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Osler, Hoskin
& Harcourt LLP

**SUBMISSION TO THE FEDERAL DEPARTMENT OF FINANCE:
STRENGTHENING THE LEGISLATIVE AND REGULATORY FRAMEWORK
FOR PRIVATE PENSION PLANS SUBJECT TO
THE PENSION BENEFITS STANDARDS ACT, 1985**

OSLER, HOSKIN & HARCOURT LLP

MARCH 16, 2009

I. WHO WE ARE

We are lawyers from the Pensions & Benefits Department of Osler, Hoskin & Harcourt LLP. Osler is a law firm with over 450 lawyers in Toronto, Montreal, Calgary, Ottawa and New York, which provides legal services to corporations in a wide variety of business law specialties.

The Osler Pensions & Benefits Department has 22 lawyers in our offices in Toronto, Montreal, Calgary and New York, plus another 10 who have been cross-appointed from the Litigation and Tax Departments. On average, the partners in our Department have over 19 years of experience. We provide advice to pension plan sponsors and administrators on the legal and regulatory aspects of pension plans and employee benefit plans, including: governance, fiduciary responsibilities, plan administration and compliance, pension fund investment, multi-employer pension plans (“MEPP”), pension committees, public sector plans, plan wind-ups, surplus utilization strategies, and the negotiation and drafting of plan and trust documents.

We have also made submissions in relation to other recent pension reform initiatives, including the Ontario Expert Commission on Pensions (the “OECF”) and the Alberta/British Columbia Joint Expert Panel on Pension Standards (the “JEPPS”).

As such, we offer the unique perspective of lawyers in a multi-jurisdictional pensions and benefits practice who are familiar with the numerous legal and regulatory issues facing pension plans across the country, as well as other reforms of Canada’s pension systems.

II. SUMMARY OF OUR SUBMISSION

In making this submission, we have responded to the issues raised by the Government of Canada (the “Government”) in its January 2009 discussion paper, “Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the *Pension Benefits Standards Act, 1985*” (the “Discussion Paper”).

Our submissions have been made from the perspective of practicing lawyers in the field of pensions and benefits. As a result, much of our submission has focused on the legal and regulatory issues affecting pension plans. For non-legal questions, we have drawn on our general experience and knowledge of pension plans, but we have not attempted to address actuarial and economic matters.

In our view, the key to ensuring the well-being of occupational pension plans is to provide incentives that encourage employers to continue to establish, participate in, improve and maintain such plans. However, currently pension plan sponsors and administrators are often faced with a complex and restrictive legal environment which adds to the time and costs required to manage pension plans and often increases their legal risks. The current financial crisis, in particular, has highlighted the need for greater flexibility and reduced administrative complexity. Changes to the federal pension regime should allow for innovation and eliminate statutory impediments preventing employers and employees from choosing pension programs that work best for them.

We recognize that implementation of the changes proposed herein will take time, as policy considerations will need to be weighed. Thus, we have set out our summary in order of priority so as to indicate those items which, in our view, are of key importance.

High Priority

Many of our defined benefit (“DB”) plan sponsor clients are telling us that they are facing critical planning choices between the need to finance their business operations and avoid layoffs, and complying with the current federal solvency funding rules. The clear consensus is that the need for funding relief should be given the highest priority on the government’s pension reform agenda. Indeed, many other Canadian jurisdictions have already adopted funding relief measures.¹ To be effective, solvency funding relief should be implemented on a basis that does not require either member consent or letter of credit security.

Once the Government has addressed the current solvency funding crisis, we would recommend that the Government focus on the following issues:

- Ensure that, in the long term, DB plan sponsors have much needed funding flexibility by making the following permanent changes to the federal *Pension Benefits Standards Act, 1985* (the “PBSA”): (i) extending the amortization period from five to 10 years (and not making such extension subject to member consent or letter of credit requirements); (ii) permitting all or a portion of a plan’s solvency deficiency to be funded through (voluntary) letters of credit; (iii) permitting contributions to solvency accounts; and (iv) providing the Superintendent of Financial Institutions (the “Superintendent”) with the discretion to approve other flexible funding arrangements (e.g., case specific discount rates).
- Do not limit contribution holidays to the year in which a valuation report is filed with the Office of the Superintendent of Financial Institutions (“OSFI”). Rather, permit plan sponsors to undertake some form of “simplified” annual valuation update to support continued contribution holidays in between more formal actuarial filings.
- Provide more regulatory guidance to sponsors of defined contribution (“DC”) plans. Specifically, establish a default investment option and “safe harbour rules”. In addition, consider the implementation of a statutory defence for DC plan administrators similar to the protection that corporate directors receive through the business judgment rule.
- Clarify that the surplus in the DB component of a hybrid plan may be used to meet a plan sponsor’s obligations under the DC component of the same plan.
- Update the investment rules in Schedule III of the PBSA (the “Federal Investment Rules”) to remove (or create exemptions from) quantitative restrictions that act as an impediment to the effective and prudent investment of pension assets.

