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Osler, Hoskin
& Harcourt LLP

**SUBMISSION TO THE ONTARIO EXPERT COMMISSION ON
PENSIONS**

Osler, Hoskin & Harcourt LLP

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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 24 lawyers in our offices in Toronto, Montreal, Calgary and New York, plus another eight 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 plans, 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 previous reviews of the Ontario *Pension Benefits Act* (the “PBA”) and the regulatory bodies that enforce it. In particular, we participated in the last significant review of the PBA in 1987.

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 the previous reforms to Ontario’s pension system.

II. SUMMARY OF OUR SUBMISSION

In making this submission, we have responded to the applicable questions posed by the OECP in its February 2007 discussion paper, “Reviewing Ontario’s Pension System - What are the Issues? A Discussion Paper for Interested Ontarians”.

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, pension plan sponsors and administrators are faced with a complex and restrictive legal environment, which adds to the time required to manage pension plans and increases the costs and legal risks for pension plan sponsors and administrators. There is also a perception among plan sponsors that the current legislative and legal regime applicable to pension plans hinders them from effectively managing their business. For example, there are a number of instances where the current PBA has been interpreted by the regulators and courts in a manner which has caused many plan sponsors to believe that the system is asymmetrical or unfairly weighted in favour of plan members, and otherwise does not recognize the dynamic business environment in which employers and the pension plans that they sponsor operate.

As we have noted throughout our submission, the key to ensuring the well-being of occupational pension plans is to provide incentives that encourage employers to continue to establish, participate in, or maintain such plans. Changes to Ontario's pension regime should allow for innovation and eliminate statutory impediments to employers and employees choosing pension programs that work best for them.

In order to address this, we believe steps need to be taken in the following areas:

Provide Clear Direction in Legislation

- The PBA should be amended to reflect the legislature's view of appropriate pension policy (not that of the courts).
- Provide over-arching principles to guide and assess those involved in pension regulation. Such principles should include the promotion of pension plans and the delivery of promised benefits, and should recognize and fairly balance the interests of all stakeholders in pension plans.
- Many of the court decisions concerning the application of pension plan (trust) assets may make sense from a traditional trust law perspective, but they do not necessarily result in good pension policy (i.e., promoting long-term health and growth of pension plans for all members). As a result, the PBA should set out specific rules and parameters related to the utilization of plan assets consistent with legislated guiding principles. Such rules would displace the common law and should enable surplus withdrawals, plan mergers/asset transfers, contribution holidays and the payment of plan administration expenses from plan funds (all in the context of ongoing plans) subject to reasonable controls that focus on the protection of accrued benefits.
- The policy rationale behind partial wind-ups and the consequences that flow from them must be reconsidered. We believe that the current partial wind-up rules (and consequences) are no longer useful or equitable. A better approach would be to eliminate partial wind-ups (and the consequences that flow from them, such as "grow-in" benefits) and instead provide improved termination benefits for all plan members. Failing this, the PBA should at least be amended to clarify the situations that trigger a partial wind-up and to eliminate the forced distribution of surplus and annuitization of benefits on a partial wind-up.
- The PBA should give clear direction on how, or the extent to which, it applies to multi-jurisdictional pension plans.

Promote a Regulatory Regime Which Encourages Funding of Pension Plans

- More onerous funding rules or expanding the Pension Benefits Guarantee Fund ("PBGF") are not the best solutions to deal with the problem of underfunded pension plans.
- Ontario's pension system should instead encourage plan sponsors to "overfund" their plans by removing the risk of capital being trapped in pension plans (for instance by removing restrictions on a sponsor's utilization of surplus in an ongoing plan).

- In addition, or if restrictions on the surplus utilization cannot be removed, the PBA should be amended to permit such things as letters of credit and solvency accounts, which could enable greater funding flexibility to plan sponsors while still preserving benefit security for plan members.
- Allow the regulator to provide discretionary relief from solvency funding requirements in appropriate cases, when consistent with the legislated guiding principles for pensions.
- As funding and investments are inextricably linked, the quantitative limits under the current investment rules need to be reconsidered. For instance, many of the quantitative restrictions found in the investment rules applicable to pension plans are outdated, and act as an impediment to effective and prudent investment of pension assets – such restrictions should no longer apply.

Enable Flexibility of Plan Design and Administration

- Plan sponsors and members should be able to choose from a wide array of plan designs that best suit their needs – pension regulation should not interfere or influence this choice of plan design (e.g., it should not drive plan sponsors or purchasers of a business away from defined benefit (“DB”) plans to defined contribution (“DC”) plans to avoid regulatory burden and legal risk).
- The regulatory system must also be flexible enough to (i) recognize that different rules may be appropriate for different kinds of plans (a “one size fits all” model of regulation clearly does not meet this goal); and (ii) encourage creativity in plan design and the development of new kinds of retirement plans that adapt to changing economic conditions and the evolving needs of the workforce in general.
- The system must recognize that plan sponsors evolve and their needs evolve – regulation should not otherwise restrict mergers and asset transfers in situations where the promised benefits (or the value thereof) are being delivered and the legislated guiding principles are not otherwise being compromised.
- Enable flexibility such that plan sponsors and employees or unions can more easily negotiate changes to their benefits structure, including benefits that have already accrued.

Regular Reviews of Pension Legislation

- It has been 20 years since Ontario’s pension legislation was reviewed. During that time, the nature of Ontario’s economy and workforce have changed considerably. Going forward, more frequent and regular reviews of the applicability and effectiveness of Ontario’s pension legislation should be mandatory (we recommend that a review be undertaken every five years).

We recognize that implementation of these steps will take time as policy considerations will need to be weighed. However, we have noted in Appendix “A” hereto those amendments that are primarily technical in nature and that could be made relatively easily by the Ontario government, thus easing a number of specific plan administration issues in the short term.

III. OUR RESPONSE TO QUESTIONS RAISED IN THE OECP DISCUSSION PAPER

We have attempted to answer the questions posed by the OECP in its February 2007 discussion paper, “Reviewing Ontario’s Pension System: What are the Issues? A Discussion Paper for Interested Ontarians”. Where a question was raised for which we felt that we did not have suitable expertise (i.e., actuarial, economic in nature), we have not provided a response to that particular question.

Throughout our submission we use the term “plan sponsor” to mean the entity (typically the employer) that establishes, maintains and contributes to the pension plan. As such, we have used the terms “employer” and “plan sponsor” interchangeably throughout this submission.

SECTION ONE: GENERAL QUESTIONS

1.1 To what extent do occupational pension plans – especially defined benefit plans – contribute to the overall provision of income security for Ontario’s older workers?

This question does not raise legal issues. However, based on our general experience, we are of the view that occupational pension plans make a significant contribution to the overall income security of Ontario’s workers.

- They provide retirees with a source of income in addition to the pensions provided or administered by the government (i.e., Old Age Security, Canada Pension Plan).
- Employees who participate in employer-sponsored pension plans receive certain benefits that are not available to those individuals who are required to accumulate personal savings for retirement:
 - An employee accumulating his or her own savings does not benefit from employer contributions, and, as a result, less money is invested for the future (and there is no guarantee that the employee will receive higher wages in return for the foregone employer contributions).
 - Personal savings do not benefit from the economies of scale associated with contributing to a large pension plan, where capital can be pooled and investment costs and risks can be shared among plan members.
 - As compared to an individual investor, pension plans are more likely to have access to better investment expertise, more varied investments opportunities (e.g., private equity) and lower fees.
 - Participating in an employer-sponsored pension plan may make workers more aware of the need to save for retirement and of retirement issues generally.
 - At the very least, participating in an occupational pension plan should provide workers with some form of retirement income.

- DB plans, in particular, improve the financial security of employees. DB plans provide a specified benefit level at retirement which means that plan members have a good sense of what they will receive at retirement, making future financial planning easier and reducing uncertainty. In addition, the impact of fluctuations in market conditions and interest rates is reduced for DB plan members.

1.2 To what extent do these plans presently meet the needs and expectations of their members and sponsors?

In our experience, employers provide pension plans as a part of their overall compensation package in order to recruit and retain employees. However, an employer's need to compensate its employees is subject to other competing interests (e.g., company profitability, strategic initiatives for the viability of the business, shareholder expectations) which must be taken into account when making decisions with respect pension plan arrangements.

As such, when pension plan arrangements become overly expensive, complex and burdensome to administer, an employer will be less likely to want (or be able) to proceed with such an arrangement. The decrease in DB plan coverage in Canada, and in the private sector in particular, (as discussed further, below) should be considered as evidence that such DB plans do not appear to be meeting the needs of many plan sponsors.

1.3 How well have these plans been managed in recent years, and how might their management be improved?

In our experience, most pension plans are well managed. However, pension plan management has become an increasingly complex and costly endeavour, and those pension plan sponsors with greater resources are often better able to meet the challenges posed by pension plan administration.

We are of the view that the management of pension plans could be improved by implementing the following changes:

- Simplify the Rules Governing Pensions: Currently, plan administrators must navigate through an increasingly complex and restrictive pension law regime. For example, the PBA often does not clearly set out the requirements that must be met by plan administrators. In the case of multi-jurisdictional plans, the legislation is different from one jurisdiction to the next. Further, the courts have interpreted certain aspects of the PBA in a restrictive (or even unexpected) manner, resulting in case law which is difficult to interpret and reconcile. **(See Questions 1.4, 1.5, 3.3, 8.1, and 8.5 for further discussion of the complexity of pension rules.)** Simplification of the rules governing pension plans would make it easier for plan administrators to manage their plans and ensure that they are in compliance with the PBA.
- Increase Opportunities for Economies of Scale: The formation of larger plans (e.g., sectoral-based, multi-employer, jointly-sponsored or cooperative plans) including plans not contemplated under our current system (e.g., new DB plans in which any employers/employees could participate) would allow organizations and individuals to pool capital and resources and alleviate the risks associated with being an individual investor. As well, if existing (larger) plans are able to administer pensions on behalf of

smaller (unrelated) employers and/or manage (invest) moneys on their behalf, it may allow organizations to outsource plan administration and investment to more experienced parties better able to manage a pension plan. (See our answer to Question 3.4 for further discussion of this issue.)

- Consider Emulating Recent Corporate Governance Initiatives: Over the past several years, there have been significant developments and improvements made in corporate governance.¹ To improve plan management, the OECP should consider whether similar standards are warranted for pension plans, for example:
 - Conflicts of Interest: In order to address the problems associated with perceived conflicts of interest, Canadian corporate governance now requires public companies to have a minimum number of Board of Directors' members who are independent of the corporation's management. In the pension environment, this could translate into a requirement that each pension plan be administered by a pension committee which must have an independent Chair. (Members of the committee could still be appointed by the employer in the case of a single-employer pension plan ("SEPP") and by the unions/participating employers in the case of a multi-employer pension plan ("MEPP").) In particular, this should be considered for plans administered by a board of trustees who have been appointed by a particular group or organization (e.g., union or participating employer). These individuals are susceptible to operating under a real or perceived conflict between the interests of those who appointed them and the interests of plan members as a whole. In our view, this conflict of interest (whether real or perceived) may be reduced by requiring part of the board (e.g., one-third) to be made up of independent trustees or by requiring such boards to have an independent chair.
 - Minimum Expertise Requirements for Plan Administrators: Corporate governance requires certain board members (e.g., audit committee members) to have a minimum level of financial literacy. If the OECP finds that the current level of plan administrator knowledge/expertise is impeding effective plan management, the OECP could consider recommending that similar requirements be applied to pension plan governance (e.g., requiring key plan decision makers such as boards, pension committees, and investment committees to meet minimum financial and investment literacy standards).²

¹ For example, the Canadian Securities Administrators issued Multilateral Instrument 52-109, which requires Chief Executive and Financial Officers to certify in their annual filings that they have evaluated the effectiveness of their company's internal controls over financial reporting, and Multilateral Instrument 52-110, which requires a public company's audit committee to be composed of at least three independent directors, all of whom must be financially literate.

² The importance of the education of board members was recognized in Canada, Senate, Standing Senate Committee on Banking, Trade and Commerce, "Corporate Governance" (August 1996) (the Kirby Commission Report), which recommended educational initiatives to broaden and enrich the pool of directors in Canada. While this recommendation was given in the context of corporate governance, it was viewed at the time as also being applicable to the governance of pension plans.

1.4 Why has coverage by defined benefit plans decreased? Why are few, if any, new defined benefit plans being established?

