THE law

A pleasant surprise

The FPR's removal means simplified administration and greater opportunities for investment of retirement plan assets. **By Paul Litner**

It is nice to be able to report on a legal development that is good news for plan sponsors. The federal government's 2005 budget gave the Canadian pension industry a proposal to repeal the Foreign Property Rule (FPR) applicable to tax-deferred retirement plans, through future amendments to the Income Tax Act (ITA).

The elimination of the current FPR should simplify plan administration, reduce investment costs and facilitate a broader array of investment opportunities for pension plans. In fact, this proposal, once enacted, is likely to have a much larger impact on the industry than the Monsanto case.

The FPR imposes penalty tax on plans where investments in foreign property exceed 30% of the cost amount of the plan's assets. Foreign property consists of shares and debt issued by non-resident entities, as well as investments in certain (Canadian and foreign) trusts and partnerships.

Many different kinds of innovative investments have been created over the years to help pension plans achieve increased international exposure without exceeding the 30% FPR. These have included derivatives and synthetic investments. But these approaches are

often more costly than investing directly in the underlying asset, usually due to management fees. The elimination of the FPR will undoubtedly cause plan administrators to, over the next year, reconsider the need for these structures. Repealing the FPR will also enable registered plans to invest in a wider range of pooled fund trusts and partnerships, many of which are currently considered to be foreign property under the ITA. However, the government intends to release a consultation paper which may propose rules/limits on investments in flow-through entities such as partnerships and income trusts. In addition, proposed new tax rules dealing with non-resident trusts and foreign investment entities are still under consideration.

Post-FPR, there are also interesting legal considerations for those who invest pension plan assets. A pension plan sponsor's overriding legal duty is to prudently invest the plan's portfolio of assets; prudence includes ensuring that assets of the plan are adequately diversified. While the FPR was in place, it would have been difficult to criticize a plan sponsor for investing plan assets in Canada to avoid incurring a penalty. Once the FPR is eliminated, however, penalty tax will not be relevant and sponsors will have to review their investment policies to determine the appropriate level of exposure to foreign investments.

Sponsors must also consider the related risks associated with currency fluctuations and how to manage those risks with increased international exposure. With defined contribution plans, sponsors will need to re-evaluate the range of investment options offered to members. If increased foreign investment is contemplated, members will need to be educated on the risks and benefits.

The proposed repeal of the FPR is effective for 2005, but will not become law until the legislation is actually passed by parliament. While there is a risk the proposal will not ultimately become law, this is unlikely. Plan sponsors should hold off making any major changes until the draft legislation to amend the ITA is available. Once a sponsor does decide to act, it will be necessary to review plan documents and to consider amendments.

Although it raises a number of legal issues, for the most part, the elimination of the FPR can only be described as good news for those who administer and invest pension assets. **BC**

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HR Outsourcing Trends

Survey shows strategic sourcing of HR to increase

In order to determine prevalence and trends in outsourcing, Hewitt Associates recently conducted surveys in both Canada and the United States on the subject of strategic sourcing.

The survey results from both countries indicate that most respondents currently outsource only in selected areas. Similar percentages of Canadian and U.S. respondents reported that they currently outsource IT/IS (50% in the U.S., 46% in Canada) and data centre activities (31% in the U.S., 27% in Canada). However, other functions (HR administration, HR call centre, manufacturing, R&D, and customer call centre) are outsourced with approximately twice the frequency in the U.S.

Looking ahead three years, survey respondents indicated they were more likely to partly or entirely outsource certain functions, with considerable growth in HR outsourcing in particular. Thirty-four percent of Canadian respondents currently outsource HR administration; that number is expected to grow to 46% in three years' time. Sixteen percent currently outsource their HR call centre. In three years, that number is expected to be 32%. It seems that Canadian organizations are following the U.S. lead with respect to HR outsourcing.

Cost reduction and improved efficiency are the top two most anticipated results of HR outsourcing in both the United States and Canada. The two main reasons for not outsourcing HR functions are also the same on both sides of the border. Respondents - mostly HR professionals - cited the fact that HR can execute these activities better than any vendors and that HR activities are critical to business success as the two primary grounds for keeping these functions in-house.

However, the trend to outsource HR in the U.S. and the anticipated increase in HR outsourcing in Canada suggest that survey respondents are able to overcome these barriers. That doesn't surprise Rob Rochkin, Vice President of HR at Aramark Canada Ltd.: "Focusing on core competencies and outsourcing non-critical activities is becoming a more pre-valent business strategy," says Rochkin. "Organizations that are service providers themselves were naturally the first to detach themselves from the emotional aspect of sourcing decisions. Now more companies are beginning to see that outsourcing can be beneficial to both their business and their employees when better service is provided at lower cost."

Hewitt's survey results indicate that the outsourcing of non-core functions is likely to continue - and the willingness to outsource HR activities in particular will increase - as organizations strive to be more efficient and use available resources more strategically.

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