¹ For example, Alberta, Manitoba, Québec, and Newfoundland have already passed amendments to either their pension benefits legislation or regulations to deal with pension plan solvency funding relief.

Other Recommendations

The Discussion Paper raises a number of other issues to which our responses may be summarized as follows:

- When a plan is fully wound up or terminated, it is reasonable to require the plan sponsor to fund the pension benefits within a five year period, but to ensure that any existing credit arrangements are not disrupted, any accelerated obligations should rank as an unsecured debt. In addition, it would be helpful to provide plan sponsors and plan members with the flexibility to negotiate alternative arrangements.
- Now that the Federal Court of Appeal's decision in *Marine Atlantic*, which determined that surplus need not be distributed in a PBSA partial plan termination, is final (as discussed below) consideration could be given to amending the PBSA to expressly reflect the decision. Similar legislation has existed for years in a number of other Canadian jurisdictions (e.g., Alberta and British Columbia).
- It is reasonable to require plan sponsors to establish a Statement of Funding Policy ("SFP"), provided that the requirements to be met by plan sponsors when drafting a SFP are clearly set out.
- Expanding pension plan disclosure to include electronic forms of communication is welcome, but communication requirements should focus on active members or, in the alternative, should specify that plan administrators need only send communications to former members based on the most recent contact information in their records.
- It is reasonable to specify that a solvency ratio of 0.85 be established as the threshold for void amendments, provided that the Superintendent retains the discretion to grant relief from such a provision where circumstances warrant.
- It should be permissible to make direct payments from DC accounts, provided that this option is offered at the discretion of the plan sponsor.
- Greater pension plan coverage should be encouraged through the promotion of alternative plan designs, including larger, pooled DC arrangements. As a part of such promotion, the PBSA should be amended to provide more guidance to administrators of MEPPs.

For ease of review, we have set out our response to the questions raised by the Government in the same order that they appear in the Discussion Paper. However, as we have highlighted above, certain items should be considered of highest priority.

III. OUR RESPONSE TO ISSUES RAISED IN THE DISCUSSION PAPER

A. Issues Pertaining to DB Plans

1. The Government of Canada is interested in stakeholders' views regarding the rules for funding solvency deficiencies and the solvency calculation itself.

As the Discussion Paper recognizes, pension plan solvency funding requirements can put a “significant strain” on a DB plan sponsor’s financial resources and, in turn, on its ability to operate its business, for example:

- Limited funding flexibility requires plan sponsors to respond to ever increasing pension plan costs (e.g., increased retiree longevity, rising plan administration costs) and volatility in the funded status of DB plans by continually contributing additional amounts to the plan.
- The need for large, solvency-driven cash contributions to a DB plan in the short term can turn into “trapped capital” in the future, causing pension surplus issues. The potential for accumulations of trapped capital in a pension plan can clearly act as a disincentive for fully funding plans which, in turn, may exacerbate any future plan funding problems.

Temporary Measures

In the past, and most recently in its 2009 Budget (the “Budget”), the Government has responded to solvency funding difficulties by proposing various temporary measures. More specifically, the Budget (and a subsequent OSFI communication) proposed that plans be allowed to extend their solvency funding payment schedule from five to 10 years in respect of solvency deficiencies reported at a plan year-end date from November 1, 2008 to October 31, 2009, subject to both members and retirees agreeing to the extended schedule, or the difference between the five and 10-year payment schedule being secured by a letter of credit. While we were pleased to see the Government’s quick response to the current financial crisis, we are of the view that the measures proposed in the Budget require revision and clarification, and that (as discussed below) permanent measures must also be taken to enhance funding flexibility in the long-term.

To be effective, and to put federal plan sponsors on a more equal footing with sponsors in a number of other Canadian jurisdictions, we strongly urge the Government to take quick action to finalize and implement solvency funding relief on a basis that does not require either member consent or letter of credit security. While we acknowledge the critical importance of pension security for plan members and pensioners, both of these pre-conditions to any temporary solvency funding relief measures are highly problematic, and fail to adequately recognize the significant logistical, employee relations and credit obstacles they entail.