Based on our experience, DB plan coverage has decreased greatly over the last ten years, particularly in the private sector. Except for companies who agree to establish DB plans as a part of the purchase of a business, we are not aware of any private sector employers choosing to set up new DB plans. On the contrary, we are aware of many DB plans that have been discontinued. The reasons underlying such decline may vary depending upon the type of employer, the size of the plan and other factors; however, in our experience, the sponsors of such plans have attributed the decline in DB plans to one or more of the following factors:

- Increased Volatility: Volatility in solvency funding requirements has made funding of DB plans increasingly unpredictable. Such unpredictability may be particularly problematic in the eyes of plan sponsors who are primarily or wholly responsible for any shortfalls in plan funding, and who may be disinclined to fund more conservatively for fear of creating “trapped capital” (as further discussed below).
- Increased Costs: In the absence of funding flexibility and a clear regulatory regime, low long-term interest rates, increased retiree longevity, rising pension plan administration costs and expensive pension benefits (that DB plans tend to provide) have made them a costly type of plan for employers to provide to employees.
- Potential for “Trapped” Capital: The need for large, solvency-driven cash contributions to a DB plan in the short term may turn into trapped capital (surplus) in the future. Under the current legal regime, it is often very difficult for plan sponsors to prove surplus ownership in order to withdraw surplus from a DB plan or to otherwise effectively use the surplus to benefit the overall organization/business of the employer. As such, the potential for accumulations of trapped capital in a pension plan clearly acts as a disincentive for fully funding plans (which, in turn, may exacerbate any plan funding problems) and for continuing the plan at all.
- Legal and Regulatory Complexity: Sponsors of DB plans are faced with a complex and restrictive legal environment, which adds to the time required to manage the plan (taking employees/officers away from their corporate functions) and increases cost and legal risk.
- Perception of Unfairness and Obstacles to Business Management: The manner in which the current PBA has been interpreted by the regulators and courts has caused many plan sponsors to believe that the system is asymmetrical or unfairly weighted in favour of plan members and poses a serious impediment to their ability to manage their businesses. For example:
 - Under the PBA it is very difficult to withdraw surplus from a DB plan. Essentially, a plan sponsor must demonstrate entitlement to surplus even if it reaches an agreement with the plan members and former members to share the surplus, and conversely, the plan sponsor must share any surplus even if the plan documents clearly specify that the employer is entitled to it.
 - The courts and FSCO have taken a narrow view of certain issues, such as the ability to transfer assets from one DB plan to another and the “protection” of plan

member benefits, hampering corporate transactions. **(See our answer to Question 8.1 for further discussion of this issue.)**

- The Superintendent and FSCO have issued orders and/or taken other regulatory actions that are not anticipated by plan sponsors and appear to be *ad hoc* due to the absence of any overarching policy directive or guideline. For example:
 - The Superintendent has ordered the partial wind-up of pension plans based on criteria which are not always clear and events that occurred years before the orders were made. Partial wind-ups can be very costly due to the entitlement of plan members to “grow-in” benefits and the requirement to distribute any surplus that existed at the time of the wind-up (even where such surplus has since disappeared).³
 - FSCO has commenced investigations into pension plan investments, making recommendations in respect of investment prudence, without there being any clear directives or policies from FSCO on what constitutes prudent investment practices.
- Rules in relation to plan funding are restrictive and provide limited options. For example, funding options available in other jurisdictions such as letters of credit are not available to sponsors of Ontario-registered pension plans.

Essentially, there are numerous factors discouraging the establishment and/or continuation of DB plans, and very few incentives to do so.

1.5 In light of recent court decisions, are appropriate legal rules in place to protect the interests of present and prospective pensioners, and of employers who sponsor plans?

The Supreme Court of Canada has stated that “...pension trusts are part of the complex of rights and obligations (not only equitable, but also contractual and statutory) between employers and employees, and obviously serve broad societal and economic purposes”.⁴ This appropriately recognizes that the (sometimes competing) interests of pension plan stakeholders (employers, unions, employees and retirees) need to be carefully and fairly balanced, taking into account that such plans are voluntary and part of the overall employment relationship.

³ In *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, [2004] 3 S.C.R. 152 (“*Monsanto*”), the Supreme Court of Canada agreed with an earlier decision by FSCO that the PBA 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).

⁴ In *Buschau v. Rogers Communications Inc.*, [2006] 1 S.C.R. 973 (“*Buschau*”), the Court recognized that plan members could not use common law rights to terminate the plan and, thereby, override the interests of the employer.

Better Recognition of the Interests of Plan Sponsors

Although the Supreme Court of Canada has specifically recognized that plan sponsors do in fact have an interest in their pension plan,⁵ this is not clearly addressed in the PBA. In our view, the PBA should be amended to clarify that plan sponsors have an interest in their pension plans and (like plan members' interests) such interests are also protected by the provisions of the PBA.

In other respects, courts have rendered decisions which have negatively affected the interests of plan sponsors. Specifically, there have been a number of recent court decisions that have considered the application of trust law principles in the pension plan context, and interpreted pension benefits legislation in a manner which creates problems for plan sponsors. It is apparent that pension legislation needs to be amended to clarify these issues.

Challenges Posed by Application of Trust Law Principles

Beginning with the Supreme Court of Canada's decision in *Schmidt*,⁶ the courts have interpreted pension plans that are funded through a trust as traditional, classic trusts (rather than as contracts or as special purpose trusts). Classic trust law principles, however, do not always translate well to the pension plan context, which is essentially a component of the employment (contractual) relationship between employee and employer.

Pension trusts are fundamentally different from classic trusts in a number of ways. A classic trust is a form of gift involving the transfer of property to a trustee for the benefit of one or more beneficiaries. A pension trust, on the other hand, is primarily a funding vehicle to provide security for future pension obligations. A pension trust is fluid in nature – new beneficiaries join the pension plan and current beneficiaries leave on a regular basis – and are closely intertwined with employment. Unlike a classic trust situation, the trustee of a pension fund typically has very little discretion in the investment or administration of the trust fund; rather, investments and payment of benefits are performed at the direction of the plan administrator and/or investment managers.⁷

As a result of these inherent differences between classic trusts and pension trusts, the application of trust law principles has added uncertainty to the pension plan regime and has resulted in decisions that may make sense for a traditional trust, but which do not result in good pension policy (i.e., promoting the long-term health and growth of DB plans for all members), for example:

- Surplus Withdrawal: Plan sponsors must demonstrate entitlement to surplus based on a review of all historical plan documentation, even where they have obtained the requisite number of consents from plan members and former members. Such requirements create a perception of asymmetry, which, in turn, discourages plan sponsors from funding to

⁵ For example, in *Monsanto*, the Court recognized that the PBA “seeks, in some measure, to ensure a balance between employee and employer interests that will be beneficial for both groups”.

⁶ *Schmidt v. Air Products Canada Ltd.*, [1994] 2 S.C.R. 611 (“*Schmidt*”).

⁷ The Association of Canadian Pension Management, *Back From the Brink: Securing the Future of Defined Benefit Pension Plans* (August 2005) at 10. See also *Buschau supra* note 4 at paras. 27-33.

surplus levels (and potentially creating trapped capital). In our experience, this process also adds numerous delays and unnecessary costs to surplus sharing arrangements -- to the detriment of employers, employees and retirees alike.

- Asset Transfers/Plan Mergers: Mergers of and asset transfers between DB plans funded through a trust are very difficult and take too long to complete. We are of the view that this is largely because FSCO is ill-equipped to deal with trust law issues and conflicting court decisions, particularly in light of the lack of legislative guidance on the matter. **(See our answers to Questions 1.6 and 8.1, below, for further explanation.)**
- Contribution Holidays and Plan Expenses: The ability of plan sponsors to take contribution holidays and to pay plan expenses from the plan fund is unclear and the subject of ongoing litigation.

Moreover, it is important to keep in mind that these trust law cases did not involve disputes about the promised benefits. Rather, they related to the aforementioned issues (i.e., surplus withdrawal, pension plan expenses, commingling of funds) – all of which are ancillary to the promised benefits. However, these cases affect the very structure of such pension plans, creating a disincentive to their establishment and expansion.

Recently, the courts have begun to realize the inherent difficulties with such a strict application of trust law principles to pension plans, and have begun moving away from this approach.⁸ For instance, in *Buschau* the Supreme Court of Canada noted:

[E]mployers establish plans because it is in their interest to do so. Under normal circumstances, they have the right not to have their management decisions disturbed. In contrast, the common law trust allows no room for the settlor's interest...a blanket statement that the employer has no interest conflicts with the usual expectations of the parties to a pension plan.⁹

Notwithstanding this recent subtle shift by the courts towards what appears to be a more modern application of trust law principles to pension plans, we are of the view that the legislation should be clarified in order to:

- clearly recognize the interests of all plan stakeholders (in particular plan sponsors);
- provide greater certainty for plan sponsors and plan members;

⁸ For example, in *Buschau*, the Supreme Court of Canada held that an old common law principle known as the "rule in *Saunders v. Vautier*" (which enables beneficiaries of a trust to unilaterally terminate the trust, provided that the beneficiaries are all adults of full mental capacity and that they together hold all of the beneficial interest in the trust property) did not generally apply in the registered pension plan context, and that the legislative context must also be taken into account. In reaching its decision, the Court recognized the unique context in which pension trusts operate.

Also, in *Kerry (Canada) Inc. v. DCA Employees Pension Committee* (2007), 60 C.C.P.B. 67 ("*Kerry*") the Ontario Court of Appeal found that while plan and trust documents continue to be the key determinant, traditional trust law principles did not prevent employers from paying plan administration expenses from the plan fund, in the right circumstances.

⁹ *Buschau*, *supra* note 4 at para. 30.

- reduce costly and often lengthy litigation; and
- remove disincentives to the establishment and maintenance of DB plans.

Potential Solutions to Trust Law Issues

Prima facie, the most straightforward way to resolve this issue would be to enact pension legislation which overrides the common law generally and specifies that contract law (rather than trust law) applies to pension plans, or that a new special set of “business trust” rules apply to pension trusts to the exclusion of common law trust principles. However, we recognize that such an approach may result in some groups asserting that their pre-existing legal rights (e.g., to surplus) are being overridden by the government. Also, there may be real practical difficulties in implementing such a regime on a full scale.¹⁰

Thus, another approach would be to legislate on an issue by issue basis. The Supreme Court of Canada pointed the way in this regard, by recognizing in *Buschau* that where the legislature has seen fit to address a particular issue (such as plan termination), classic common law trust principles should not be applied in such a way as to thwart the legislative intention.

If this approach is adopted, we recommend that the PBA be amended to specifically deal with the following issues, at a minimum:

- Surplus Withdrawal: Similar to the federal *Pension Benefits Standards Act, 1985* (the “PBSA”), the plan sponsor should not be required to demonstrate its legal entitlement to surplus if a “claim” to surplus is established through the consent of specified groups. Provided that the employer could demonstrate legal entitlement (based on a review of the historical documents) *or* could obtain the consent of a specified percentage (perhaps two-thirds) of plan beneficiaries, final approval of the surplus sharing arrangement and disbursement of the funds would be given by the Superintendent (i.e., investigations into surplus entitlement would not be required where the requisite level of member consents has been obtained). By permitting negotiated surplus sharing settlements to proceed notwithstanding historical trust terms, the PBA would greatly reduce the problem of trapped capital in pension plans, and remove one disincentive that employers have to fund pension plans in a more conservative manner.
- Asset Transfers/Plan Mergers: Plan sponsors should be able to transfer assets from one pension fund to another or merge together two or more plans without restrictions on how the assets are utilized or commingled, provided that prescribed conditions are met (e.g., members must receive accrued pension benefits equal in value to the benefits they received prior to the asset transfer/plan merger). The approval of asset transfers or plan mergers should not turn on particular phrases used in trust agreements established decades ago (such as “exclusive benefit” provisions); rather, the focus of the PBA should be on protection of the members’ benefits, defined as the protection of the value of the promised retirement benefits.

¹⁰ For example, there may need to be grandfathering for certain groups (e.g., those with ongoing litigation based on existing laws) and/or transitional provisions allowing plans to move from the existing regime to the new regime (e.g., allowing plans to move to the new system with the consent of plan members, former members and any unions that represent them).

- Contribution Holidays: Plan sponsors should be able to take contribution holidays provided that they continue to meet prescribed plan funding requirements. Again, the PBA should focus on the protection of members' promised benefits, and eliminate the need to justify contribution holidays based on historical plan provisions. Where a pension plan is in substantial surplus, it does not make economic sense from the employer's perspective to trap that surplus in the plan, based on a plan term found in the historical plan documentation.
- Plan Administration Expenses: Plan sponsors should be able to pay reasonable administrative expenses from the plan fund, whether such expenses are incurred by a third party service provider, a third party administrator or by the plan sponsor acting as the plan administrator, provided that the expenses are permissible under the current plan documents. Importing classic trust law restrictions into this area ignores the practical aspects of pension plan administration. Again, the focus of the PBA should be on protecting members' promised pension benefits, while providing employers greater flexibility in the administration of the pension plan. In this regard, consideration could be given to only permitting expenses to be paid from the fund if the plan's funded ratio exceeds a prescribed level.

Interpretation of Pension Benefits Legislation

The PBA has been described as “carefully calibrated” legislation that was intended to clearly set out the roles and responsibilities of plan administrators. However, those of us who practice in the area readily concede that in many respects the PBA is not clear and often appears to be contradictory or inconsistent. The PBA has been the subject of a number of interpretation problems wherein the courts have been asked to resolve conflicting PBA interpretations raised by plan sponsors and plan members. The courts have rendered decisions which have had a negative impact on plan sponsors¹¹ or which have raised additional interpretation issues.¹² Such decisions make the administration of pension plans more difficult, and create disincentives for the establishment of new pension plans as well as the continuation of existing ones.

¹¹ For example, as a result of the Supreme Court of Canada's decision in *Monsanto*, plan sponsors are required to distribute 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). While this may simply be an example of interpreting legislation in accordance with its “plain meaning”, the decision has resulted in some plan sponsors facing an untenable situation (i.e., partial wind-ups may be ordered years after they have occurred and by that time pension plan surplus which existed as at the partial wind-up date may have “disappeared” due to volatile market conditions or changes in actuarial assumptions).

