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SENT BY COURIER

The Honourable Dwight Duncan
Minister of Finance, Chair of Management Board of Cabinet
7 Queen's Park Crescent
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Frost Building South
Toronto, ON M7A 1Y7

Dear Minister Duncan:

Comments on Bill 120 An Act to amend the Pension Benefits Act and the Pension Benefits Amendment Act, 2010 ("Bill 120")

We commend the Ontario Government for continuing to push forward with reforms to Ontario's private pension system. However, we are concerned that certain of the proposed amendments, as drafted, may not have the intended effect or may have unintended consequences.

Our comments in this letter are directed at four areas of Bill 120 which address matters that have traditionally formed a large part of our pension and benefits practice at Osler and with which we have a great deal of experience: pension plan expenses (Bill 120 s. 8); contribution holidays (Bill 120 s. 17); surplus withdrawal (Bill 120 s. 26-29); and the treatment of surplus in merged plans (Bill 120 s. 26). There are a number of other provisions in the Bill (e.g., the limitation of the solvency funding exemptions to jointly sponsored plans) that are troubling to us and to some of our clients. We will provide additional comments on other aspects of the Bill by separate submission.

As indicated at the end of our letter, we are also requesting a meeting with you at your earliest convenience.

A. Plan Expenses

Bill 120 would add a new section 22.1 to the *Pension Benefits Act* (the "PBA"). To the extent that this new section expressly permits reasonable fees and expenses for the administration of the plan and the administration and investment of the pension fund to be paid out of the pension fund, it is very helpful. It is also helpful that the government

has clarified that the administrator may pay "internal" expenses[1], as well as the expenses of third parties, from the pension fund. We believe that these provisions generally promote the government's objective of "improving plan administration".[2]

Our concerns lie with the wording of the exceptions to the general rule and in particular with sections 22.1(2)(a) and 22.1(5)(a). Section 22.1(2) provides that

> "the administrator is not entitled to be paid from the pension fund any fees and expenses relating to the administration of the pension plan or the administration and investment of the pension fund,
>
> > (a) if payment to the administrator is prohibited, <u>or payment of the fees and expenses is otherwise provided for, under the documents that create and support the pension plan or the pension fund; or</u>
> >
> > (b) if payment to the administrator is prohibited, or payment of those fees and expenses is otherwise provided for, under the Act or regulations;

The term "the documents that create and support the pension plan" is used in other places in the Bill in a way which suggests that it is intended to refer to historical, and not just current, plan documents. If so, this language may have the effect of codifying the existing common law with respect to pension plan expenses as laid down by the Supreme Court of Canada in the *Kerry* case. [3]

In our view this is not an "improvement" to plan administration in accordance with the government's stated objectives. On the contrary, as drafted, these provisions will most likely make plan administration even more difficult. First, the clause "or payment of the fees and expenses is otherwise provided for," is far too ambiguous and arguably introduces a new test into the Act. We note, for example, that expense provisions in pension plans often permit the payment of expenses from the fund "unless (first) paid by the employer". It has been generally accepted that an employer who paid the expenses from its own revenues could then seek reimbursement from the fund based on this language. Section 22.1 arguably casts doubt on this practice and the "otherwise provided for" wording should be deleted. Plan administrators may face a whole new round of

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1 expense allocations and disbursements in respect of plan administration functions performed by employees of the administrator

2 See the Technical Backgrounder released August 24, 2010 and October 19, 2010 Bill 120 press release.

3 *Kerry (Canada) Inc. v. DCA Employees Pension Committee*, [2009] SCC39 (S.C.C.).

uncertainty and expense-related litigation based on the current wording of section 22.1. This deletion should also apply to the "otherwise provided" wording in section 22.1(5).

Second, section 22.1(5) provides:

> (5) However, the administrator is not permitted to pay from the pension fund to an agent, employer or other person described in subsection (4) the fees and expenses relating to the administration of the pension plan or the administration and investment of the pension fund,
>
> > (a) if payment to the administrator or to the agent, employer or other person is prohibited, or payment of the fees and expenses is otherwise provided for, under the documents that create and support the pension plan or the pension fund; or
> >
> > (b) if payment to the administrator or to the agent, employer or other person is prohibited, or payment of those fees and expenses is otherwise provided for, under the Act or regulations.

On a literal reading of section 22.1(5)(a), the administrator may not pay expenses incurred by third parties if the plan documents prohibit payment to the administrator. We do not think this is the intended result. There could be situations where the plan documents prohibit the administrator from charging internal expenses to the fund, but do not prohibit payment by the fund of certain third party expenses. The phrase "to the administrator" should be removed from sections 22.1(5)(a) and (b).

It is also important to recognize that the codification of the common law test in the PBA will likely result in the imposition on administrators of onerous new regulatory requirements. What will this mean as a practical matter? It is likely that FSCO will develop a plan expenses checklist, similar to the "Transamerica Checklist", which will require an administrator to establish to FSCO's satisfaction that it is entitled to charge expenses to the fund based on legal analysis of the historical plan documents. However, unlike FSCO's "Transamerica Checklist" which only affects Ontario plans undergoing mergers or sales of business, this requirement will affect every DB plan sponsor in Ontario. The cost of determining expense payment entitlement through legal opinions and litigation will impose additional financial burdens on already overburdened administrators.