For example, member consent, even the so-called “negative consent” options currently in place in some provinces, involve lengthy delays and uncertain outcomes at a time when speed and certainty are key to ensuring that employers are able to take advantage of the relief measures quickly, so that they achieve their desired result of helping employers, their workforces and their pension plans to survive this difficult economic cycle.

Also, we are of the view that it should be made clear as a part of any solvency relief legislation (and indeed pension legislation generally) that the decision to take advantage of any funding relief (and any related filings) is one that a plan sponsor makes as employer (and not as plan administrator). In our view this is essential to enable employers to take advantage of the relief without fear that they could be subject to subsequent allegation that in making this decision they somehow failed to properly exercise their fiduciary obligations as plan administrator.

As such, we would recommend that the Government act quickly to implement solvency funding relief, and not make such relief subject to obtaining member consent or a letter of credit.

Permanent Measures

In order to ensure that, in the long term, plan sponsors are provided with much needed funding flexibility, while plan members' benefit security is maintained, we would recommend that the Government consider making the following *permanent* changes to the PBSA:

- Extended Amortization Period: The solvency deficiency amortization period should be permanently and unconditionally changed from five to 10 years for all current and future solvency deficiencies. Specifically, the extension should not be subject to member consent conditions or letter of credit requirements, but voluntary letters of credit would be permissible, as discussed below.
- Voluntary Letters of Credit: In the past, the Government has enacted regulations to permit the use of letters of credit for solvency funding on a *temporary* basis. However, since then other jurisdictions, such as Alberta, have passed *permanent* regulatory amendments to permit all or any portion of a plan's solvency deficiency to be funded through a letter of credit. In our view, the Government should follow suit and enact similar permanent amendments. With the passing of such legislation, sponsors of DB plans will be able to better manage solvency deficits and achieve potential savings that may enhance their productivity and competitiveness in the economy. Through better management of funding levels, companies will be able to avoid large (solvency driven) cash contributions in the near term that may turn into trapped capital (surplus) in the future. In addition, letters of credit provide security to plan members in that it is a direct obligation of the financial institution that issued it, and is not contingent on the sponsor's solvency.
- Voluntary Solvency Accounts: Amend the PBSA to permit contributions to solvency accounts, which would be available as a plan asset if needed (i.e., in the event of a plan termination). However, these accounts would permit employers to more freely use account funds that are not required to protect the solvency position of the plan and would remove a major disincentive to fully funding plans. We note that the JEPPS report recently recommended permitting such accounts.²

These suggestions should not be the only flexible funding options available. In our view, the Superintendent should also have the discretion to consider and approve other flexible funding

² See Recommendation 8.1.2-A of the JEPPS report.

arrangements (e.g., the extension of amortization periods or case specific discount rates³) that continue to effectively balance the legislative objectives of security of benefits for plan members and stability of costs for plan sponsors, taking into account the long term nature of a pension plan and the competing demands for capital faced by all plan sponsors in operating their business.

2. **The Government of Canada is seeking views on whether to require that plan sponsors fully fund pension benefits when a plan is fully terminated, but provide that payments can be made over a period of five years, and treat the outstanding obligation as an unsecured debt of the company. In addition, the Government is seeking views on conditions, if any, where a plan could be terminated in an underfunded position by virtue of an agreement between the sponsor and plan members.**

Most jurisdictions in Canada require that when a plan is fully wound-up (or terminated), plan sponsors fully fund the pension benefits within a five year period. In our view, it makes sense for the Government to institute a similar change for federally registered plans, as it would promote consistency with these other jurisdictions and provide better benefit security for plan members. To avoid disrupting existing credit arrangements, any such accelerated obligation should rank as an unsecured debt.

The Discussion Paper's additional suggestion that plan sponsors and plan members be permitted to negotiate an agreement whereby the plan would not be fully funded on termination, but rather benefits would be reduced in exchange for some other form of compensation, while not necessarily consistent with other jurisdictions, might provide plan sponsors with greater flexibility. We are of the view that such flexibility would be beneficial, as it would permit the affected parties to respond to circumstances which may warrant the implementation of alternative arrangements.

3. **The Government of Canada is seeking views on whether to eliminate the concept of partial termination from the Act but require immediate vesting of pension benefits for all members.**

As a result of the *Monsanto*⁴ decision, plan members have argued that partial termination benefits be expanded beyond immediate vesting to include surplus distribution. For plans registered under the PBSA, the Federal Court of Appeal has held that plan sponsors do not have to distribute surplus on the partial termination of a DB plan.⁵ As a result, while uncertainty surrounding the surplus distribution implications of partial plan terminations may continue to discourage plan sponsors in Ontario and a number of other Canadian jurisdictions from fully

³ For example, the use of larger discount rates that would reflect investment portfolios other than long-term Government bonds could be permitted.

