be sharp.

3. PRIVATE PENSIONS

There is, however, still another and perhaps more significant meaning to government pension fund policy. It is *policy* in fact to use the monies to finance government. No firm policy has been devised in the use of private pension monies, with the result that those supplying the dollars are seeking maximum returns. Moreover, the major financial institutions have entered the arena of pension funds, doing whatever is necessary to capture the pension dollar. In the course of competition for *big corporate accounts* the rigidity of firms, of fixed techniques, have been discarded by the financial institutions.

Consider the insured pensions offered by Canada's life companies. Indeed, the fact that they are "insured" is the only common denominator to any of the categories that follow. And, the categories, it must be emphasized, are all subject to modification, to meet consumer demand. Illustrative groupings include individual annuity contracts, group annuity contracts, deposit administration plans, and variable accumulation plans.

(a) *Individual Annuity Contracts*

Life insurance companies currently offer individual annuity policies on the lives of individual employees. The policies may be assigned under the terms of a specific trust agreement in order to carry out the conditions of a broader pension plan. This type of insured pension trust is a series of individual policies which develops some economy of scale on assignment. However, it should be

211. Interviews with officials of pension fund management, Canada Permanent Trust Company, March 13, 1969.

noted that these arrangements are no more than individual annuity policies with the terms, conditions, contribution base, and vesting standards varying according to the insurance company involved, and the particular arrangement entered into. They may be held individually by employees under a retirement savings plan registered with the Revenue Department. Policies purchased by the employer can be brought together under a trust agreement. Employees could do the same thus creating an employee's pension plan independent of employment, and obtaining economies of scale.

Plans involving individual policies of annuity appear to be especially popular where few employees are involved. Variations on this type of pension arrangement can also be useful where the predictability of pension benefits required is uncertain. In fact, the insurance company takes over the complete control of pension arrangements on an individual policy basis, leaving both the employee and the employer free from further investment decision.

(b) *Group Annuity Contracts*

The group annuity contract is the most important form of insured pension plan in Canada. It is popular with small to medium sized industries; it differs from the individual annuity contract arrangement in that a master policy is issued to the employer setting all the conditions and terms of the pension plan. The plan features a single premium, with the insurance company maintaining separate records of account for each employee. A definite amount of deferred annuity is purchased each year for each employee, with the master policy being the vehicle for any economies of scale. Like individual policies of annuity, the assets of the group annuity plan are not separated from those of the insurance company. Being a part of the general insurance funds, the premiums, rate of return, and legal restrictions would include those relating to life insurance companies generally.

In reality this type of pension arrangement is no more than a group insurance plan. The insurance company undertakes to pay sums certain at future dates, but there is no specific pension "fund" into which contributions are made, nor against which benefits may be claimed. Such plans could maintain all the general benefits of life insurance policies, *i.e.* cash surrender values and loan provisions, thereby leaving an inherent flexibility with the employer, and the alternative of changing pension arrangements.

(c) *Deposit Administration Plans*

The deposit administration plan is used primarily for large groups of employees; it provides still greater flexibility. Under the deposit administration plan there is no allocation to individual employees until actual retirement. Contributions are accumulated in a separate fund into which the life insurance company credits a return based on its earnings in the entire life insurance company investment portfolio. Minimum rates of return and administration charges are specified in the contract undertaken. The life company accepts deposits from the employer, accumulates them, and purchases any annuities as

directed by the employer on the retirement of employees. The employer is generally responsible for calculation of deposits and withdrawals.

The insurance company is really paid to be a money manager in this arrangement. The result is that any number of different arrangements can be written depending on the funding corporation's needs. The return credited with the deposited monies by the employer can be linked to the life insurance company's performance and rate of return that it pays to its policyholders, or, a specific rate of return can be guaranteed by the life company itself. The insurance company can be called upon to provide actuarial services, just as the employer may choose to maintain his own actuarial records.²¹² So long as the contribution, vesting, benefit, and other conditions of the employer-employee pension plan arrangement meet with the satisfaction of the regulating bodies, a life company is generally prepared to offer flexible arrangements. The insurance company is using its skill as a long-term money manager, and any guarantees undertaken by the insurance company relate to the same types of liability that a life insurance company would undertake in its other policies of insurance—fixed term, sum certain.

(d) *Variable Accumulation Pension Arrangements*

Perhaps, the maximum investment-give a life company can offer is the variable pension contract. The insurance company can write individual variable annuity policies for employees rather than fixed sum obligations. The same could be done under a group policy. The basic feature of this plan is that no specific return is guaranteed by the insurance company. The variable scheme would fluctuate in direct relation to the value of the managed segregated fund where the pension monies would be put. The life company, moreover, could offer units to the pension in existing segregating funds operated as part of its variable annuity business. Of course, if the pension were large enough, a segregated fund for it alone could be established.