¹² For example, in *Ontario Teachers' Pension Plan Board v. Ontario (Superintendent of Financial Services) and Stairs* (2004), 70 O.R. (3d) 61 (“*Stairs*”), the Court of Appeal determined that assignment of a portion of the pre-retirement death benefits to a member's former spouse by domestic contract took priority over the death benefit otherwise payable under the plan to the new spouse on the member's death prior to retirement. This decision did not add clarity to the already complicated and confusing legal regime governing division of pensions on marital breakdown, but rather raised other plan interpretation questions (e.g., whether the *Stairs* decision can be applied to the division of post-retirement pension benefits in the event of the marriage breakdown of a pension plan member).

As noted above, there are number of amendments which should be made to the PBA in order to address problems arising as a result of the application of traditional trust law principles. Upon review of the PBA, we have noted a number of other provisions which require amendment, for example:

- the definition of “multi-employer pension plan”, which can sweep in arrangements that were not intended to operate as MEPPs (e.g., business structures such as joint ventures and partnership arrangements);
- the division of pension benefits upon marital breakdown (which are confusing and difficult to administer); and
- requirements to protect benefits when transferring assets from one plan to another (i.e., by providing identical benefits rather than benefits of equal value).

(See Appendix “A” for a complete list of the PBA sections which, in our view, require review and amendment. Also, see Sections 3 and 8 for further suggestions regarding potential improvements to the PBA.)

Interests of Present and Prospective Pensioners

In addition to the interests of plan sponsors, we recognize that there is a need to balance the interests of active members (or prospective pensioners) and pensioners. This is particularly true with respect to MEPPs, where boards of trustees that administer the MEPP must balance these groups’ potentially competing interests when making funding decisions (e.g., considering whether to increase contributions or reduce benefits). It would be helpful if the PBA was amended to provide better clarity in this regard.

1.6 Are appropriate oversight mechanisms available to ensure compliance with the legal rules?

In our view, the challenges facing plan sponsors would best be resolved by amending the PBA to address ongoing problems, such as inflexible plan funding rules, restrictive requirements that hamper corporate transactions, limited access to surplus, costly partial wind-up provisions and general legal and regulatory complexities. **(See Sections 1, 3, 5 and 8 for further discussion of these issues.)**

That being said, we are of the view that current regulatory oversight is not adequate and that, as part of legislative reform, the role of the current regulator, FSCO, should also be revisited.

Assessment of Current Regulator

FSCO

Prior to 1998, Ontario pension plans were regulated by the Pension Commission of Ontario (the “PCO”). The PCO, which focused exclusively on the regulation of pensions, was responsible for enforcing the PBA, developing pension policy and adjudicating pension-related disputes.

In 1998, through the enactment of the *Financial Services Commission of Ontario Act* (the “FSCO Act”), the PCO was amalgamated with the Ontario Insurance Commission and the

Deposit Institutions Division of the Ministry of Finance to form FSCO. As a result, the same regulatory body regulates insurance, credit unions, co-operatives, caisses populaires, mortgage brokers and loan and trust companies, as well as pension plans. FSCO's responsibilities include enforcing the PBA and developing pension policy. FSCO is composed of a chair, two vice-chairs, the Superintendent and the Director of Arbitrations appointed under the *Insurance Act*. There is no express requirement in the PBA nor the FSCO Act that any of these individuals have pension expertise.

The policy making function performed by the old PCO now appears to have been subsumed within FSCO, with little or no input from those with experience or expertise in the pension industry. Moreover, there are no guiding principles with respect to policy development (or FSCO's mandate more generally) set out in the legislation.¹³ Consequently, there has been a paucity of policy development by FSCO resulting in a lack of clear direction or guidance for plan sponsors and administrators.

This lack of a clear direction has become apparent with respect to the regulation of pension plan investments. FSCO has commenced investigations into pension plan investments, making recommendations in respect of investment prudence, without there being any clear directives or policies from FSCO on what constitutes prudent investment practices. In addition, pension plan investing has become extremely sophisticated, requiring an understanding of very complex legal and financial structures. In our experience, plan sponsors have remarked that FSCO does not appear to have adequate expertise or resources in place to effectively regulate this area.

To further complicate matters, since FSCO was established, pension issues became the subject of much more litigation than in the "PCO years". As a result of many contentious court decisions, FSCO has been forced to continually react to the latest interpretation of the PBA or trust law principles by the courts who often have no specialized expertise/experience in pensions and no role or interest in developing pension policy. Since court decisions are frequently reversed or are "limited to their facts" by subsequent decisions, FSCO's reactive approach creates a huge amount of uncertainty in the industry (and further incentives for employers to wind-up their DB plans at

¹³ Such lack of a guiding principle is in contrast with the federal pension regulator – the Office of the Superintendent of Financial Institutions ("OSFI") - for example. Like FSCO, OSFI has a broad mandate, as it regulates and supervises federally-regulated financial institutions, such as deposit-taking institutions and insurance companies, in addition to pension plans. However, unlike FSCO, the *Office of the Superintendent of Financial Institutions Act* (the "OSFI Act") sets out OSFI's guiding principles with respect to pension matters, which primarily focuses on ensuring that pension plans meet minimum funding standards.

Pursuant to Section 4(2.1) of the OSFI Act, the objects of the Office, in respect of pension plans, are

- (a) to supervise pension plans in order to determine whether they meet the minimum funding requirements and are complying with the other requirements of the Pension Benefits Standards Act, 1985 and its regulations and supervisory requirements under that legislation;
- (b) to promptly advise the administrator of a pension plan in the event that the plan is not meeting the minimum funding requirements or is not complying with other requirements of the Pension Benefits Standards Act, 1985 or its regulations or supervisory requirements under that legislation and, in such a case, to take, or require the administrator to take, the necessary corrective measures or series of measures to deal with the situation in an expeditious manner; and
- (c) to promote the adoption by administrators of pension plans of policies and procedures designed to control and manage risk.

the first opportunity). Moreover, as we noted, many of these court decisions require FSCO to interpret trust law which, in our view, is well outside their area of expertise.

An example of how FSCO's application of case law involving trust law principles may be problematic for plan sponsors can be seen in its response to the *Transamerica* case.¹⁴ The decision in *Transamerica* was initially interpreted by FSCO as preventing plan mergers in most situations. FSCO subsequently relaxed its position, but it still requires an assessment of the plan terms on whether the merger is permitted and whether the assets can be fully co-mingled, which goes beyond the mandate of the protection of benefits. Furthermore, FSCO is continuing to assess merger applications based on its revised interpretation of trust principles, which, in our experience, has led to significant delays in merger approvals (in some cases in excess of five years).

Tribunal

The FSCO Act also established the Financial Services Tribunal (the "Tribunal") to adjudicate disputes arising in any of the sectors regulated by FSCO. While the FSCO Act does provide that "to the extent practicable" members appointed to the Tribunal have "experience and expertise in the regulated sectors" and "requirements, if any, for experience and expertise" be taken into consideration when assigning Tribunal members to a panel,¹⁵ this does not guarantee that a pension expert will be on any panel constituted to hear a pension dispute. Courts, in particular, have taken note of these "loose" criteria, refusing to recognize the expertise of the Tribunal and affording less judicial deference to Tribunal decisions.¹⁶ This could be an indication that the Tribunal is not serving its intended function.

In our view, the Ontario government needs to reassess the reason for having a Tribunal and whether it continues to fulfil its mandate. We note that Ontario is one of the few jurisdictions to have a specialized adjudicative tribunal to hear appeals of decisions by the regulator. If the intent was to have matters heard by an expert body with technical expertise on pension matters, then the FSCO Act and PBA could be amended to better clarify that intent. If the intent was also to establish an administrative tribunal to provide more access for plan members and plan sponsors to have pension issues resolved quickly and with less cost than through the courts, then this objective is not effectively being met since many disputes still end up in court and the Tribunal is simply becoming an additional (first) step in the litigation process. If the Tribunal is to be retained and effective, then steps should be taken to ensure more deference is given to

¹⁴ In *Aegon Canada Inc. and Transamerica Life Canada v. ING Canada Inc.*, [2003] O.J. No. 4755 ("*Transamerica*"), the Ontario Court of Appeal found that there was an obligation to separately maintain the assets of the two predecessor plans in light of the terms of an undertaking given to the Ontario regulator and historical "exclusive benefit" language found in an earlier version of the trust associated with one of the predecessor plans. Such exclusivity language prevented the co-mingling of assets to enable the assets of one predecessor plan to offset the liabilities of the other under the merged plan.

¹⁵ See sections 6(4) and 7(2) of the FSCO Act.

¹⁶ For example, see *Monsanto* where the Supreme Court of Canada found that the Tribunal was a "general body" that was created to replace "the specialized Pension Services Commission", and had no specific pensions expertise nor policy-making functions: "there is little to indicate that the legislature intended to create a body with particular expertise over the statutory interpretation of the [PBA]". As a result, the Court held that less deference should be given to the Tribunal's interpretation of the PBA and a standard of review of correctness was appropriate.

Tribunal decisions and to clarify which kinds of pension issues/disputes are to be resolved by the Tribunal versus the courts.

Effective Regulator

In our view, in order to ensure FSCO is an effective regulator, the OECP should consider one or more of the following steps:

- As we suggested in our answer to Question 1.5, the PBA should be amended to provide specific principles/standards to guide FSCO in dealing with surplus, plan mergers/asset transfers, contribution holidays and plan administration expenses issues under the PBA, which would relieve FSCO from having to apply common law trust principles to such issues and attempt to interpret court decisions that often appear to be contradictory. Following such amendments, FSCO will simply be required to interpret and enforce the legislation (and pension policy), rather than the common law.
- The FSCO Act should be amended to give those involved in pension regulation overarching principles to guide and assess them in the regulation of the Ontario pension system. In our view, such guiding principles should reflect the legislature's view of appropriate pension policy (not the courts') and should include the following:
 - promotion of pension plans (i.e., coverage, funding, benefits);
 - recognition of the interests of all stakeholders in the pension plan (i.e., members, former members, plan sponsors (employers) and, where appropriate, unions);
 - indicate that the regulator's mandate is to focus on the protection of defined benefits and that surplus is secondary to that objective;
 - clarity of roles and responsibilities of all persons involved with the operation or administration of the plan;
 - flexibility (e.g., in funding, plan design) to accommodate different types of plans and new or innovative retirement savings plans; and
 - a proper balance between affordability/predictability of cost for plan sponsors and security of benefits for plan members.
- FSCO should be restructured so that the Pension Plans Branch:
 - operates under legislated, pension-specific guiding principles (as described above);
 - is adequately staffed by individuals with the requisite level of expertise in pension matters; and
 - has relatively broad policy-making powers within the framework set out in its legislated mandate (which would include the requirement to consult with industry stakeholders on pension policies as they are developed). (Such policies would provide plan sponsors with additional guidance in areas not specifically

addressed by the legislation -- since it is virtually impossible to address all potential issues in any legislative area).

- The FSCO Act should be amended to specify that a minimum number of members of the Tribunal and all of the members of any panel hearing a pension matter have pension expertise, and that any decision of the Tribunal be treated with deference by the courts (i.e., a privative clause should be included in the legislation).
- In the alternative, if the Ontario government does not view the Tribunal as playing a meaningful role in resolving pension disputes (whether between the regulator and stakeholders or as between plan members and the plan sponsor/administrator), then the PBA should be amended to provide that appeals of the Superintendent's decisions should be made directly to a court (as is the case with OSFI decisions) and the Tribunal should be discontinued in the pension sector.

1.7 Should different kinds of workers, employers and plans be subject to different regimes of regulation?

A fundamental principle of pension regulation needs to be the establishment of a level playing field for all plans/participants in the system. In other words, plan sponsors and members should be able to choose from a wide array of plan designs that best suit their needs. Pension regulation should not interfere with or influence this choice of plans by, for example, adopting rules that favour one group of stakeholders (e.g., plan members) to the detriment of another (e.g., plan sponsors), and thereby influencing plan sponsors to choose other plan designs that provide more balanced regulation.

Having said that, the regulatory system must also be flexible enough to (i) recognize that different rules may be appropriate for different kinds of plans (a "one size fits all" model of regulation clearly does not meet this goal); and (ii) encourage the development of new kinds of retirement plans and creative plan designs that adapt to the ever-changing economic conditions and needs of the workforce in general (e.g., new rules to permit phased-in retirement arrangements).

Pension plans with different risk/reward characteristics could be subject to different legislation, regulations and policies where appropriate. In particular, we are of the view that different rules would be appropriate for (i) DC plans versus DB plans; and (ii) MEPPs versus SEPPs.

DC versus DB Plans

DB plans, which promise a specified benefit at retirement, are inherently different in structure and have different risk characteristics as compared to DC plans, which invest a specified amount of contributions on behalf of employees. 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.

These differences mean that, in many respects, DB and DC plans should be subject to different legislative and regulatory requirements. However, in reality much of the PBA is only applicable to DB plans, and the PBA provisions which do apply 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 the most obvious example, it is not at all clear how the investment rules in the PBA are to apply to DC plans.

To reflect these differences, and to fill the void of legislative direction in administering DC plans, separate PBA provisions should be enacted which recognize the distinct nature and risk characteristics of DC plans. These should include:¹⁷

- Safe Harbour Rules: If the Ontario government or FSCO has a view on what constitutes a prudent investment for a DC plan (e.g., a specified range of investment choices or a proper default option), then clear guidelines as to what is expected should be provided.¹⁸ In our view, it would be appropriate for such guidelines to take the form of “safe harbour rules”¹⁹, which would enable DC plan administrators to reduce their risk related to plan member investment choices by meeting specified criteria. Such criteria (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;
 - investment options that are offered must represent a sufficiently broad range of alternatives;
 - 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 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).