⁴ In *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, [2004] 3 S.C.R. 152 ("*Monsanto*"), the Supreme Court of Canada ("SCC") found that the Ontario *Pension Benefits Act* requires the distribution of a proportional share of surplus when a DB pension plan is partially wound up (not at some future date when the plan is fully wound up, as had been the practice prior to this case).

⁵ In *Cousins v. Canada (Attorney General) and Marine Atlantic Inc.*, (2008) 68 C.C.P.B. 54 ("*Marine Atlantic*") the Federal Court of Appeal held that *Monsanto* did not apply in the federal context; leave to appeal to the SCC was denied on March 5, 2009.

funding their plans, this is no longer the case for federal plan sponsors. However, consideration could be given to amending the PBSA to expressly reflect the Federal Court of Appeal decision. Similar legislation has existed for years in a number of other Canadian jurisdictions (e.g., Alberta and British Columbia).

With respect to immediate vesting other than in the context of a partial plan termination, the Government should understand that many plan sponsors may oppose such a reform on a number of grounds including:

- the added cost - depending upon the degree and demographics of employee turnover; and
- the potential negative impact on employee retention and training costs.

4. The Government of Canada is seeking views on whether to:

- **Require administrators to establish a SFP in a similar fashion as the Statement of Investment Policies & Procedures (“SIP&P”). The SFP would be examinable upon request, like the SIP&P.**
- **Allow required disclosure items to be disseminated by electronic means, at the option of the receiving member or beneficiary.**
- **Expand the categories of members required to receive plan information to include former members and retirees, where it is appropriate.**

Increased plan transparency can enhance pension plan governance, which, in turn, helps to ensure that plan administrators meet fiduciary obligations and statutory standards of care, increase the efficiency of plan administration, and reduce legal, funding and other risks affecting the pension plan. However, as we discuss below, we are also of the view that it is important to ensure that any such enhancements do not complicate plan administration to the extent that they act as disincentives to maintaining and continuing DB plans.

Statement of Funding Policy

In our view, it is reasonable to require plan sponsors to establish SFPs, particularly in light of the funding difficulties which have been recently encountered by many plan sponsors. This suggestion is consistent with pension reform initiatives in other jurisdictions, including the JEPPS report, which recommended that all DB plans be required to have a funding policy.⁶ However, it is important to ensure that the requirements to be met by plan sponsors when drafting a SFP are clear. Thus, it would be helpful to outline, in regulation, the necessary elements of a SFP – similar to the requirements for a SIP&P. For example, the JEPPS report suggests that a SFP including the following:

- an explanation of the purpose of the policy;
- a summary of the risks to which the plan’s funded status is exposed;

⁶ See Recommendations 7.1-B and 7.1-C of the JEPPS report.

- a description of the policies adopted to protect the plan’s funded position against the risks identified (e.g. asset valuation methodology, how economic assumptions are developed, funding margins, funding thresholds for benefit increases and decreases); and
- an explanation of how the funding policy was developed (the rationale for the policy selected to protect the plan’s funded position against the risks identified).

The SFP could also include a formal policy on contribution holidays, as suggested below.

Disclosure Requirements

We understand that the Government is proposing that plan transparency be enhanced by requiring that annual statements (similar to those currently provided to active members) be provided to retirees and deferred vested members. In order to facilitate such additional disclosure requirements, the Government has also suggested that plan sponsors be permitted to disclose items via electronic means.

Certainly, improving plan transparency can be beneficial and promote better pension plan governance. Also, in light of most people’s reliance on and familiarity with electronic forms of communication, expanding the methods for pension plan disclosure to include electronic means would be helpful for plan members who prefer to receive communications in that manner, and offer an efficient and cost-effective communications alternative for plan sponsors.

That being said, we do, however, have concerns with the Government’s proposal to expand the class of persons entitled to receive annual plan information to include deferred vested members and retirees. In our experience, it can be very time consuming and costly to locate former plan members and deferred vested members, in particular. As such, requiring plan sponsors to provide annual statements to former plan members adds yet another administrative complexity, increases the time required to manage the plan, and, in turn, may discourage plan sponsors from continuing or maintaining such plans. One way to alleviate this concern may be to clarify that plan administrators need only send communications to inactive members based on the most recent address on company records, and otherwise need not search for current addresses if such records are deficient or if communications are returned because the address is not current. We would also note that some of the other pension reform initiatives have focused on disclosure to active plan members. For example, the JEPPS report specified in its recommendations that plan administrators be required to “disclose to *members* key information”.⁷

In our view, OSFI’s oversight of federally regulated plans ensures that the interests of former members are sufficiently protected. For example, OSFI runs solvency (stress) tests on a semi-annual basis to estimate solvency ratios for all DB pension plans. This test provides OSFI with important information, allowing it early detection of solvency and funding problems, which, in turn, helps OSFI to safeguard members’ and former members’ benefits. Therefore, we would recommend that any disclosure requirements (whether existing or enhanced) focus on providing the requisite information to active plan members.