Whatever range of choice may be afforded by the insurance industry it does not approach the near absolute discretion allowed by the device of a trust that need only meet the broad terms of the provincial Pension Acts, and the Income Tax Act.²¹³ By category there are two general types of plans: corporate and private. Basic to each type is the trust relationship which the law permits each party to define. It follows that in the larger pension schemes the indenture of trust is more like a carefully drafted contract representing the very special needs of the funding party. It matters not that the fund is characterized as private or corporate.

An employer may choose private individuals to operate and manage a pension fund; or an employer and employees' group may establish a Pension Fund Society.²¹⁴ The only dictates are those of money; such funds generally are

212. Cloward, *Pensions in Canada*, CCH CANADA 1964, at 151.

213. REV. STAT. ONT. 1965, c. 96; CAN. REV. STAT., c. 148 (1952), as amended.

214. Pension fund societies are created pursuant to the Pension Fund Societies Act, CAN. REV. STAT. c. 208 (1952).

large.²¹⁵ They can exceed those of corporate trustees. Some of the private trusts have a long history. For those corporations with fund contributions of substantial size the private trustee plan has offered nearly unlimited discretion, for the trust agreement can be a unilateral statement of obligation written by the funding party.

The corporate trustee is an entity with whom a funding corporation must negotiate. Yet even here it is the trust indenture that marks the guidelines. The corporate trustee can serve any function ranging from a mere agent, following investment instructions, to that of money manager. Of course, the rate of compensation will be geared to the service rendered. The most important matter is to have funds flow through the financial institution under its view.

The success of the trustee fund—as a device—is beyond dispute. By yearend 1967 they held \$8,068 million (book value) representing 70 percent of the total of all private pensions. Trustee plans then covered 69 percent of all employees and accounted for 77 percent of total contributions to private pensions.²¹⁶ The investment assets of trustee pensions were 20 percent of all personal savings in 1967 and their growth rate has been approximately 12 percent annually.²¹⁷ Of the 3,789 trustee funds of 1967, 72 percent were administered by corporate trustees and 26 percent by individual or private trustees. Yet, corporate trustees had only 35 percent of total trustee pensions, and individual trustees held 50 percent. Nearly 8 percent were under the control of pooled investment funds.²¹⁸ The distribution of the investments made for 1967 shows stocks and bonds as the dominant receiver of funds.²¹⁹

1967 Investment	Book Value	Market Value
Pooled Pension Funds	\$ 610 m - 7.6%	\$ 616 m - 7.8%
Mutual Funds	\$ 40 m - 0.5%	\$ 58 m - 0.7%
Bonds	\$ 4,761 m - 59.0%	\$ 4,225 m - 53.8%
Stocks	\$ 1,514 m - 18.7%	\$ 1,826 m - 23.2%
Mortgages	\$ 724 m - 9.0%	\$ 720 m - 9.2%
Real Estate, etc.	\$ 49 m - 0.6%	\$ 49 m - 0.6%
Miscellaneous	\$ 370 m - 4.6%	\$ 370 m - 4.7%
Totals	\$ 8,068 m - 100 %	\$ 7,864 m - 100 %

More and more of the new investment funds generated annually by trustee pension plans are channelled into equities. Over the past few years an ever increasing proportion of total assets accumulated by these pension plans have

215. DOMINION BUREAU OF STATISTICS, TRUSTEED PENSION PLANS FINANCIAL STATISTICS, 22 (1968).

216. DOMINION BUREAU OF STATISTICS, TRUSTEED PENSION PLANS FINANCIAL STATISTICS, 15 (1967).

217. *Id.* at 7.

218. *Id.* at 9.

219. *Id.* at 11.

been in common and preferred stocks. Equities in aggregate pension portfolios have increased dramatically from \$258 million in 1960, representing only 7 percent of total assets accumulated at that time, to a new high in 1968 of \$1,954 million which in relative terms amounted to 22 percent of the total, a rise of nearly 4 percent over the previous year. In addition, since over one-third of trust company pension funds were in equities it is estimated that pooled fund units in pension portfolios accounted for another 2 percent, bringing the total proportion held in stocks to 24 percent in 1968. Nearly three-quarters of these equities were in common shares of Canadian companies with a relatively small proportion in Canadian preferred shares. In recent years an increasing amount has been directed towards non-Canadian investment, largely in United States securities. In 1968, holdings of non-Canadian common shares rose by \$172 million to a total of \$502 million. In relative terms these foreign equities increased to 5.6 percent of total assets in 1968, compared with 4.1 percent a year earlier and less than 1 percent in 1960.²²⁰