If the government is serious about improving plan administration, a simple "fix" would be to clarify that all reasonable administration expenses can be paid from the plan fund without regard to historical plan documents as long as the current or amended plan terms permit such payments. This could be accomplished by adding the following phrase at the end of sections 22.1(2)(a) and 22.1(5)(a): "currently in effect". It would also be desirable

to expressly override trust principles by adding the following provision: "The current plan documents prevail over any historical plan documentation and they prevail despite any trust that may exist or may have existed in the past." If funding security is a material concern of the government in relation to expense payments, then restrictions around funded ratio requirements could be considered.

B. Contribution Holidays

New section 55.1 of the PBA makes the ability to reduce or suspend contributions dependent on the plan documents, effectively incorporating the common law trust analysis of contribution holidays into the PBA. Codification of the common law on this issue will likely result in onerous new regulatory requirements and additional costs for plan sponsors. For example, should FSCO determine that a historical plan review to determine the validity of contribution holiday provisions is required for PBA compliance, this will add significant costs to plan administration without adding any value. We do not believe that this is the intention behind the reforms, and would urge the government to clarify that the limitation is restricted to current plan documents, as amended. For greater certainty, section 55.1 should also expressly override trust law principles.

C. Surplus Entitlement

We wish to thank the government for responding to the concerns that we, and others, raised about the wording of the surplus withdrawal provisions in Bill 236. The new provisions should be very helpful. However, we have a few concerns of a technical nature.

First, we note that it is not clear from new sections 79(3.1)(b) and 77.11(5) that, in the context of a partial plan wind-up, the consent requirements in section 77.11(5) 2. and 3 are limited to affected partial wind-up members, not the plan members as a whole. Similar wording appeared in the repealed surplus provisions in Bill 236 and we recently learned that FSCO interpreted the partial wind-up member consent requirement as applying to all plan members, not just the members affected by the partial wind up. Unless this issue is addressed, Bill 120 would change the partial wind-up surplus rules dramatically, since surplus attributable to a portion of the plan members would have to be distributed across the entire plan membership in order to obtain the requisite level of consent. We do not believe that this was intended.

Second, based on the wording of section 77.11(1), we think the regime established under new section 77.11 is intended to permit an employer to apply for a payment of surplus on the basis of legal entitlement to surplus only (and not just through the member consent process established in section 77.11(5)). However, we are concerned that the requirement that "the payment of surplus to the employer on the wind up [or partial wind

up] of the pension plan [be] authorized in a manner described in section 77.11" (emphasis added) in new sections 79(3)(b) and 79(3.1)(b) could be interpreted as limiting the methods available for the withdrawal of surplus to that in section 77.11(5) or arbitration since no process (or "manner") is prescribed for a withdrawal of surplus based solely on entitlement. To clarify the intent, we suggest replacing the words "in a manner described in section 77.11" with the words "under section 77.11" and revise section 79 to expressly contemplate surplus withdrawal based on demonstration of surplus entitlement instead of satisfying member consent thresholds.

Third, while we are supportive of introducing arbitration as a method for dealing with certain aspects of surplus sharing implementation, we believe that it should be used only as a last resort if the parties cannot reach a resolution through good faith negotiations. We note that the new provisions do not impose any limits on the exercise of discretion by the Superintendent of Financial Services to appoint an arbitrator. This leaves the process open to abuse and may put the Superintendent in difficult positions. For example, the settlement process could be disrupted by a relatively small group of individuals who for personal reasons may oppose a settlement that is being negotiated in good faith by a majority of the members represented by counsel. We recommend that section 77.12(7) be amended to include criteria to guide the Superintendent in the exercise of the discretion to appoint an arbitrator and to add greater clarity to the extent of the arbitrator's authority. In addition, we urge the government to prescribe a reasonable and practical time period under section 77.12(1) before arbitration can be invoked. In our experience any such period which is less than one year would not be reasonable.

D. Surplus in Merged Plans

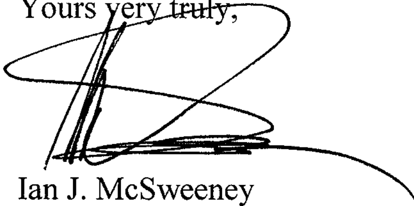
Section 77.11(4) provides that surplus arising under any plan into which assets have been transferred is to be construed as prohibiting the payment of surplus to the employer unless both plans provided for payment of surplus to the employer prior to the merger. What is the policy behind this provision which would operate to displace the traditional law of trust principle allowing tracing for mixed trust assets in favour of an approach which taints the entire mixed fund with the restrictive language contained in only one of the predecessor plans? This provision would prevent the sponsor of a merged plan from receiving any surplus from a merged plan other than by way of member consent unless both predecessor plans confer surplus entitlement on the employer. We would be surprised if this is the intended result, since it will operate to discourage plan mergers to the disadvantage of affected members and sponsors. Plan mergers often allow members and sponsors to better fund and secure benefits as well as providing members who happen to be in both predecessor plans with better pensions than they might otherwise have if the plans are kept separate and they receive partial pensions from each plan. We assume that this was not the intent. Surplus issues under merged plans should be treated the same as other plans under section 77.11. Section 77.11(4) should be eliminated or, in

the alternative, revised to clarify that only the current terms of the predecessor plan documents at the date of merger are relevant.

We thank you for the opportunity to provide comments on the pension reform proposals in Bill 120. We consider these matters sufficiently important to request a meeting with you at the earliest opportunity. I understand that you are extremely busy and will try to make myself available to a time of your choosing.

I look forward to hearing from you.

Yours very truly,



Ian J. McSweeney
IJM:vc

c. Alex Mazer, *Director of Policy, Minister of Finance, Chair of Treasury Board and Chair of the Management Board of Cabinet*
Steve Orsini, *Associate Deputy Minister, Office of the Budget, Taxation and Pensions*
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