⁷ See Recommendation 7.1.2-A of the JEPPS report.

5. The Government of Canada is seeking views on whether:

- **Plan sponsors be required to develop a formal policy on contribution holidays for inclusion in an SFP; and**
- **To the extent that employer contributions are permitted under the tax rules, plan sponsors only be permitted to take a contribution holiday in the year in which a valuation report, filed with OSFI, shows a surplus in the plan on a solvency basis.**

Plan sponsors should be able to take contribution holidays provided that they continue to meet prescribed plan funding requirements, and members' promised benefits are protected. As a part of the protection of member benefits, in our view it is reasonable to require plan sponsors to include a formal policy on contribution holidays in their SFP. This also increases transparency, which, as we noted above, we generally support.

We are of the view, however, that the Government's proposal to limit contribution holidays to one year is overly restrictive. We understand that this measure is intended to prevent plan sponsors from continuing to take contribution holidays based on actuarial valuations that have become materially "out of date" due to deteriorating assets. However, where a pension plan is in sufficient surplus, it does not make economic sense to trap that surplus in the plan, based on a "blanket" provision limiting all contribution holidays to a one-year term. In addition, it must be recognized that annual valuation filings may represent a burdensome and needless expense.

In the alternative, we would suggest that the Government permit plan sponsors to undertake some form of "simplified" annual valuation update to support continued contribution holidays in between more formal actuarial filings. Specifically, we would suggest that a simplified mechanism for making such a determination, including the methodology and assumptions the actuary should use, be clearly set out in the regulations. For example, a method akin to the "stress" testing that OSFI does on a semi-annual basis to estimate solvency ratios for all DB pension plans (as discussed above in our answer to Question A.4) could be implemented.

6. The Government of Canada is seeking views on whether to amend the regulations to prescribe a solvency ratio level of 0.85 for the purpose of implementing the void amendment provision in the Act.

We understand that the Government has proposed that a solvency ratio of 0.85 be established as the threshold for void amendments under section 10.1(2)(b) of the PBSA, in order to prevent an underfunded plan from implementing an amendment that would further reduce its funded position. We agree that it is important to ensure that pension plans are adequately funded, and a solvency ratio of 0.85 does appear to be a reasonable threshold. There may be circumstances, however, where a plan amendment that reduces the solvency ratio below 0.85 is necessary. As such, we are of the view that it is important for the Superintendent to continue to have the discretion to grant relief from such a provision (as is currently provided under section 10.1(2)).

B. Issues Pertaining to DC Plans

1. The Government of Canada is seeking views on the practicality and desirability of safe harbour protection, and what considerations should be made in the determination of the qualified default investment options.

In our view, any default investment option should focus on capital preservation or other low risk investment options that are clearly disclosed to the plan members as the default option. Once the Government develops a position on what constitutes proper default investment options, clear guidelines as to what is expected of plan sponsors seeking to rely on these default options should be provided. In our view, it would be appropriate for such guidelines to take the form of “safe harbour rules”, which would enable DC plan administrators to reduce their risk related to plan member investment choices by meeting specified criteria. As the Discussion Paper notes, safe harbour rules and “qualified default investment alternatives” have been implemented in the United States.⁸ Safe harbour rules (which should be no more onerous than rules applicable to registered retirement savings plans or deferred profit sharing plans in order to ensure a “level playing field”) could, for example, include some or all of the following requirements:

- a minimum number of investment options must be offered to plan members in addition to the default option;
- investment options that are offered must represent a sufficiently broad range of alternatives to allow an acceptable degree of diversification at the discretion of members apart from the default option;
- plan members must be able to change their investment choices relatively easily;
- plan members must be provided with investment information (e.g., how different investment funds work, the potential risks and returns associated with different types of investments, performance reports); and
- plan members must be provided with investment-decision making tools (e.g., asset allocation models, and/or calculators to help determine required contribution levels).