220. Note 215, *supra* at 13. Most noticeable in this trend is the holding of Government of Canada Bonds, which has declined both in actual and relative terms; *i.e.*, in 1960, \$653 million being 18% of total assets; in 1968, \$491 million being under 6% of total assets. Holdings of "other" bonds have moved from a figure of \$2,104 million in 1960 to \$4,523 million in 1968. While such bonds have consistently accounted for over half of the book value of trusted pension plan portfolios, there has been a traceable decline in relative terms in these holdings notwithstanding increases in value.

There is one area of fixed income securities that has retained a constant position in relative values—mortgages. Notwithstanding similar safety features to bonds and higher net yields especially with rising interest rates, the proportion of assets in this area did not visibly change. Holdings in mortgages declined from 1967 to 1968 from 9% of total assets to 8.6%; however, their value increased \$52 million. This area, coupled with the "filler"—cash and short term investments—account for a relatively stable portion of funds as invested.

As stated previously, there is a marked difference between private and public funds notwithstanding the fact that both may be "trusteed." The details of this "difference" are typified in investment behaviour, attitudes and philosophies.

Although these comments relate to a sample of, rather than all public sector funds, certain behavioural characteristics would appear to be constant. For reasons that may be traced in the investment restrictions of the particular legislation authorizing the fund, and/or certain "independent" administrative theories, these funds (except federal crown corporations) are almost entirely invested in fixed income securities. In this sample group, the proportion of assets in bonds has ranged from a high in 1960 of 83% to a figure of 73% in 1968. Holdings in Government of Canada Bonds, by comparison, have remained constant although in relative terms, the structure has seen investment fall from 18% of total assets in 1960 to 8% in 1968. Following, in many cases, legislative requirements, holdings of municipal and provincial securities have tripled in value from 1960-1968 but the relative effect has not changed the 60% figure of assets that these bonds represent. Fixed income securities are clearly more than "popular."

On the other hand, holdings in equities have remained constant. While many are, in fact, not permitted to hold such securities, public sector funds hold almost 10% of their assets in this medium, a gain from 1% in 1960. However, this marked gain is attributable to federal crown corporation purchases where 25% of the assets of eight such funds were channelled in this direction. It would seem that under favourable conditions, public sector funds are prepared to invest in equities; legislation and certain administrative decisions have influenced the reverse trend.

Trusteed funds in the private sector present a considerably different approach to behaviour; there

The trustee plan, private or corporate, can be one that dramatizes the role of the funding entity as an investing institution in its own right. The trust company, the life company, and the mutual fund can take on the character of being solely conduits, intermediaries, using monies *as directed*. To illustrate, consider the Bell Telephone Pension Fund Study of 1967. Seventeen Canadian industrial or service companies holding twenty-four pension plans were surveyed. Each plan covered a minimum of 1,000 employees, and seven covered more than 10,000 workers. The study concluded that company management frequently participated in shaping investment policy even though the plan might be administered by a corporate fiduciary. The words of the Bell report bear repeating:²²¹

In the majority of cases, senior company management (and in about half of these cases the board of directors) participate in the investment of pension funds to the extent that they establish the broad policy within which fund investments are to be made. In other cases there is an expressed desire for companies to divorce themselves as much as possible from the operation of the fund, either because they want no responsibility for the management of employee contributions (because they do not want to risk criticism by unions or others), or merely because they do not feel they have the necessary expertise to perform such a function. The majority of companies feel however, either that the size of their contributions to the fund does have enough of an impact on company operations that they should at least retain policy-making control over the investment management of the fund, or that they have enough investment expertise in their own organization to properly guide its cause.

The measure of managerial involvement can take many forms. Gross figures in generalized narrative, even from as few companies as twenty-four, do not offer a precise measure of individual corporate policy. For a limited purpose only, to demonstrate one medium-large corporation's search for the "correct" pension policy, there is now set forth the narrative of Rio Algom Mines Ltd., an Ontario corporation, engaged in mining and specialty steel producing, with assets at yearend 1969 of \$235.6 million.²²²

is a more distinct performance orientation as evidenced by sharper trends in investment philosophy. The percentage of common stocks has increased from a level of 11% of total assets in 1960 to 30% of total assets in 1968, both figures at book value. This marked change reflected a declining preference for fixed income securities, bonds dropping from 73% of total assets in 1963 to 44% in 1968. The decline occurred in the bond area generally, with the most notable trend being away from Government of Canada bonds. Although all bond holdings declined in relative terms, Government of Canada bonds fell from 18% of the total in 1960 to 4% in 1968; by comparison, provincial and municipal bonds fell from an earlier high percent of total assets position in 1960 to 21% in 1968 while corporate bonds declined from 26% to 19%. A clear preference to equity investments exists and appears to be increasing. *Id.* at 13, 16, 20, 21.