¹⁷ While we recognize that the Joint Forum of Financial Market Regulators’ “Guidelines for Capital Accumulation Plans” do provide guidance with respect to DC plan investments and information to be provided to plan members, they do not have the force of law and we are of the view that clear legislative rules and policy/regulatory guidance from FSCO is also required.

¹⁸ If the government/FSCO does not have such views, then investment options should be left to the discretion of the plan sponsor and any legislative guidance should focus on other duties (such as the provision of information to plan members, as discussed below).

¹⁹ 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. (Plan sponsors, however, are still required to prudently select and monitor the available investment alternatives and perform other fiduciary duties.)

- Information for Plan Members: The PBA should clearly set out the information that DC plan sponsors must provide to their members on an ongoing basis. 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 investment options are being added or removed or any other significant changes are being made.

MEPPs versus SEPPs

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. Bankruptcies, particularly where they involve a number of participating employers, may, in turn, affect the funded status of the MEPP.

MEPPs are not subject to the PBGF, and usually, they cannot demand additional funding from the participating employers. As a result, often their only course of action is to either reduce benefits for retirees or increase contributions (dramatically) for members. This is quite different from a SEPP.

Notwithstanding the foregoing, recent litigation and regulatory proceedings²⁰ indicate that participating employers could potentially be required to make contributions to a MEPP which are in addition to negotiated contribution levels in order to fund a plan deficit. Moreover, the liability for such a deficit may be joint and several, with the result that participating employers could be liable to fund a deficit related to employees of another participating employer which has become unable to pay its share of the contributions. In our experience, such risks act as a serious disincentive to employers who may have considered participating in a MEPP.

Another issue requiring consideration is the overly broad definition of MEPPs in the PBA, which can sweep in business structures such as joint ventures and partnership arrangements, where the participating employers are not "affiliates", but are related entities nevertheless. This type of plan operates in a manner more akin to a SEPP; however, due to a lack of precision in the PBA definitions it may technically be subject to all of same requirements/restrictions applicable to MEPPs.

²⁰ For example, in the case of the Participating Co-operatives of Ontario Trusteed Revised Pension Plan (the "Participating Co-operatives Plan"), which is a MEPP in a significant deficit, the Superintendent has taken the position that the plan cannot be amended to reduce members' accrued benefits (which is permitted under section 14 of the PBA) because the governing plan and trust documents prohibit such a reduction. Furthermore, the Superintendent has taken the position that the participating employers must fund the plan's deficit.

In our view, the Ontario government should encourage the formation of MEPPs and other similar jointly sponsored or co-operative plans. It should do so by amending the PBA to (i) address the distinct risks associated with MEPPs (e.g., specifying that employers participating in a MEPP will not be held jointly and severally liable for plan deficits – which in our view was the intent behind the current legislative provisions) while keeping in mind the need to balance the interests various "generations" of members in a MEPP; and (ii) recognize other types of plans that do not necessarily fall neatly within current MEPP or SEPP categories.

1.8 How much importance should be attached to the harmonization with the law of other Canadian jurisdictions?

Issues Underlying Need for Harmonization

Currently, administrators of multi-jurisdictional pension plans must comply with different legislative requirements in each jurisdiction where its plan members work. This means that such plans are more complex and costly to administer, and members of the same plan may receive different benefits depending upon where they lived/worked.

This variety of legislative requirements can complicate plan administration and may give rise to a “checkerboarding”²¹ type of approach to the determination of benefits. It may also result in uncertainty for members (and their families) if they move from one jurisdiction to another.

For example, the minimum standard for calculating pre-retirement death benefits for a vested pension varies from one jurisdiction to the next. In certain jurisdictions, such as Alberta, Manitoba, New Brunswick, Newfoundland and Labrador, Ontario, Québec, and Saskatchewan, the minimum value of the pre-retirement death benefit is 100% of the commuted value of vested benefits accrued after a specified date (which date varies from jurisdiction to jurisdiction). However, in other jurisdictions such as British Columbia and Nova Scotia, the minimum value of the pre-retirement death benefit is 60% of the commuted value. In Newfoundland and Labrador, Saskatchewan and the federal jurisdiction, if the deceased member would have been eligible for an early retirement pension, the spouse receives a lifetime pension equal to 60% of the member’s early retirement pension. The treatment of excess contributions, whether or not a spouse may waive his or her entitlement to a pre-retirement death benefit, and the entitlements of other potential beneficiaries (i.e., where there is no spouse) also vary greatly from jurisdiction to jurisdiction.

The Memorandum of Reciprocal Agreement (which was executed in 1968 by Alberta, Manitoba, Newfoundland, Nova Scotia, Ontario, Québec and Saskatchewan) (the “Reciprocal Agreement”) was intended to facilitate the administration of multi-jurisdictional plans. It provides for the delegation of the responsibility for enforcing the rules prescribed by pension legislation in each jurisdiction to the regulatory authority in the jurisdiction of plan registration.

²¹ Checkerboarding refers to the process of calculating/determining benefits in accordance with the legislation of each province in which a plan member has worked. For example, if an employee, who worked for one employer and was a member of the same pension plan, but worked at the employer’s locations in Alberta, Ontario and Québec, terminated her employment, the pension benefits that the employee accrued while in each jurisdiction would be calculated in accordance with the varying requirements of each jurisdiction.

However, the Ontario Divisional Court's decision in *Leco*²² seriously questioned the common practice that had evolved under the Reciprocal Agreement. Up to that time, the general view was that pursuant to the Reciprocal Agreement, procedural and administrative matters could be determined according to the law of the province of registration, while member entitlements could be determined according to the law in each member's province of employment.²³ Following the decision in *Leco*, this practical approach to the administration of multi-jurisdictional pension plans was no longer permitted.

This case also caused Canadian pension regulators to be much more cautious in their approach to the administration of multi-jurisdictional plans – especially where the other jurisdiction was Québec. In turn, this has made it even more difficult for employers to administer multi-jurisdictional pension plans.

Potential Solutions

Ideally, pension laws across Canada should be harmonized as much as possible, as it would simplify the administration of multi-jurisdictional plans and would provide greater certainty for plan members. However, given that harmonization would require the amendment of other jurisdictions' legislation, we understand that it may not be achievable. Consideration could, however, be given to the following alternatives:

- Review the pension legislation of other jurisdictions for provisions compatible with or similar to those of the PBA. Where applicable, amend the Ontario regulations to defer to specified provisions of other jurisdictions' pension legislation (i.e., override the PBA) in respect of Ontario members of such plans if the plans are registered in such other jurisdictions.
- Consistent with other Canadian jurisdictions,²⁴ amend the PBA to specify that a final location approach (as opposed to checkerboarding) is to be used when calculating/determining a plan member's benefits.

²² *Leco (Québec (Régie des rentes du Québec) v. Pension Commission of Ontario* (2000), 24 C.C.P.B. 111 (Ont. Div. Ct.) ("*Leco*").

²³ In *Leco* the employer obtained PCO consent to a refund of surplus from an Ontario registered pension plan. The *Leco* plan, which had members in Québec and several other provinces, had been wound up in 1987 prior to the introduction of Ontario's 1991 consent-based surplus withdrawal rules. The PCO approved *Leco*'s surplus refund in June 1997 but the refund was challenged by former Québec members and their union. The case quickly became a jurisdictional dispute between the Québec and Ontario pension regulators (the "Régie" and the PCO) which led to two judicial review proceedings (one in Ontario and one in Québec) and a contested Ontario court application. In the end, these proceedings quashed the PCO's original consent allowing the employer surplus withdrawal, split the surplus between Québec and non-Québec pension liabilities, and ordered that the Québec portion of the surplus be subject to the surplus arbitration provisions of the Québec pension legislation. The Ontario courts referred the disposition of the non-Québec portion of the surplus back to the PCO, which, following a hearing, confirmed its original decision allowing the employer's withdrawal application, but restricted to the non-Québec portion of the surplus.

²⁴ For example, see sections 31, 32 and 34 of the Alberta *Employment Pension Plans Act*, sections 26, 27 and 29 of the British Columbia *Pension Benefits Standards Act* or sections 21(1), (1.1), (2), and (2.1) of the Manitoba *Pension Benefits Act* for a final location approach.

- Seek a revised multi-lateral agreement among the pension authorities which clarifies the procedural and administrative matters that may be determined in accordance with the law of the province of the plan's registration.

1.9 What are the overall effects of the present system of occupational pension plans on Ontario's social policies and economy?

Based on our general experience, we are of the view that occupational pension plans can provide increased financial security for seniors, which means that they will rely less on government assistance. With less money required for seniors, taxpayer dollars can be used to fund other social programs.

This was recognized by the Supreme Court of Canada in *Buschau*:

Pension benefits also serve broader social goals, which were recognized by the Court of Appeal (*Buschau No. 2*, at para. 47), citing approvingly E. E. Gilless (now a justice of the Ontario Court of Appeal), "Pension Plans and the Law of Trusts" (1996), 75 *Can. Bar Rev.* 221, at pp. 232-34. Together with government programs and individual savings, pension plans provide an aging population with invaluable financial support. In recognition of the social value of such an investment, pension contributions receive special tax treatment. The social component of private pension plans plays a crucial role in an era in which public pension programs have not yet been reformed to ensure adequate funding...²⁵

Pension plans can also have a direct impact on the economy. All pension plans are investors in the public markets. Larger plans can make significant investments in a variety of public and private Canadian businesses, thereby boosting the Canadian (and Ontario) economy. Some of the larger public sector plans, in particular, have been significant investors in infrastructure, thereby assisting the government in the development of public-private partnerships and providing much needed capital to upgrade Ontario's infrastructures.

However, in order to see these positive contributions to Ontario's social policies and economy, steps must be taken to ensure that occupational pension plans remain viable and employers see the value in providing them (which, as we note throughout our submission, is not the case under the present system). Amendments need to be made to the PBA to resolve ongoing problems faced by plan sponsors and, as further described in our response to Question 3.3 below, to address problems created by Sections 6-7.2 and Schedule III of the *Pension Benefits Standards Regulations* (the "Federal Investment Rules"), which create impediments to pension funds investing in private equity and infrastructure.

²⁵ *Buschau*, *supra* note 4 at para. 13.

SECTION TWO: EFFECTS OF A CHANGING SOCIAL AND ECONOMIC ENVIRONMENT

We have chosen to provide one response to Questions 2.1-2.8, as follows.

2.1 How have long-term changes in the structure of Ontario's economy, in its labour market and social welfare policies, and in patterns of employment, unionization and compensation affected occupational pension plans?

2.2 How will longer life expectancies and the end of mandatory retirement affect such plans?

2.3 Is the ratio of retirees to active members of occupational pension plans changing, and, if so, why? What are the effects of such changes on these plans?

2.4 How have recent fluctuations in investment returns and long-term interest rates affected defined benefit plans in particular?

2.5 Are such fluctuations likely to accelerate or decelerate in the future? Can new tendencies be identified that might affect these plans positively or negatively?

2.6 How might changes in the viability, coverage, cost and funded status of occupational pension plans affect the prosperity, security and well-being of Ontario workers and pensioners?

2.7 What has been the impact of inflation on pensioners and pension plans? How common is the indexation of pension benefits?

2.8 How does the health of occupational pension plans affect the robustness of the Ontario economy and the success of Ontario businesses? How might their health affect different workplace constituencies such as public and private sector employers, large and small enterprises and unionized and non-unionized workforces with different demographic profiles located in various work settings?

Changes in Ontario's social and economic environment definitely impact pension plans. In our view, such changes could be addressed by (i) promoting a flexible regulatory system; and (ii) ensuring that the PBA is reviewed (and revised as necessary) on a regular basis.

As we noted in our answer to Question 1.7, it is important to ensure that Ontario has a regulatory system that is flexible enough to encourage the development of new kinds of retirement plans and creative plan designs that adapt to the ever-changing economic conditions and needs of the workforce in general.

In an environment of (hopefully) expanding pension coverage, where new innovative designs may emerge, the PBA should be subject to periodic legislative review on a frequent cycle (we suggest every five years) in order to address the ongoing development of these new pension arrangements.

2.9 Are changes in the structure and governance of occupational pension plans likely to affect their administration and financial well-being, and if so, how?

An effective pension plan governance structure is important. Pension plan governance has developed in the form of best practices, principles and guidelines developed and promulgated by pension industry stakeholders and regulators over the past decade. Good pension governance helps to ensure that plan administrators meet fiduciary obligations and statutory standards of care, increase the efficiency of plan administration, reduce legal, funding and other risks affecting the pension plan, and improve communication with plan members.

If the OECP believes that changes to need to made to the governance of pension plans, in our view the OECP should consider corporate governance reforms (in particular with respect to board independence and financial literacy requirements) and whether such reforms would also be beneficial for pension plans, subject to the appropriate modifications. **(See our answer to Question 1. 3 for further discussion of this issue.)**

However, in our view current pension plan governance structures are not the root of the problems facing Ontario occupational pension plans. As we note throughout our submission, the key to ensuring the well-being of occupational pension plans is to provide incentives that encourage employers to continue to establish and maintain such plans. In order to ensure that such incentives are in place, amendments need to be made to the PBA to resolve ongoing problems faced by plan sponsors, including amendments to enhance plan funding flexibility and address legal and regulatory complexities.