We recognize, however, that both the JEPPS and Nova Scotia reports specifically rejected safe harbour rules, considering them too prescriptive. The JEPPS report did suggest, though, that plan sponsors who can demonstrate adherence to a “pension judgment rule” be provided a statutory defence similar to the protection that corporate directors receive through the business

⁸ In the United States, certain “safe harbour” rules under *Employee Retirement Income Security Act* (“ERISA”) provide a plan sponsor with relief from specific fiduciary duty liabilities provided that the plan satisfies specified requirements. For example, sponsors of “individual account plans” that permit participants to direct the investment of assets in their accounts among a broad range of investment alternatives and that meet certain conditions outlined in ERISA (e.g., at least three investment options with different risk and return characteristics, ability to change investments at least quarterly and sufficient information to allow informed investment decisions) will not be liable for any loss that is the result of a participant’s exercise of control over the assets in his account. The *Pension Protection Act of 2006* and related regulations added a new safe harbour, which defined qualified default investments and protected plan sponsors from liability should they select such investment options. (Plan sponsors, however, are still required to prudently select and monitor the available investment alternatives and perform other fiduciary duties.)

judgment rule. Thus, should the Government decide not to proceed with safe harbour rules, we would suggest that it consider instituting a similar pension judgment rule, which we discuss in further detail below, in our answer to Question B.3.

2. The Government of Canada is seeking views on whether to allow the payment of variable retirement benefits directly from the DC account.

Currently, the PBSA requires DC benefits to either be annuitized at retirement or transferred to a registered retirement vehicle. It is not possible to leave DC benefits in a federally registered plan for pension conversion.

However, as the Discussion Paper indicated, payments directly from DC accounts have been permitted in other jurisdictions. For example, Alberta recently amended its pension legislation to authorize “DC Retirement Income Accounts”, which provide sponsors of DC plans with the option of offering a pension benefit payable directly from the DC plan, similar to a life income fund payment.

In our view, it would be reasonable to permit a similar option for federally registered plans. However, as the Discussion Paper notes, a direct payment option would add to plan administration costs, and as such this option should be offered at the discretion of the plan sponsor.

3. The Government of Canada is seeking views on whether it is appropriate to revise the standard of care for employers sponsoring DC plans to ‘good faith’ rather than ‘fiduciary’.

As we discuss below in our answer to Question C.4, there are many differences between DB and DC plans which mean that, in many respects, DB and DC plans should be subject to different legislative and regulatory requirements. One of the primary concerns for plan sponsors and administrators is the identification of those matters of responsibility that will attract a standard of care and those that will not. While changing the standard of care for administration of DC plans from “fiduciary” to “good faith” could respond to some of these concerns and, potentially, encourage sponsors to provide DC plan coverage by reducing administration risks, members may be concerned that a seeming “relaxation” of the standard of care could undermine responsible plan governance in cases where a well defined standard of care may be appropriate.

A better approach may be to follow the suggestions in the JEPPS report to permit plan sponsors to rely on a “pensions judgment rule” (similar to the business judgment rule) as a statutory defence. Specifically, the JEPPS report noted that the business judgment rule offers a defence if the decisions were made:

- in good faith;
- on an informed basis (including obtaining expert advice, where appropriate);
- in the interests of the corporation; and

- in the absence of conflicts of interests.⁹

By implementing such a rule, plan fiduciaries would be encouraged to follow good practices and processes, without having to be concerned that every decision could lead to litigation and potential liability even where prudence and diligence have been exercised in the decision-making.

We also note that the JEPPS was of the view that the pension judgment rule could be utilized by sponsors of all types of plans when making fiduciary decisions. Similarly, the Government may want to consider extending the protections of a pension judgment rule to sponsors of DB as well as DC plans.

4. The Government of Canada is seeking views on whether it is appropriate to clarify that DB surplus can be used to offset employer’s DC current service costs for hybrid plans.

While courts have recognized that surplus in the DB component of a hybrid plan may be used to meet a plan sponsor’s obligations under the DC component of the same plan (so called “cross-subsidization”)¹⁰, there is still some uncertainty, as the Canadian case law is not yet settled¹¹, and there continues to be an emphasis on the need to review historical plan documents. This uncertainty is another example of the disincentive that exists to fully fund DB plan components for fear of creating trapped capital (surplus). The PBSA should encourage flexibility in the utilization of plan assets to fund all types of plan benefits, whether DB or DC.

Accordingly, it would be very helpful if the Government provided plan sponsors with much needed certainty, by clarifying that surplus in a DB component of a hybrid plan can be used to fund the current services costs for the DC component. We note that such a clarification, subject to certain requirements, was also recommended by the OECP¹² and the JEPPS¹³.

5. The Government of Canada is seeking views on required administrative practices that may impede the proper and efficient administration of DC plans.

In our experience, many plan administrators find the continued administration of the accounts of deferred vested members, some of whom it is not possible to locate, costly and inefficient. We are of the view that it would be more effective to:

⁹ See the discussion on p. 113 of the JEPPS report.