221. *Bell Canada Pension Fund Study*, July 1967 (Comments Section) at 9.

222. Much of the information relating to Rio Algom was obtained from interviews conducted during March 1969 by A. Young, M. Jacobson, and P. Mullins, research assistants, with Mr. Allan Lomas, Personnel Manager of Rio Algom.

Rio Algom's pension arrangement with employees is not unusual. Workers pay a fixed percentage of their gross salary into the pension. And, the company contributes whatever additional dollars are needed to keep the pension fully funded. Before 1968 Rio Algom had its pension administered by a life insurance company which guaranteed a return of 5 to 6 percent. As part of the agreement Rio Algom had to purchase individual annuities on which benefits would be paid by the life company to qualifying employees. A "service charge" of 20 percent was to be levied should Rio Algom attempt to liquidate any portion of the total investment pool.

Rio Algom management grew dissatisfied with life insurance administration. It allowed them only a fixed, though guaranteed, rate of return. It permitted no opportunity to share in the actual growth of the capital pool provided by the pension flow. From Rio's view there might be the chance to cut company contribution through *participation* in sound investments. A corporate decision was made; further pension administration through the life insurance company was dropped.

Under the terms of an agreement drafted in no small part by Rio the company pension was placed in the hands of Montreal Trust Company. Rio was to pay a straight administration fee. And, more important, Rio could share in capital growth; control investment policy; and terminate the trust agreement without difficulty or excessive cost.

To maintain their control over the investments, the mining company set up a pension fund investment committee of three persons. The committee compares the performance of the Montreal Trust with that of corporate fiduciaries. They seldom tell Montreal Trust what to purchase but they do suggest changes in portfolio content.

For its part, Montreal Trust suggests various equity positions which the committee for Algom approves or rejects. The meetings between the trust company and the committee in the past were infrequent. But, according to Rio Algom, this will be altered. Increased sessions are planned as Rio moves to a more active role. The main problem for Rio, said one of its executives, is the lack of expertise possessed by the committee members with respect to the intricacies of the financial markets. As a result, Rio may hire a pension fund consultant to advise and direct to maximize performance.

Reflecting perhaps an aggressive investment policy the Rio fund has a substantial equity commitment. As of September 30, 1968 their investments had a book value of \$2.3 million divided among the following categories:

Government mortgages	\$ 465,000	20 %
Corporate bonds	580,000	25 %
Mortgages	74,000	3.5%
Equities	1,280,000	51.5%
Total Book Value:	\$2,300,000	100 %

Yet, for Rio even a 51 percent equity position is not enough. The company in 1969 was considering a larger stock position. The rationale *seemed* directed more to growth than having the pension fund become an active trader. If so, this is in accord with the Bell Canada study finding that “most of the funds studied are growing and equity capital gains realized through trading have been quite limited. That is, funds have been concentrated on equity purchases more than on equity trades. Planned increases in equity holdings seem to be the general rule.”²²³

4. CONCLUSION

Rio Algom has an immediate concern with obtaining a pension at the lowest possible price. It wants and has obtained flexibility. The financial institutions, in the case of Rio Algom, trust companies and life insurance companies, have competed to handle substantial savings. But neither financial institution has been able to impose its will on Rio. In the final analysis, the trust company capturing the account has been compelled to act fully as a financial intermediary; it takes its final instructions from Rio, and, it seems, Rio is becoming motivated to shape more detailed instructions. One question that arises for the future is whether Rio will ever use its growing pension to achieve *other* corporate objectives.

Suppose, for example, Rio were contemplating a corporate takeover of XYZ Ltd. Analysts were of the uniform view that XYZ was a sound investment, a growth company whose stock was undervalued in the market. Would it be improper for Rio to order its corporate trustee to make significant purchases at fair prices? Is such a procedure so different from a trust company buying from one of its trust accounts to sell to another? Isn't the fundamental question one of fairness? But, if this is so, how is fairness to be measured, if the facts aren't disclosed? How are employees, the ultimate beneficiaries of a pension, to know that their fund may be placed in jeopardy?