SECTION THREE: INNOVATION AND CONSTRAINTS IN PENSION POLICY MAKING

3.1 What role are occupational pension plans, especially defined benefit plans, likely to play in the array of strategies which will provide economic security for future generations of older Ontarians?

This is primarily a non-legal question, however, based on our general experience, our thoughts on this question are as follows.

The Canadian pension system is built on three pillars:

- Pillar One: Means-tested, minimum pension income provided by governments through tax revenues (i.e., Old Age Security, Guaranteed Income Security, provincial subsidies and the like).
- Pillar Two: Employment-related, mandatory pension plans to which all working Canadians must contribute (i.e., Canada/Québec Pension Plans).
- Pillar Three: A variety of voluntary retirement savings or employment pension plans.

Weakness in any one of these pillars puts pressure on the other two. Thus, a “balanced system” which evenly distributes the obligation to fund retiree benefits among the three pillars is optimal for ensuring economic security for future generations of older Ontarians.

Occupational pension plans are an important component of Pillar Three, helping to ensure its stability. This is the case because, as we noted in our response to Question 1.1, they tend to better provide income security for retirees (as compared to retirees who were required to accumulate personal savings for retirement).

DB plans, in particular, improve the financial security of older employees. DB plans provide a specified benefit level at retirement, which means that plan members have a good sense of what they will receive at retirement, making future planning easier and reducing uncertainty. In addition, the impact of fluctuations in market conditions and interest rates is reduced for DB plan members.

3.2 Will these strategies, in combination, provide all retired Ontarians with a measure of equity and security?

Amending the PBA in order to create incentives for plan sponsors to establish/continue pension plans makes it more likely that Ontarians will be covered by an occupational pension plan, which, in turn, improves the chances of retirees being provided with a measure of security in retirement.

3.3 What can be done to strengthen the role of occupational pension plans in the short term? In the longer term?

Short Term

In the short term (which we view as being within six months of the completion of the OECP’s final report), there are a number of amendments which the Ontario government could make to clarify certain PBA provisions subject to misinterpretation which, in turn, would help to strengthen the role of occupational pension plans.

As we noted in our answer to Question 1.5, the PBA has been the subject of numerous interpretation problems. As a result, the courts have been asked to resolve these conflicting PBA interpretations raised by plan sponsors and plan members. The courts have rendered a number of decisions which have made the administration of pension plans more difficult and have created disincentives for the establishment of new pension plans as well as the continuation of existing ones. Upon review of the PBA, we noted a number of provisions which require clarification. **(See Appendix “A” for a list of the PBA sections which, in our view, require review and clarification.)**

Long Term

In the long term (which we view as being within two to four years following the completion of the OECP’s final report) the Ontario government should:

- override trust law principles in relation to specific issues;

- amend the partial wind-up rules, including the rules governing the consequences of a partial wind-up (e.g., grow-in benefits);
- increase pension plan funding options in order to provide greater flexibility;
- promote alternative pension plan arrangements;
- take steps to address difficulties faced by administrators of multi-jurisdictional plans; and
- seek changes to or provide exemptions from the Federal Investment Rules.

Override Trust Law Principles

As we noted in our answer to Question 1.5, the application of traditional trust law principles to pension plans has, in certain circumstances, acted as a disincentive to the establishment, continuation and full funding of DB pension plans. Thus, in our view the Ontario government should amend the PBA (and thereby override the common law) to set out specific rules and parameters related to surplus withdrawal, plan mergers/asset transfers, contribution holidays and the payment of plan administration expenses. **(See Question 1.5 for further discussion of this issue.)**

Amend Partial Wind-Up Provisions and/or Grow-in

In our view, the Ontario government needs to reconsider partial wind-ups, and the benefits provided to members on partial wind-ups, and assess whether they are still meaningful and equitable in today's environment. For example, the implications of partial wind-ups to members are increased benefits – vesting, awarding any discretionary (consent) benefits, grow-in benefits and a distribution of surplus. It might be more equitable and provide greater clarity to members and sponsors if vesting and termination benefits were improved such that they would be available to all members, not just those affected by a partial wind-up. Improving termination benefits would allow grow-in benefits to be removed from the PBA on a prospective basis and could obviate the need for partial wind-ups altogether. If the concept of partial wind-ups is to be retained, then we are of the view that the requirement to distribute surplus should be removed and the rules as to what constitutes a partial wind-up (and when one can be declared) need to be significantly clarified. **(See Appendix “A” for specific recommended changes to the PBA, and our answer to Question 8.5 for further discussion of partial wind-up issues and potential solutions.)**

Provide Greater Flexibility With Respect to Pension Plan Funding

As we noted above in our answer to Question 1.4, in our view inflexible funding rules have contributed to the decline in DB plan coverage. As such, it is our view that the Ontario government should make legislative amendments to enhance funding flexibility (keeping in mind that such measures are secondary in that they would be less important if sponsors were given freer access to excess funds (surplus) in an ongoing plan (as discussed above)). Specifically, consideration should be given to permitting letters of credit and solvency accounts.

- Letters of Credit: Other jurisdictions, including the federal jurisdiction, Alberta, New Brunswick and Québec, have already passed legislative or regulatory amendments to

permit pension plans to be funded in part through letters of credit. Ontario should follow suit and enact similar 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 today's 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 (bank) that issued it, and is not contingent on the sponsor's solvency.

- Solvency Accounts: Contributions to solvency accounts would be available as a plan asset if needed (i.e., in the event of a plan wind-up). However, these accounts would (by virtue of an express statutory override) not be subject to traditional trust law principles, allowing an employer to more freely withdraw or otherwise reallocate excess amounts in the account that are not required to protect the solvency position of the plan.

These should not be the only flexible funding options available. In other words, the regulator should have the discretion to consider and approve other flexible funding arrangements that continue to effectively balance the legislative objectives (principles) 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.

Alternative Plans

As we note in our answer to Question 3.4, we are of the view that the Ontario government should actively encourage pension plan arrangements other than conventional SEPPs and DB only or DC only plans. 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, in our view the Ontario government should consider the following:

- plan designs that have features of both DB and DC plans;
- simplified DB plans for individual members;
- the creation of broadly available (e.g., industry-wide) pension plans that would better achieve economies of scale and would not restrict employees to participating in a plan only if 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).

Multi-jurisdictional Plans

As we noted in our response to Question 1.8, the many differences in pension legislation across the country make multi-jurisdictional plans more complex and costly to administer, and mean

that members of the same plan may receive different benefits depending upon where they live. Harmonization of the pension laws across Canada would be helpful, as it would simplify the administration of multi-jurisdictional plans and would provide greater certainty for plan members. However, as we discussed above, harmonization may not be achievable.

Thus, we would recommend that the Ontario government consider the alternatives described in our response to Question 1.8.

Federal Investment Rules

In most jurisdictions, including Ontario, pension plan investments are governed by the Federal Investment Rules. 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 understand that the Federal Investment Rules are outside of the Ontario government’s jurisdiction; however, we are of the view that it would be in the best interests of Ontario pension plans (and, potentially, the Ontario economy in general) to seek changes to or at least a review of these rules. In the alternative, if such an approach is not feasible, we would recommend that Ontario amend its regulations to permit exemptions from certain Federal Investment Rules (e.g., an exemption from the 30% Limit) for certain pension plans (e.g., pension plans which have minimum amount of assets, as prescribed) and exemptions from the Look Through Rule for broadly held pooled investment vehicles. **(See Appendix “A” for other issues related to the Federal Investment Rules which require clarification.)**

3.4 What degree of latitude or encouragement should Ontario pension law and policy provide for plans other than conventional single-employer plans? Should it actively encourage the formation of larger, more sophisticated sectoral, multi-employer, jointly sponsored or cooperative plans? Should other experimental designs be accommodated under the *Pension Benefits Act* and, if so, subject to what conditions and controls?

The formation of larger, more sophisticated sectoral, multi-employer, jointly sponsored or co-operative plans have many advantages that should be considered and potentially encouraged:

- greater economies of scale;
- improved portability of the workforce;
- opportunity for pooling of capital, which should improve net investment returns and reduce risk;
- opportunity for pooling of risk related to employer bankruptcies; and
- reduced risk of plan wind-ups (unless wide-spread industry/sector downsizing).

This type of plans or arrangements currently exist in some industries, but there are certain legal risks associated with MEPPs, in particular, which may act as disincentives when employers consider whether to join such a plan. **(See our answer to Question 1.7 for further discussion of such disincentives.)**

If the Ontario government wants to encourage the formation of MEPPs and other sectoral, jointly sponsored or co-operative plans, it must address this issue by enacting legislation that specifies that employers participating in a MEPP will not be held jointly and severally liable for plan deficits (which in our view was the intent behind the current legislative provisions). This is another example where the rules in the PBA, in this case related to funding on wind-up, do not adequately address types of plans other than traditional DB SEPPs.

That being said, we are of the view that these types of plans should have strict governance standards to ensure that they are properly managed and that the interests of various groups of participants (actives members, retirees) are fairly balanced. In addition, there should be completely transparent communication - filing and/or disclosure of benefit and funding policies - to ensure that stakeholders are fully aware of how the plan is to be managed.

SECTION FOUR: THE ROLE, RISKS AND ATTRACTIONS OF DEFINED BENEFIT PENSION PLANS

4.1 What are the unique attractions of defined benefit plans? What special problems are associated with them?

DB plans have a number of features which can make them more attractive than other types of retirement plans:

- Greater Predictability: By providing a specified benefit level at retirement, DB plans reduce uncertainty for members, making future planning with respect to retirement easier for members.
- Greater Income Security: The impact of fluctuations in market conditions, interest rates and longer than expected longevity is reduced for DB plan members.
- Workforce Management: DB plans can assist employers with recruitment, retention and termination (i.e., early retirement packages) of employees.

However, as we noted in our answer to Question 1.4, DB plans are also subject to special problems, including: increased volatility and costs, the potential for “trapped” capital, legal and regulatory complexity, and a perception (on the part of plan sponsors) that the system is asymmetrical or unfairly weighted in favour of plan members and poses a serious impediment to their ability to manage their business.

4.2 Will fluctuations in unionization rates and in levels of public-sector employment affect the extent of their coverage and their financial viability in general and in different sectors?

4.3 What is the effect of employer business strategies on the form of pension provision? What is the impact of privatization, mergers, acquisitions and bankruptcies on defined benefit plans?

Corporate transactions, privatizations, mergers, acquisitions and bankruptcies are a fact of life for private sector employers and we do not see this as having a direct impact on DB plans. However, the current restrictions in the PBA, which prevent employers from merging pension plans or transferring assets from one plan to another, have provided incentives for plan sponsors (or purchasers of businesses) to close DB plans and move to DC plans or other forms of capital accumulation plans (e.g., group registered retirement savings plans) for existing or transferring employees. For example, on an asset sale, purchasers will often not want to replicate a DB plan – instead providing a DC plan for “future service only” – which means that members are left with a “frozen benefit” in the DB plan and a reduced pension overall. Pension legislation should recognize the dynamic and ever-changing nature of employers who sponsor pension plans and should not create obstacles to the continuation of pension plans. (See our answer to Question 8.1 for further discussion of this issue and some of the reasons underlying the migration from DB to DC plans.)

4.4 To what extent should public policy promote and protect defined benefit plans because of their attractions? To what extent can changes in public policy and legislation reduce or eliminate the perceived shortcomings of defined benefit plans to encourage their wider adoption?

It is in the public interest to promote and protect DB plans:

- As we noted in our answers to Questions 1.1, 3.1 and 4.1, DB plans offer a number of unique attractions for employees and employers. They provide a specified benefit level at retirement, which means that plan members have a good sense of what they will receive at retirement, making future financial planning easier and reducing uncertainty.

In addition, the impact of fluctuations in market conditions and interest rates is reduced for DB plan members.

- As we noted in our answer to Question 1.9, pension plans can also have a direct impact on the economy, as DB plans, with their large pools of assets managed by knowledgeable investment managers, can make significant investments in Canadian businesses and infrastructure, thereby boosting the Canadian (and Ontario) economy and development of infrastructure.

As we have noted throughout our submission, the current laws and regulations create disincentives to continue or set up a new DB pension plan. If these disincentives were removed, through legislative amendments and changes to the regulatory regime, it is very possible that employers (at the very least current sponsors of such plans) would consider DB plans as a viable option.

4.5 Should indexation of defined benefit plans to offset inflation be left to the discretion of the plan sponsor, subject to collective bargaining in the case of unionized workplaces?

Inflation protection should be left to the discretion of the plan sponsor, subject to collective bargaining where applicable. Pension plans are voluntarily provided by employers. There are no minimum benefit levels prescribed by the legislation. In our view imposing pension plan terms on plan sponsors will serve only to make the provision of DB pension plans less attractive.

4.6 To what extent should public policy encourage experiments with new varieties of occupational pension plans (such as cash balance plans that are widely used in other countries) or with alternative types of income security plans designed to deliver retirement benefits to workers comparable to those provided by conventional defined benefit plans?

In our view the Ontario government should allow for innovation. There should not be statutory impediments to employers and employees choosing pension programs that work best for them. (Also see our answers to Questions 1.7, 3.4 and 4.4.)

4.7 Should Ontario compile and publish materials that might enable members and sponsors to make more informed choices among different types of plan design and strategy?

