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Give Pension Funds Greater Voice; Scrap 30 percent Limit on Voting-Equity Stakes: C.D. Howe Institute

Toronto, Feb. 25 – Regulators should eliminate the 30 percent rule that limits pension funds from holding more than 30 percent of the voting equity in a corporation, according to a study released today by the C.D. Howe Institute. In *A Matter of Voice: The Case for Abolishing the 30 percent Rule for Pension Fund Investments*, law professor Poonam Puri points out that pension fund managers have devised elaborate ways to effectively skirt the rule. She makes the case that it is time for regulators to enforce the rule or eliminate it entirely, and give pension funds a voice commensurate with their equity stake.

Professor Puri says regulations designed to ensure the stability of pension plans through diversification currently take two forms: general “prudent person” standards which managers must comply with, and a series of more specific quantitative rules which restrict the activities of pension managers. One particular rule, the 30 percent rule, she says, is an impediment to the investment decisions of Canadian pension plans. The paper argues that the rule should be eliminated in favour of greater reliance on a principles-based approach.

The 30 percent rule restricts pension plans from holding more than 30 percent of the votes eligible to elect the board of directors of a Canadian corporation. The original motivation was to encourage passive investment by financial institutions and prevent the concentration of ownership of commercial business by Canadian financial institutions. In practice, the rules do not restrict managers from taking large stakes in corporations, but do require them to construct elaborate transactions in order to satisfy regulators.

The author outlines three principle challenges to the 30 percent rule: 1) the rule is only subject to superficial compliance as regulators have allowed companies to work around the rule, resulting in unnecessary complexity and increased transaction costs; 2) since no other OECD jurisdiction has a similar rule, Canadian plans are at a disadvantage relative to foreign competitors when competing for a given investment; and 3) there are governance problems that result from disaggregating ownership from control.

A better method than quantitative restrictions, says the author, is to rely on prudent person standards. This allows managers to use their expertise and discretion in constructing their portfolios. The author explains the case for adopting prudent person standards combined with appropriate guidance and direction to pension fund managers in place of quantitative restrictions. Her evaluation of the potential reforms leads to the conclusion that the 30 percent rule should be eliminated.

The Commentary *A Matter of Voice: The Case for Abolishing the 30 percent Rule for Pension Fund Investments* is available at www.cdhowe.org.

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A Matter of Voice: The Case for Abolishing the 30 percent Rule for Pension Fund Investments, C.D. Howe Institute Commentary No. 283, by Poonam Puri (February 2009). 15 pp; \$12.00 (prepaid, plus postage & handling and GST – please contact the Institute for details). ISBN 0-88806-74&-X.

Copies are available from: Renouf Publishing Company Limited, 5369 Canotek Road, Ottawa, Ontario K1J 9J3; or directly from the C.D. Howe Institute, 67 Yonge St., Suite 300, Toronto, Ontario M5E 1J8. The full text of this publication is also available from the Institute's website at www.cdhowe.org.