¹⁰ In *Kerry (Canada) Inc. v. DCA Employees Pension Committee* (2007), 60 C.C.P.B. 67, (“*Kerry*”) the Ontario Court of Appeal found that surplus in the DB portion of the plan could be used to meet the employer’s contribution obligations under the DC component of the plan, provided the plan was properly structured so as to make the members of the DC component beneficiaries of the plan’s DB and there was nothing in the original plan text and trust which prohibited contribution holidays. Also see *Barclays Bank plc v. Holmes* [2000] PLR 339 Ch.

¹¹ The *Kerry* case was heard by the Supreme Court of Canada in November of 2008. As of the date of this submission, a decision was still pending.

¹² See Recommendation 5-21 of the OECP report.

¹³ See Recommendations 8.1.2-B and 8.1.3-F of the JEPPS report.

- require such members to transfer out their benefits, upon termination of their employment, to some form of retirement account (e.g., a registered retirement savings vehicle); or
- provide a procedure for payment to be made to a public body in respect of unlocateable former plan members.¹⁴

The larger issue facing administrators of DC plans, however, is the lack of regulatory guidance in general (i.e., much of the PBSA is aimed at DB plans). We discuss this issue further, below, in our answer to Question C.4.

C. Other Issues Respecting the Framework for Private Pension Plans

1. The Government of Canada is seeking views on whether there is interest in alternative plan designs that may not currently be accommodated by the legislative framework.

In our view the Government should promote greater pension coverage by actively encouraging pension plan arrangements other than conventional single-employer pension plans (“SEPPs”). The Canadian economy has changed greatly since employers first began to provide pension plans to their employees, and it is time that Canadian pension arrangements adapted to these changes. For example, the Government could consider amending the PBSA as follows:

- promoting broadly available (e.g., industry-wide) pension plans that would better achieve economies of scale (i.e., opportunities for pooling of capital and risk), improve portability of the workforce, reduce the risk of plan wind-ups (unless wide-spread industry/sector downsizing), and enable employees to participate in a plan whether or not their employer (or union) chooses to sponsor one; and
- enabling existing large, sophisticated plans to manage funds and/or provide plan administration services on behalf of other unrelated pension plans or organizations (this would allow smaller employers, who do not want to incur the cost or responsibility of administering a DB plan on their own, to offer employees access to a well managed DB plan).

Certain of these types of plans or arrangements (i.e., MEPPs) currently exist in some industries, but there is little specific guidance in the PBSA dealing with how MEPPs are to be regulated. This may act as a disincentive when employers consider whether to adopt such a plan. (See our answer to Question C.2, below, for further discussion of MEPPs.)

¹⁴ For example, the OECF recommended that an “Ontario Pension Agency” be established to “receive, pool, administer, invest and disburse stranded pensions in an efficient manner”. See Recommendations 5-2 and 5-7 of the OECF report.

2. The Government of Canada is seeking views on whether there are legislative impediments to the creation or operation of MEPPs, and if there are improvements that could usefully be made to the legislative framework for these arrangements.

MEPPs

MEPPs have very different risk and reward characteristics as compared to SEPPs. MEPPs, by their very nature, involve the participation of a number of unrelated employers who have no control over each other's financial circumstances. Sponsor bankruptcies, particularly where they involve a number of participating employers, may, in turn, affect the funded status of the MEPP. Often an underfunded MEPP's only course of action is to reduce benefits unless member and/or employer contributions can be increased. This is quite different from a SEPP.

Notwithstanding these differences, much of the PBSA is aimed at SEPPs, and there is very little guidance specifically for MEPPs. This lack of guidance may act as a disincentive to employers. In our view, the Government should encourage the formation of MEPPs and other similar jointly sponsored or co-operative plans by providing potential participating employers with some specific guidance. For example, the PBSA should be amended to address the distinct risks associated with MEPPs (e.g., clarifying that employers participating in a MEPP are only liable for their contribution obligation and will not be held jointly and severally liable for plan deficits).

Pooled DC Plans

The Discussion Paper also proposed the establishment of larger, pooled DC arrangements. As we noted above, in our answer to Question C.1, a large multi-employer DC pension plan that can take advantage of economies of scale by pooling capital and risk is an option that should be made available to plan sponsors and members. We note that a number of the provinces have been considering such an arrangement. For example, the JEPPS included a recommendation for such a plan, being the "ABC Plan", in its report¹⁵.

3. The Government of Canada is seeking views on the relevance of Simplified Pension Plans, and whether there are any impediments in the legislation to the adoption of such arrangements.