Once all of the necessary legislative and regulatory changes have been made to resolve the issues facing occupational pension plans (as discussed herein) published materials which assist plan members and sponsors in making informed choices with respect to the different types of plans would be helpful.

4.8 Would joint administration of defined benefit plans, or other changes in their structure and governance, make them more attractive to employers or less?

There is no evidence that joint administration produces better results. For example, Québec has utilized a joint administration model (i.e., pension committees) for a number of years and there is no evidence that such a model has resulted in DB plans being more attractive to employers. One may argue that, in fact, such a model has made DB plans less attractive – in our experience many employers have tried to contract out of joint administration and have found that they cannot.

If the OECP believes that changes need to be made to the governance of pension plans, in our view the OECP should consider corporate governance reforms (in particular with respect to board independence and financial literacy requirements) and whether such reforms would also be beneficial for pension plans, subject to the appropriate modifications. **(See our answer to Question 1.3 for further discussion of this issue.)**

That being said, expanding the available options for employers and employees in the structure and governance of DB plans may be beneficial to the overall pension system, provided that any such options are voluntary (i.e., not mandated).

SECTION FIVE: UNDERFUNDING AND OVERFUNDING

5.1 Are existing definitions of plan “solvency” realistic?

5.2 Are the consequences of over or underfunding for employers, workers and pensioners fair, clearly stipulated, well understood and appropriately enforced?

Historically, the consequences of over and underfunding for plan sponsors have not been clearly stipulated or well understood. Taking steps to better address these kinds of issues (e.g., the development of written funding policies) on a proactive basis would be a helpful change. This is particularly important for any plans that are (or will be) exempt from solvency requirements and have benefits that may be reduced in the event of significant underfunding.

There is a perception among many stakeholders in the pension industry that there is an asymmetry of risk in relation to DB plan funding, particularly in the case of SEPPs, which is detrimental to plan sponsors. Plan sponsors are ultimately responsible for the funding of pension benefits and usually are wholly responsible for any shortfalls, but their ability to access or make use of surplus (other than for benefit improvements) is very limited. The current surplus withdrawal process, for example, is impractical and cumbersome in that it requires a plan sponsor to demonstrate legal entitlement to surplus even where it has obtained the requisite amount of support from plan members and former members.

In our view, the main focus of the PBA for an ongoing plan should be on protecting and securing the pension benefits that have been promised to members. Recent cases involving the “use” of surplus for contribution holidays, payment of plan expenses, or funding benefits to new groups of beneficiaries have, in our view, distracted all stakeholders from this fundamental goal.

Steps need to be taken to address plan sponsors’ perception that pension regulation does not fairly balance the (sometimes competing) interests of plan sponsors and plan members. In our view, this can be accomplished by addressing a number of the points made throughout our submission, including, for example:

- amending the PBA to specifically recognize a plan sponsor’s interest in a DB plan (see **our answer to Question 1.5**);

- adopting express principles which indicate that the regulator is focussed on protection of defined benefits and surplus is secondary to that objective (**see our answer to Question 1.6**); and
- encouraging overfunding of plans by easing plan sponsor access to surplus (subject to reasonable controls) (**see our answer to Question 1.5**).

5.3 Is there a necessary connection between underfunding and overfunding? If so, what does that connection mean for how the rules should address both situations?

Yes, there is definitely a connection between underfunding and overfunding in relation to DB plans.

The funded status of plans can go up and down year after year based on changes in contribution levels, interest rates and demographics. Underfunding and overfunding is part of the cyclical nature of an ongoing plan (i.e., it is never perfectly funded while ongoing).

As a result of the *Monsanto* decision (discussed above) and the difficulties associated with withdrawing surplus from a DB plan, sponsors are effectively encouraged to make only minimum statutory contributions. In other words, plan sponsors' attempts to avoiding overfunding (and, thereby, creating pension plan surplus) promotes pension plan underfunding. To state the obvious, this is not an ideal situation from the perspective of the plan members.

In our view, the Ontario government should address this situation by (i) encouraging plan sponsors to overfund (by removing barriers to sponsor access to surplus in an ongoing plan); and, failing that, (ii) enhancing funding flexibility through provisions permitting letters of credit and solvency accounts, thus providing greater flexibility to plan sponsors while strengthening benefit security for plan members. (**See our answers to Questions 1.5 and 3.3 for a further discussion of these issues and descriptions of letters of credit and solvency accounts.**)

5.4 Should the pension regulator have wider powers to address funding concerns? If so, should these be discretionary powers?

Greater funding flexibility (as discussed in our answers to Questions 3.3 and 5.3) – as opposed to increased regulatory oversight – is the better way to resolve funding concerns. However, the pension regulator needs some residual powers to allow for alternative flexible funding arrangements (as further described in our answer to Question 5.6).

5.5 Should different rules apply to different kinds of plans and different kinds of employers? If so, what distinctions would be appropriate and why?

As we noted in our answer to Question 1.7, pension plans with different risk/reward characteristics (such as DB plans versus DC plans and MEPPs versus SEPPs) could be subject to different legislation, regulations and policies with respect to plan funding, where appropriate.

5.6 Should relief be provided against present solvency funding requirements, and if so, to which types of pension plans, in which sectors, and under what conditions?

In our view, all plans (regardless of type or sector) should have access to more flexible plan funding requirements. In particular, the PBA should be amended to clarify that other funding options such as letters of credit and solvency accounts (as we suggest in our answers to Questions 3.3 and 5.3) are permitted. It would also be a good idea to allow the regulator to grant discretionary relief from solvency funding requirements in appropriate cases (e.g., where the regulator is satisfied that the plan members' benefits will be otherwise protected or that the members' best interest is in having the plan (and employer contributions) continue, rather than winding up the plan).

5.7 Should the sponsoring employer's financial strength be taken into account? And if so, to what extent and by what means?

In our view, it would be difficult to quantify an employer's creditworthiness in a manner that is relevant for plan funding purposes, for example:

- Accounting rules applicable to financial statements are not necessarily designed with pension plan funding issues in mind (e.g., a "write down" on a financial statement does not necessarily impact a plan sponsor's ability to fund its plan).
- Private companies (which are not subject to the same disclosure rules as public companies) may be able to arrange their financial statements in a manner that makes them appear more financially sound than they actually are.
- Credit rating services (such as Moody's) may base their ratings on criteria that are not necessarily indicative of a plan sponsor's ability to fund its plan.

We also note that, under the current PBA, the financial strength of the employer is not a condition to establishing a plan, nor does it determine different funding levels. If the employer's financial strength is not a condition taken into account in determining solvency funding levels, it is not appropriate for the regulator to take steps to require additional funding levels based on its perception of an employer's diminished financial strength.

5.8 What types of measures might be made available to employers to enable them to deal with funding deficiencies that seem likely to be short term?

In our view, letters of credit and solvency accounts (as discussed in our answer to Question 3.3) could be used to enable employers to deal with funding deficiencies in the short term.

SECTION SIX: ENSURING SOLVENCY IN A VOLATILE ECONOMY

6.1 Should Ontario urge the federal government to amend the Income Tax Act to allow plan sponsors to make extra contributions to the plan from time to time to keep it solvent over the long term?

We are of the view that amendments to the Income Tax Act (Canada) (the “ITA”) to allow plan sponsors to make extra contributions are desirable, but should be considered secondary to (i) removing barriers in the system which create disincentives to overfund; and (ii) increasing funding flexibility (i.e., letters of credit, solvency accounts). If the PBA is amended to give plan sponsors freer access to use of surplus and/or to permit greater funding flexibility, plan sponsors will be better able to manage plan funds and avoid excess surpluses in the short term and solvency deficiencies in the long term.

Nonetheless, we are of the view that the current limits in the ITA are too low. Accordingly, we think it would be helpful for Ontario to urge the federal government to amend the ITA to allow plan sponsors to make extra contributions when required, although we would not consider this to be a top priority.

6.2 Should plan sponsors be given greater latitude to increase contributions or reduce benefits under carefully specified conditions?

In our view, the PBA should be amended to provide plan sponsors with greater flexibility to increase contributions or reduce benefits under carefully specified conditions. For example, early retirement provisions that were introduced in an environment of excess labour supply may no longer make sense in an environment of labour shortages. Subject to the agreement of interested plan members (or any unions representing them), plan sponsors should be able to terminate this type of provision with respect to benefits earned to date (in addition to the current ability to make this change with respect to future accruals) or, in the alternative, to increase plan members’ contributions in order to continue the benefit.

There would have to be specific rules enacted to ensure that plan members are properly advised of any changes and understand their implications, for example:

- requirements with respect to the content and timing of notices to plan members; and
- requirements with respect to independent advice.

6.3 Should public policy encourage some other approach to the possible loss of plan solvency, such as mandating the establishment of earmarked contingency reserves?

We understand a contingency reserve to be a reserve account established within the current funding vehicle to protect a plan against investment losses or lower than expected investment returns. In simple terms, this would mandate plans to fund to higher solvency levels than is currently the case.

In our view, in the current environment of inflexible pension plan funding, mandating the establishment of earmarked contingency reserves within a pension trust would discourage the establishment of new DB plans and the continuation of current ones. As we have noted above, due to the application of classic trust law principles to the pension plan context and difficulties associated with withdrawing surplus from a DB plan, sponsors are encouraged to make only minimum statutory contributions to pension plans in order to avoid the creation of trapped capital (surplus) in the future. A contingency reserve would most likely be viewed by plan sponsors as another potential source of trapped capital.

Presumably, the objective of contingency reserves is to enhance benefit security. In our view, this objective could be better achieved by establishing solvency accounts. Contributions could be made to solvency accounts, which would be available as a plan asset if needed (i.e., in the event of a plan wind-up). However, these accounts would (by virtue of an express statutory override) not be subject to traditional trust law principles, allowing an employer to more freely withdraw or otherwise reallocate excess amounts in the account that are not required to protect the solvency position of the plan.

6.4 If a plan sponsor decides to pursue riskier investment strategies to deal with solvency concerns, should this decision be required to be taken according to some special procedures, or made subject to more intensive oversight?

While pension investment and funding are inextricably linked, specific funding rules targeted to investment risks will be extremely difficult to implement (e.g., who determines what investments are more (or less) risky given currency risks, credit risks, etc.?). Currently, a plan administrator needs to exhibit prudence in setting its investment strategy. The “prudent person rules” are sufficient for this purpose and by their nature need to be applied on a case-by-case basis. Similarly, regulatory oversight needs to reflect both the prudent person rules and the fact that pension plans and their sponsors are unique. It too needs to be implemented on a case-by-case basis.

6.5 What effect might changes in the investment strategies of pension plans, and in the rules governing investment strategies, have on capital markets in Ontario?

SECTION SEVEN: THE PENSION BENEFITS GUARANTEE FUND

We have chosen to provide one response to Questions 7.1, 7.2, 7.3, 7.4 and 7.5, as follows.

7.1 Are the present rules concerning premiums, eligibility for protection and levels of protection appropriate? If not, how might these be changed in the longer term?

7.2 Is the PBGF adequate to meet foreseeable claims on it under existing eligibility rules? If not, should the existing rules be changed? Should the PBGF be more appropriately funded?

7.3 Is a guarantee fund, such as the PBGF, the most appropriate way to protect the interests of plan members and pensioners from the effects of plan underfunding or the employer’s insolvency? If not, what are the alternatives?

7.4 Should oversight of the PBGF continue to be assigned to Ontario's pension regulator or should it be moved to some other institution? What powers should the overseeing institution have to adjust premiums paid to and benefits paid from the plan?

7.5 What connection should any of the above changes have to rules governing the funding of pension plans?

In our view, guarantee funds such as the PBGF are an inadequate and imperfect solution to the underfunding of DB pension plans for a number of reasons:

- Those plans with the greatest need have sponsors with the least ability to pay for realistic insurance levels.
- An unfair burden, relatively speaking, falls on sponsors with well-funded plans.
- Guarantee funds encourage practices that expose the fund to the risk of large claims (i.e., benefit improvements or reckless investment policies).
- In the jurisdictions which have guarantee funds, such funds tend not to be self-funded in that they need to rely on government funding to pay out all covered benefits. Often, as is the case with the PBGF, several very large claims use up most of the assets of the guarantee fund. As a result, the guarantee funds transfer risk from those with pensions, albeit underfunded ones, to taxpayers generally, many of whom have no pensions at all.
- Guarantee funds distort regulatory or governmental intervention in underfunded circumstances, as there is an inherent conflict in protecting plan members and protecting taxpayers.
- Currently, not all Ontario pension plans are eligible for coverage under the PBGF. MEPPs, which are arguably more inherently at risk for funding problems than SEPPs, are exempt from PBGF premiums and, as a result, members cannot receive any benefits.

While the PBGF has provided protection to members in some instances, overall, guarantee funds are not an appropriate way of addressing pension plan funding problems. Any guarantee fund system will have the inadequacy and the inherent flaws referred to above.

As such, proper funding rules which provide for flexibility and fairness and encourage employers to fully fund their plans without fear of creating trapped capital and, thereby, avoid creating situations requiring them to call upon the assistance of a guarantee fund are the preferable protection for members' promised pension benefits.

SECTION EIGHT: SIGNIFICANT CHANGES TO PENSION PLANS AS A RESULT OF CHANGES IN THE EMPLOYMENT RELATIONSHIP: WIND-UPS, SPLITS, MERGERS AND INSOLVENCIES

8.1 How should the PBA deal with plan mergers, splits and restructurings? How might such changes affect plan members? How might they affect plan funding?