Yet, it must be asked whether “jeopardy” means the same as “fairness”? After all, the company's obligation is to ensure a fully funded pension, nothing more—unless the agreement of pension so specifies. Why should it have to account or even hesitate to make full use of pension monies? The answer may be found in part in the law. Dollars contributed to pensions are given favored treatment for purposes of taxation. The clear intent of the legislation is to have those dollars used for the subject of pensions, nothing else. The difficulty with a corporation applying pension fund assets to corporate ventures is one of a diffusion of responsibility. The law may be most flexible, but it is not totally elastic; pension funds are to be used for pension purposes. The difficulty is not so much with the law as the mechanisms for reporting, disclosure, and enforcement.

In reality the trustee pensions of the private sector stand as the most

223. *Supra* note 221, at 6.

significant pool of savings dollars. The law in theory imposes few restraints on investment policy and still fewer in fact. Around this important source of capital have gathered the major financial institutions. The strict lines separating one institution from another, the trust company from the life insurance company, have fallen in the bid for pension business.

A vital part to the understanding of this competitive framework is the role of the federal government as a pension supplying entity. The Canadian government (and that of Quebec) in providing subsistence levels is shaping the direction of competition. The performance of pension funds in Canada cannot be gauged on pure theories of safety and minimum benefits. Instead, the gauging of performance of a pension fund management group must appreciate that all performance is relative to existing subsistence levels. Pension fund management is sheltered from the unique liability structures of banks, life insurance companies, mutual funds, and trust companies. Investment results and benefits have become an exclusive measure of performance. This sheltering role of government is as important as any regulatory scheme that could be devised.

Private pension fund investment can be expected to be, and to an extent is, more aggressive. As an example, if common stock investment is aggressive, then the corporate trustee pension funds must be deemed performance oriented. Even insured plans represent sophisticated money management in these circumstances. The anomalous feature to pension fund behaviour is represented by public funds such as the Canada Pension Plan itself, or, at the local level, the Metropolitan Toronto Police Benefit Fund.

The performance of public funds, and the obvious conflicts of interest that are inherent in the management, have both been explained on the basis of broad public policy considerations. Government has a need for capital. Public servants, employees of government, as a "public duty" should meet that need. And, evidently this applies as well to the citizenry funding the Canada Pension Plan. Sacrifice is expected; the same objectives evidently are not to be obtained through general tax laws applicable to all, to businesses as well as citizens.

The public employees can make the sacrifice twice, once through the Canada Pension Plan, and once through the pension of the government department. Such a feature is unique in the study of financial institutions in Canada. The Government's need for money, or its desire to steer investment capital in certain directions, has usually taken the form of controlling all members of the institution, or persuading the institution as a whole. There are few other examples of regulation involving a particular member in the group. It is a perplexing situation. If the acknowledged public policy makes pension fund capital available for government use, then at a minimum, all pension funds should seemingly be obliged to buy, for example, Government of Canada Bonds. If the financing of public projects is currently being done with public pension funds, it is difficult to understand why all pension funds, or more broadly, all financial institutions, should not participate in this goal. The public

fund area of pension funds represents a unique conflict of interests, but more particularly, highly discriminatory practice in regulation and control.

Pension funds are not static; they are growing, but it is difficult to gain perspective on their behaviour. A provincial regulatory framework exists; mandatory uniform regulation has been obtained. Its objectives, however, are narrow. It is concerned primarily with funding. The use of law as a regulatory device in a capital short economy is yet to be examined seriously. Public employees, for example, have been the object of discriminatory treatment. The law has been framed broadly. It has not been used to articulate public policy in the use of pools of accumulated capital such as pension funds. It has not been used to order a scale of priorities that could, for example, require a percentage of all pensions to be invested in residential mortgages.

And perhaps just as important, the law has not set a code of regulatory behaviour for the institution of pension funds in which most financial institutions participate. There is the opportunity to move away from rigid, non-realistic institutional lines, to recognize the similarity of trust companies to life insurance companies. There is the opportunity to regulate the *function* as contrasted to the institution.†

†Editor's Note: This Article is one of a series by Professor Baum which sets forth the role of various institutions in the development of Canada. The other articles are: *Catalyst for Change: Mutual Funds in Canada*, 59 GEO. L.J. — (1971); *Giants of Finance: The Banks of Canada*, 59 GEO. L.J. — (1971); and *The Near-Banks: The Trust Companies of Canada*, 45 TUL. L. REV. — (1971). These articles will be available in 1971 as a book entitled—THE SILENT PARTNERS OF CANADA: INSTITUTIONAL INVESTORS AND CORPORATE CONTROL.