We understand that Simplified Pension Plans offer small employers the opportunity to provide a pension plan to their employees, as they have reduced costs and simplified plan administration. We do not have any views, however, with respect to any possible impediments in the PBSA preventing the adoption of such plans.

4. The Government of Canada is seeking views on the appropriateness of reorganising the Act to provide greater clarity on the differing legislative provisions applicable to DB and DC plans. Specific examples of legislative impediments and uncertainties are particularly desired.

Generally, we agree with the OECF, JEPPS and Nova Scotia reports, all of which recommended that legislative provisions need to be tailored to different types of plans.

¹⁵ Chapter 11 of the JEPPS report discusses in detail the feasibility of establishing a multi-employer DC plan for all employers and employees working in Alberta and British Columbia, including the self-employed.

This suggestion is particularly applicable to DB versus DC plans, which vary greatly in structure and risk characteristics. A DB SEPP sponsor must ensure that the plan is funded such that, at retirement, a certain benefit is payable to the member. In contrast, a DC plan sponsor must ensure that plan members have sufficient investment choices and are able to make informed investment decisions in structuring their own diversified retirement savings investment portfolio having regard to their individual risk tolerances and circumstances. These differences mean that, in many respects, DB and DC plans should be subject to different legislative and regulatory requirements. However, as the Discussion Paper notes, much of the PBSA is directed at the administration of DB plans, and the provisions which are applicable to both DB and DC plans do not distinguish between them. As a result, DC plan administrators are often uncertain as to how to ensure regulatory compliance. To give a strong example, it is not clear how the Federal Investment Rules apply to DC plans, if at all.

To reflect these differences, and to fill the void of legislative direction in administering DC plans, we are of the view that: (i) PBSA provisions that apply to all plans; (ii) PBSA provisions that are only intended to apply to DB plans; and (iii) PBSA provisions that apply only to DC plans should each be set out in separate parts of the legislation and regulations.

When enacting separate “DC only” provisions, recognition should be given to the distinct nature and risk characteristics of DC plans. Particular areas of concern are: plan investments and plan member information requirements. As we noted above, in our answer to Question B.1, legislative guidance on DC plan investments could take the form of safe harbour rules. With respect to plan member information, it would be helpful if the PBSA clearly set out the information that DC plan sponsors must provide to their members on an ongoing basis. For example, such information requirements could include the following:

- a summary of the member’s investments;
- a summary of the member’s investment activity and transactions;
- descriptions of the available investment funds;
- information on fees and expenses;
- a summary of contribution details; and
- information to be provided when investments options are being added or removed or any other significant changes are being made.

5. The Government of Canada is seeking views on ways to improve the regulatory framework governing pension investment.

In our experience, certain of the Federal Investment Rules related to quantitative restrictions have become outdated and are no longer practical.

For example, plan administrators are prohibited from investing plan assets in the securities of a corporation to which are attached more than 30% of the votes that may be cast to elect the directors of the corporation (the “30% Limit”). The 30% Limit was implemented at a time when pension funds were largely passive investors that were much smaller than they are now, relative

to the economy as a whole. With the growth in size of public sector plans and the switch to more active investment strategies, the 30% Limit has become problematic:

- complex and costly structures required in order to ensure regulatory compliance act as a disincentive to potential investment partners or as a reason for such partners to exact a “price” for their tolerance of such structures; or
- pension plans may be forced to take a sub-optimal proportion of desirable investment opportunities.

Another example of a problematic requirement is the provision which deals with indirect investments (the “Look Through Rule”). The effect of the Look Through Rule is to require a plan administrator to take into account all of the plan’s holdings (direct or indirect) in a particular company or group of companies for purposes of the 10% rule. This rule is particularly problematic for broadly held pooled investment vehicles.

We note that all of the recent expert commissions, the OECF, the JEPPS and the Nova Scotia panel, emphasized the need to reform the Federal Investment Rules. For example, the JEPPS report recommended that the Alberta and British Columbia pension legislation be “uncoupled” from the Federal Investment Rules “to remove quantitative restrictions on investments and increase reliance on the prudent investor principle.”¹⁶

The Government may also want to consider moving away from the Federal Investment Rules’ quantitative restrictions to more broad-based principles. At the very least, we would recommend that the Government amend the PBSA to permit exemptions from certain Federal Investment Rules (e.g., 30% Limit) for certain pension plans (e.g., pension plans which have a minimum amount of assets, as prescribed) and exemptions from the Look Through Rule for broadly held pooled investment vehicles.

¹⁶ See Recommendations 7.2-A, 7.2-B and 7.2-C of the JEPPS report.