Plan Mergers/Asset Transfers

In our experience, pension plan mergers and asset transfers are utilized by companies for a number of reasons, including:

- a plan in surplus may be merged with a plan in deficit in order to use the surplus in one plan to offset the funding obligations with respect to the other;
- plans may be merged or assets transferred as a part of a corporate restructuring in order to achieve certain synergies and thereby reduce administrative costs; or
- assets may be transferred as a part of a sale of business in order to:
 - keep plan members “whole” by permitting future salary increases to apply to benefits accrued in the vendor’s pension plan;²⁶ and
 - permit the vendor to transfer liability for such benefits to the purchaser.²⁷

Plan Mergers/Asset Transfers Limited by Current Legal Regime

A lack of clarity in the case law, coupled with minimal legislative guidance and restrictive policies developed by FSCO, have greatly limited pension plan mergers and asset transfers in Ontario:

- Impact of *Transamerica*: As a result of the *Transamerica* case, the ability to transfer assets between DB pension plan trusts – something which previously had been broadly accepted as permitted – has been called into question. Consequently, FSCO has imposed strict conditions on applications for the transfers of assets between pension plans, including mergers of pension plans operated by the same employer. The imposition of such conditions has made asset transfers and mergers between DB plans difficult and complex.

²⁶ Otherwise, affected plan members’ benefits would remain “frozen” in the vendor’s pension plan, as the benefits would be determined based on their earnings up to the date of sale, without the benefit of including future earnings increases with the purchaser.

²⁷ Section 80(2) of the PBA specifically excludes any continuing obligation for benefit funding for a former employer where a successor employer specifically assumes responsibility for the accrued pension benefits of the affected employees.

- Requirements to Transfer Identical Benefits: FSCO has taken the position that, under section 80 of the PBA, plan members whose benefits are being transferred into another DB plan must be offered benefits identical in every respect to those provided in the exporting plan. Identical benefits are difficult for the importing plan to administer since a plan amendment is required and the benefits may be different than those offered under the main plan formula.
- Proportionate Share of Surplus on Transfer of Assets: On a plan split or asset transfer, the PBA does not clearly provide that a proportionate share of assets to liabilities (which would include proportionate share of surplus) must be transferred from the vendor's (exporting) to the purchaser's (the importing) plan. However, in the *Burke*²⁸ decision, the Ontario Superior Court found that the failure to transfer a proportionate share of surplus on a transfer of pension benefits and assets constituted a breach of trust on the basis that the transferred plan members had an expectation that surplus might be used for future benefit increases. In our experience, the possibility that surplus may have to be transferred as a part of an asset transfer discourages sponsors of the exporting plan from proceeding with the asset transfers and, more generally, from continuing to sponsor a DB plan at all.

Potential Solutions

- In our view, the above-noted issues that are preventing plan sponsors from proceeding with plan mergers and asset transfers could be addressed by taking the following steps:
 - Amend the PBA to override *Transamerica* (and trust law as it applies to plan mergers) to make it clear that plan mergers and asset transfers between DB plans are permitted in appropriate circumstances (e.g., provided members' accrued pension benefits are not reduced) or at least to make it clear that the regulator may approve such mergers without consideration of trust law rights to surplus (these rights may be asserted by members in the courts, subject to reasonable limitation periods).
 - Amend the PBA to make it clear that on an asset transfer the successor plan need not provide identical benefits, but rather may provide benefits of equivalent value.
 - Amend the PBA to clarify what obligation, if any, exists to transfer a proportionate share of surplus on a pension asset transfer or plan split, and that the transfer is subject only to the agreement of the parties and does not depend on the historical terms of the exporting plan's trust.
 - Amend the PBA to clarify that deemed continuation of employment rules (sections 80 and 81) do not prevent plan members from collecting a pension from one employer and then accruing a pension with the new employer, if the first plan allows it.

²⁸ *Burke v. Hudson's Bay Company* (2005), 51 C.C.P.B. 66 (Ont. S.C.J.).

Effect of Proposed Changes on Plan Members/Plan Funding

In our view, addressing the above-noted concerns (as suggested above) would simplify plan mergers and asset transfers and make them more likely to proceed, which, in turn, would have the following positive implications:

- Plan members affected by a sale of business would remain “whole” by receiving one pension from the purchaser.
- Plan sponsors would be able to reduce administrative costs associated with administering more than one plan and to take advantage of surplus in one plan to meet funding obligations in another.
- Plan sponsors who are undergoing corporate restructuring would have greater flexibility with respect to their pension plans. This makes it more likely that the plan sponsors will continue those plans. It also facilitates corporate restructuring, generally, and the associated economic growth in Ontario.
- None of the changes would jeopardize members’ accrued pension benefits.

8.2 Should the same wind-up procedures apply to all kinds of pension plans, or do some require more intensive controls than others? Should wind-up procedures be simplified?

In our view, the issue is not whether certain kinds of pension plans should be subject to different wind-up procedures, but rather whether certain wind-up procedures and rights should be applied at all. We can think of no basis on which wind-up rules ought not to be applied to all types of plans. (See our answer to Question 8.5 for discussion of how wind-up procedures could be simplified.)

8.3 Should the pension regulator retain discretion within certain parameters to order a wind-up when the viability of the plan is at stake because of corporate restructuring or threatened insolvency?

Clearly, the insolvency of an employer with an underfunded plan can lead to a pension plan wind-up where plan members’ benefits are in jeopardy to some degree. On the other hand, regulatory intervention requiring additional plan funding before there is an actual insolvency can create further uncertainty regarding the status of the plan sponsor or the insolvency itself (e.g., the Air Canada insolvency). Uncertainty in this area or precipitate action on the part of the regulator can have serious financial consequences to a business in financial difficulties, as well as its creditors and owners, thus impairing the ability of the business to restructure.

We are of the view that the protection of the plan members and the imperatives of corporate health and survival must be carefully balanced. Regulators should be entitled to require an up-to-date valuation where the plan is underfunded and the employer is in financial difficulty, but they should not be able to mandate plan funding that is in excess of what the employer is already obligated to contribute under the PBA. In our view, any regulatory action should be in accordance with clearly defined and articulated criteria, and upon full discussion with the plan sponsor. (Also see our answer to Question 5.7.)

8.4 Should the PBA be amended to more specifically deal with pension plan mergers?

The PBA should be amended to override trust law as applies to plan mergers, and to specify the circumstances under which pension plan mergers are permitted and the requirements that must be met in order for plan mergers to proceed. (Also see our answer to Question 8.1.)

8.5 Should partial wind-ups in Ontario be eliminated entirely, as they have been in Québec? If not, should Ontario adopt clearer or different rules concerning the distribution of plan surpluses and the preservation of “grow-in” rights in the event of partial wind-ups?

Difficulties with Partial Wind-Ups

There are a number of issues associated with pension plan wind-ups which cause difficulties for plan administrators:

- the Superintendent’s broad discretionary power to order the wind-up of a pension plan;
- the application of the rules governing the full wind-up of pension plan to a partial plan wind-up; and
- the inclusion of “grow-in” rights on plan wind-up.

Superintendent’s Discretion to Order a Wind-Up

Section 69 of the PBA provides the Superintendent with a fairly broad discretionary power to order the wind-up of a pension plan. The circumstances under which the Superintendent will order a partial wind-up are not always clear, leading to uncertainty for plan sponsors. For example, pursuant to section 69(1)(d) of the PBA, the Superintendent may order a plan wind-up where a “significant” number of members of the pension plan cease to be employed by the employer. The PBA does not provide a definition of what constitutes a “significant” number. The Superintendent, FSCO, the Tribunal and the courts have not adopted a specific minimum percentage as a basis for determining what constitutes a significant number. Nor is the measure of “significant” confined to a determination of the relevant number of terminations, as the case law has held that “significant” can be viewed either in absolute terms (based on the absolute number of terminations) or in relative terms (based on a comparison between the number of terminations and the total number of active plan members).²⁹ To further compound such uncertainty, it is possible for partial wind-ups to be ordered many years after the underlying events have occurred – there is no limitation period in the PBA.

Full versus Partial Wind-Up Rights

Certain member rights on the full wind-up of a pension plan have been applied to partial plan wind-ups, leading to difficulties for plan administrators:

²⁹ See, for example, *Hydro One Members’ Committee v. Superintendent of Financial Services, Hydro One, Power Workers’ Union and Society of Energy Professionals* (August 2, 2007) FST File No. P0257-2005 (F.S.T.) and *London Life Insurance Company v. Ontario (Superintendent of Financial Services)* (2000), 26 C.P.P.B. 244 (F.S.T.).

- Application of *Monsanto* Case: As we noted in our answers to Question 1.5 and 3.3, the *Monsanto* decision requires the distribution of a proportional share of surplus when a DB pension plan is partially wound up, rather than at a future date (i.e., when/if the plan is fully wound up). Such a legislative requirement is problematic in that it does not recognize the fluid nature of pension plan surplus (i.e., volatile market conditions can make a “surplus” disappear almost overnight) or the fact that partial wind-ups may be ordered by the Superintendent years after they have occurred.
- Forced Annuitization: FSCO has interpreted the definition of “partial wind up” under the PBA³⁰ to require annuities to be purchased for affected members, so that their benefits are not payable from the pension plan itself. Depending on the level of interest rates at the time, such an annuity purchase could result in significant (and unforeseen) costs being borne by the pension fund. Furthermore, forced annuitization may cause plan members to lose out on potential *ad hoc* increases to pensions in pay that the plan sponsor may in the future decide to provide to those pensioners whose payments are being made from the plan fund.

Grow-In Rights

Grow-in rights entitle certain members of wound-up plans not only to the pension benefits that they have earned up to the wind-up date, but also to the early retirement benefits that they would have “grown into” had both the plan and their employment continued. As we noted in our answer to Question 3.3, grow-in benefits distort the pension promise, as they provide members with benefits that were not necessarily intended by the plan sponsor.

Grow-in rights can create an additional funding burden on the affected pension plan, particularly where the plan provides generous benefits (i.e., early retirement provisions) which the members are able to grow into. Moreover, the liabilities for “grow-in” rights have to be taken into account in any solvency valuation. Apart from Ontario and Nova Scotia, there is no other jurisdiction in Canada that imposes similar rules.

Potential Solutions

In our view, the above-noted requirements regarding surplus distribution, forced annuitization and grow-in rights act as a disincentive to fully funding DB pension plans, providing generous benefits (e.g., early retirement provisions) and establishing/continuing such plans at all. As such, the Ontario government needs to reconsider the purpose of partial wind-ups, the benefits provided to members on partial wind-ups and whether they are still meaningful and equitable in today’s environment.

Our understanding is that partial wind-ups were instituted in order to protect employees about to lose their jobs as a result of downsizing, insolvency or a sale of business, because they were being denied the opportunity to realize the full value of their DB plan benefits. However, as a result of the *Monsanto* decision, members’ partial wind-up benefits have expanded to include not

³⁰ The definition of partial wind-up states that a partial wind-up is “the termination of part of a pension plan and the distribution of the assets of the pension fund related to that part of the pension plan”.

only increased termination benefits – vesting, awarding any discretionary (consent) benefits, and grow-in benefits – but also entitlements to surplus distribution (being an *ad hoc* benefit).

The policy rationale underlying the entitlement of some members affected by a particular event to special benefits, while others who terminate in the normal course are not entitled to any improved benefits is not clear to us. In our view, grow-in benefits distort the pension promise, providing some members with benefits that were not necessarily intended by the plan sponsor. For example, while the sponsor may have a sound rationale for including early retirement enhancements in its pension plan, being forced to provide such enhancements upon a partial wind-up being declared, while other plan members who terminate outside of a partial wind-up do not receive a similar benefit, is in our view a distortion of the economic relationship between employer and employee and an unnecessary legislative intervention into the bargain that the parties have reached. Similarly, the distribution of surplus on a partial wind-up does not appear to be equitable since other terminated members who are not part of the partial wind-up enjoy no such rights.

The government should consider whether it might be more equitable and provide greater clarity to members and sponsors if vesting and termination benefits were improved such that they would be available to all members, not just those affected by a partial wind-up. Improving termination benefits would allow grow-in benefits to be removed from the PBA on a prospective basis and could obviate the need for partial wind-ups altogether. The removal of partial wind-ups from the legislation has already been implemented successfully in Québec. The termination of grow-in benefits would also make Ontario consistent with almost every other jurisdiction in Canada and, thereby promote harmonization (which would be helpful for administrators of multi-jurisdictional plans, as discussed below).

If the concept of partial wind-ups is to be retained, then we are of the view that the following issues require clarification and/or amendment. **(Also see Appendix “A” for specific recommended changes to the PBA.)**

- Clarify the circumstances in which the Superintendent may order a partial wind-up (e.g., the employer has terminated the employment of a specified percentage its workforce).
- Specify that surplus does not have to be distributed on a partial plan wind-up unless the plan so provides.
- Specify that the distribution of benefits and any surplus (if applicable) does not require the purchase of annuities for affected members.
- Impose a limitation period of three years on the Superintendent’s authority to declare that a partial wind-up has occurred.
- Address surplus issues on wind up. The PBA could be amended to provide for employer ability to withdraw surplus if it can demonstrate legal entitlement (based on historical plan provisions) *or* if it obtains the consent of two-thirds of plan members and two-thirds of former plan members.

- Eliminate grow-in benefits, consistent with almost every other jurisdiction in Canada. (Thus, such a change would also promote harmonization.) Or, in the alternative, blunt the impact of grow-in benefits (as Nova Scotia has done) by specifying that:
 - liability for the value of grow-in benefits is no longer required to be included in solvency valuations; and
 - on full or partial plan wind-up, grow-in benefits are payable only if there are surplus funds remaining after all other benefits have been paid.

8.6 What would be the best approach to protecting the ongoing rights of plan members and pensioners, in the event of a material change in the identity, structure or financial circumstances of a sponsoring employer?

Change in Identity/Structure

In our view, the rights of plan members and pensioners affected by a change in the identity or structure of the sponsoring employer are already protected by the current legislative scheme. Section 80 of the PBA deals with member rights in the context of a sale of business (i.e., where there is a successor employer), and section 81 addresses situations where the employer has established a successor pension plan. Both sections specify that when there is a transfer of assets from one pension fund to another, the Superintendent must consent to the transfer. The Superintendent is also required to refuse to consent to a transfer that does not protect the pension benefits and any other benefits of members and former members, including pensioners. Furthermore, upon the sale of a business the legislation preserves entitlement to the benefits accrued to the date of sale, and recognizes service with both the vendor and purchaser in determining eligibility for, and vesting of, benefits under both the vendor's plan and the purchaser's plan.

Change in Financial Circumstances

The idea of giving pension funding a priority in bankruptcy has been raised in recent cases³¹ and proposed legislative amendments.³² Currently, any unfunded pension liability is an unsecured claim, while the deemed trust/statutory lien provision in respect of unpaid pension contributions do not prevail in a bankruptcy. We are of the view that there are serious risks and challenges in giving pension funding any greater priority:

- a possible increase in the sponsor's cost of capital;
- some companies with significantly underfunded plans could have serious difficulty raising capital;

³¹ See, for example, *Re Ivaco Inc.* (2007), 56 C.C.P.B. 1 (Ont. C.A.).

³² The *Wage Earner Protection Program Act* (Bill C-55), which was passed by the federal government in 2005, but never proclaimed, would have created a priority claim in bankruptcies and receiverships for unpaid "normal service" employer pension contributions as well as for employee contributions that were deducted by the employer but not paid into the plan.

- it could have an impact on a company's share price, potentially affecting the company's ability to meet debt obligations;
- it could impact the value of that company in the investment portfolios of other pension plans;
- solvency valuations can be very volatile, and usually are not performed very frequently (thus it is not clear how a company's creditworthiness would be determined); and
- we are aware of situations where lenders of capital have insisted on constraints around a company's pension plan (e.g., on benefit improvements or the establishment of new plans).

Thus, in our view the better approach would be to entitle regulators to require an up-to-date valuation where the plan is underfunded and the employer is in financial difficulty, but any further action should be in accordance with clearly defined and articulated criteria, and upon full discussion with the plan sponsor. In addition, as we discuss throughout this submission, proper funding rules which provide for flexibility and fairness and encourage employers to fully fund their plans without fear of creating trapped capital are the preferable protection for members' promised pension benefits.

SECTION NINE: REGULATING THE PENSION SYSTEM

9.1 Should Ontario be seeking to replace or reinforce existing interprovincial arrangements that give it responsibility for pension plans with members outside the province?

In our view, Ontario should seek a revised multi-lateral agreement among the pension authorities which clarifies the procedural and administrative matters that may be determined in accordance with the law of the province of the plan's registration. **(See our answer to Question 1.8 for further discussion of pension plan harmonization issues.)**

9.2 Should an effort be made to clarify and codify the law governing pension plan funding in Ontario? If so, should the PBA be amended to encompass matters now dealt with by the general law?

The intent of this question is not entirely clear to us.

If the OECP is asking whether more prescriptive rules regarding funding requirements and actuarial valuations should be added to the PBA (similar to the U.K.), then in our view the answer is "no". We understand that such prescriptive rules lead to greater volatility in plan funding.

If, on the other hand, the OECP is asking whether the PBA should be amended to permit greater funding flexibility, then in our view, the answer is "yes". In particular, the PBA should be amended to clarify that other funding options (i.e., letters of credit, solvency accounts) are permitted. **(See our answers to Questions 3.3 and 5.3.)**

If the OECP is asking whether the PBA provisions governing the respective roles and responsibilities of plan sponsors and actuaries in plan funding need to be clarified, we would agree. Rather than creating a general fiduciary duty in respect of plan funding, it would be helpful for the PBA to be amended to clarify precisely “who must do what” in relation to funding decisions. Subject to legislated minimum standards, a plan sponsor’s decision as to how much to fund in any given year (or how often to file valuation reports) should be an “employer” decision and not a fiduciary one.

9.3 Should an effort be made to ensure that pension plan sponsors and beneficiaries are better acquainted with their rights and obligations?

Once all of the necessary legislative and regulatory changes have been made to resolve the issues facing occupational pension plans (as discussed herein) we are of the view that an effort should be made to ensure that pension plan sponsors and beneficiaries are better acquainted with their rights and obligations.

9.4 Are the powers and staff resources of FSCO, the FST and the Superintendent of Financial Services adequate to perform the tasks presently assigned to them, and would the assignment of further responsibilities require additional powers and resources?

As we noted in our answer to Question 1.6, we are of the view that that the current regulatory oversight of Ontario pension plans is inadequate and ineffective. In our experience, there is a lack of clear directives or policies on certain issues (e.g., pension plan investments) and many pension plan transactions requiring FSCO approval (e.g., plan mergers, asset transfers) take years to complete due to FSCO delays. Appeals of FSCO decisions to the Tribunal are often an inefficient use of time and resources, as their decisions are shown no deference by the courts.

While some of these problems may be due in part to insufficient resources, in our view, the underlying causes are:

- the failure to set out clear guiding principles for FSCO;
- contentious court decisions requiring FSCO to interpret legal issues outside of its expertise; and
- the failure to specifically require that FSCO and the Tribunal are staffed by members with the appropriate expertise.

In our view, before any further responsibilities or powers are bestowed on FSCO, the Superintendent or the Tribunal, it is critical that the regulator be restructured and, in particular, FSCO’s focus be shifted to enforcement of the PBA. In our answer to Question 1.6 above, we set out the steps that, in our view, need to be taken in order to ensure that Ontario pension plans are subject to an effective regulatory body.

9.5 Should some of these tasks be reassigned to other bodies, such as the courts, or discontinued altogether?

FSCO

As we noted in our answers to Questions 1.6 and 9.4, due to a number of contentious court decisions, FSCO has been required to focus a great deal of its resources on the interpretation and application of trust law issues. This is an area in which FSCO has no special expertise and in which neither FSCO nor the Tribunal are accorded any deference by the courts. As we suggested in our answer to Question 1.5, we are of the view that this issue could be best resolved by amending the PBA (and thereby overriding trust law principles) to specifically address plan mergers, asset transfers, plan administration expenses and surplus distributions. Such changes would shift FSCO's focus from the application of trust law to the enforcement of legislative provisions which, in our view, is a more appropriate use of FSCO's resources.

Tribunal

We note that the role of the Tribunal appears to have evolved over the years from hearing appeals from Superintendent orders on broader regulatory matters (e.g., plan wind ups, surplus withdrawal approvals) to hearing individual complaints over plan benefit entitlements. Such individual plan member disputes are initiated by the member complaining to the Superintendent that the plan administrator is not following the plan documents as filed. If the Tribunal is to serve as a low cost/expeditious adjudicator of such disputes (rather than the courts), then this should be better recognized in the PBA and steps taken to ensure the courts give more deference to Tribunal decisions. **(See our response to Question 1.6 regarding the need for amendments to the Tribunal structure.)**

9.6 What is an appropriate regulatory role for expert and professional bodies in the Ontario pension system?

FSCO has established advisory councils which are invited, from time to time, to provide confidential advice to the Superintendent on forthcoming policies and other initiatives. Both FSCO and the Ministry of Finance also engage in *ad hoc* consultation sessions with the pension industry (or selected sectors) on particular issues.

However, in our view, both FSCO and the Ministry of Finance should avail themselves of industry expertise more often than they do. Consultation with industry experts is particularly important in the pension field, as many of those involved in pension policy and regulation gained the majority, if not all, of their expertise within government. Those in the industry have broad-based expertise in the pension system (whether it be legal, actuarial, investment or otherwise) and are able to bring a different perspective to the table.

This different perspective may be particularly helpful when considering the realities of the Ontario/Canadian business environment. For example, the current pension legislative and regulatory regime does much to hamper business transactions (i.e., pension plan asset transfers are almost non-existent, purchasers are required to provide identical benefits). Industry experts would be able to advise the Ontario government on how the current legal regime affects Ontario's businesses and economy.

APPENDIX “A” – AMENDMENTS TO THE PBA AND THE REGULATION

Section(s)	Description of Provision(s)	Issue	Recommendation
Act s.1(1)	A partial wind-up is “the termination of part of a pension plan and the distribution of the assets of the pension fund related to that part of the pension plan”.	This has been interpreted to require annuities to be purchased for members affected by a partial wind-up, so that their benefits are not payable from the pension plan itself.	Clarify that annuities need not be purchased for members affected by a partial wind-up.
Act s.1(4)	A pension plan is not a MEPP if the contributing employers are “affiliates” within the meaning of the Ontario <i>Business Corporations Act</i> (the “OBCA”).	This exception is too narrow. For organizations to be considered affiliates, one must be a subsidiary of the other or both must be subsidiaries of a third corporation or they must be “controlled” by the same person. More than 50% ownership is required for there to be control. This means that, for example, joint ventures cannot be considered affiliates for purposes of the PBA.	Remove reference to affiliate as defined in the OBCA. Draft definition of affiliate that takes into account purpose of the PBA (i.e., different corporate structures which may not be related for corporate purposes would be sufficiently related for purposes of participation in a pension plan).
Act s.22(4)	A plan administrator shall not knowingly permit its interests to conflict with its duties in respect of the plan.	It is unclear how this provision interacts with the “related party provisions” of the Federal Investment Rules (sections 15, 16 and 17 of Schedule III).	Clarify what constitutes a conflict of interest under the PBA in light of the requirements of the related party rules.

Section(s)	Description of Provision(s)	Issue	Recommendation
Act s. 26(1)	The Superintendent shall require notice to members of adverse amendments.	In <i>Kerry</i> , the Court held that the plan administrator had a duty to give notice of a potentially adverse amendment.	Clarify who is responsible for determining whether an amendment is adverse and notice is required; OR eliminate this provision, since following the notice the Superintendent has no power to disapprove the amendment in any event (the regular PBA notice provisions should apply).
Act s.48(13), 51	Entitlement to pre-retirement death benefits and division of pension on marriage breakdown.	The requirements of these provisions and how to implement them are not clear, leading to great confusion among plan administrators and divorcing spouses.	Provide clear rules for valuation and division of pension benefits on marriage breakdown (we note that British Columbia has done much work in this area).
Act s.50	A pension plan may provide for the commutation of small benefits.	This exception permitting the commuted value of a pension to be paid out (rather than an actual pension) is too low.	Increase the amount which may be considered a small benefit.
Act s.69	The Superintendent may order the partial wind-up of a pension plan.	The circumstances in which a partial wind-up may be ordered by the Superintendent are not clear, and there is no limitation period applicable to such orders.	Make partial wind-up orders by the Superintendent subject to a limitation period (e.g., three years).
Act s.70(6)	Members affected by the partial wind-up of a plan have the same rights as they would have had on a full plan wind-up.	Pursuant to <i>Monsanto</i> , members are entitled to surplus distribution on a partial plan wind-up.	Clarify that this provision does not mean that partial wind-up members are entitled to a distribution of any surplus.

Section(s)	Description of Provision(s)	Issue	Recommendation
Act s.79(3)(b)	The Superintendent shall not consent to a surplus application unless the plan provides for payment of surplus to the employer.	Unlike many jurisdictions in Canada, employers must demonstrate entitlement to surplus even if they have a very high percentage of member consents.	Permit employers ability to withdraw surplus if they can demonstrate entitlement <i>or</i> they obtain the consent of two-thirds of members and two-thirds of former members (i.e., those still entitled to benefits).
Act s.80	On a sale of business, members' employment is deemed not terminated.	Deemed continuation of employment prevents employees from exercising portability options.	Permit portability.
Reg. 79	Assets of all plans must be invested in accordance with the Federal Investment Rules.	Some of the Federal Investment Rules are no longer practical. For example, the 30% Rule (sections 11-14 of Schedule III) prohibits plans from investing 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 and the Look Through Rule (section 2 of Schedule III) requires plan administrators 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.	Create exemptions to specified Federal Investment Rules for Ontario pension plans which have a minimum amount of assets, as prescribed, and for broadly held pooled investment vehicles.

Section(s)	Description of Provision(s)	Issue	Recommendation
New Provisions	<p>Add provisions:</p> <ul style="list-style-type: none"> • permitting phased retirement (the Ministry of Finance has circulated draft amendments to the ITA permitting phased retirement); • providing a procedure for payment to be made to a public body in respect of unlocateable former plan members (i.e., deferred vested members) and spouses of former plan members; • permitting corrections of past mistakes which involve immaterial amounts (as prescribed) through lump sum payments; and • clearly providing that any employer payments in respect of a wound up plan that are in excess of those needed to fully discharge an unfunded deficiency identified in the wind-up report will be treated as an “over contribution” (not surplus) and can be returned to the employer. 		