ACPM Brief to the Government of Ontario

Commenting on

Bill 120, an Act to amend the Pension Benefits Act and the Pension Benefits Amendment Act, 2010

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Prepared by:
ACPM Advocacy and Government Relations Committee

ACPM/ACARR
The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

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TABLE OF CONTENTS

FOREWORD

The Association of Canadian Pension Management (ACPM)

The Association of Canadian Pension Management (ACPM) is the informed voice of Canadian pension plan sponsors, administrators and their allied service providers. Established in 1976, the ACPM advocates for an effective and sustainable Canadian retirement income system through a non-profit organization supported by a growing membership and a team of volunteer experts. Our members are drawn from all aspects of the industry from one side of this country to the other. We represent over 400 pension plans consisting of more than 3 million plan members, with total assets under management in excess of $330 billion.

The ACPM promotes its vision for the development of a world leading retirement income system in Canada by championing the following Guiding Principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders' interests; and
- Excellence in governance and administration

Introduction

ACPM is pleased to again provide our input to the Government of Ontario regarding proposed reforms to the Ontario *Pension Benefits Act* (the "PBA"). In this Brief you will find our comments on certain sections of the proposed reforms to the PBA contained in Bill 120, *An Act to amend the Pension Benefits Act and the Pension Benefits Amendment Act, 2010* ("Bill 120").

ACPM is pleased with the efforts the Ontario government is taking to reform the pension system and address many of the issues that require attention. However, we are concerned that several of the amendments to the PBA proposed in Bill 120, as drafted, may not have the intended effect, and require further clarification to avoid unintended consequences.

Our comments are directed at the following sections of Bill 120, which are of concern to ACPM:

- Plan Expenses,
- Contribution Holidays,
- Surplus Withdrawals,
- Plan Mergers and Splits,
- Letters of Credit, and
- Solvency Funding Exemptions.

Note: *In addition to this submission, we have also submitted a request that ACPM be included on the November 24th list to appear the Standing Committee on Finance and Economic Affairs so that we may be able to provide further input or answer any questions the Committee may have of us on the subject of Bill 120.*

1. <u>**PLAN EXPENSES (BILL 120 S. 8)**</u>

Bill 120 adds a new section 22.1 to the PBA dealing with plan expenses. 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, and will promote the government's objective of "improving plan administration".

However, we are concerned that the wording of the exceptions to the general rule, in particular sections 22.1(2)(a) and 22.1(5)(a), will not have that result. The phrase "the documents that create and support the pension plan" is used in these sections in a way which could be interpreted as referring to historical, and not just current, plan documents. If so, 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 onerous.

Moreover, the clause "...payment of the fees and expenses is otherwise provided for," is too ambiguous and introduces a new (higher) limitation into the PBA than exists at common law. For example, expense provisions in pension plans often permit the payment of expenses from the fund "unless (first) paid by the employer". An employer who paid the expenses from its own revenues could then seek reimbursement from the fund based on this language, but Section 22.1 arguably casts doubt on this practice. We submit that this clause should be deleted from section 22.1(2)(a) and (5)(a). Otherwise, plan administrators may face a whole new round of uncertainty and expense-related litigation based on the new wording of section 22.1.

Also, section 22.1(5)(a) may prohibit the administrator from paying expenses incurred <u>by third parties</u> if the plan documents prohibit payment <u>to the administrator.</u> We do not think this is the intended result--there could be situations where the plan documents prohibit the <u>administrator</u> from charging internal expenses to the fund, but do not prohibit payment by the fund of certain <u>third party</u> expenses. Therefore, the phrase "to the administrator" should be removed from sections 22.1(5)(a) and (b).

We think that the most straight-forward "fix" would be to amend Bill 120 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."

2. <u>**CONTRIBUTION HOLIDAYS (BILL 120 S. 17)**</u>

From the Government's August 24, 2010 announcement of its proposed reforms to the PBA, we had understood that the intention was to amend the PBA to clearly state that contribution holidays are expressly permitted unless prohibited by plan documents, i.e. that the ability to take contribution holidays where the transfer ratio is at 105 or above is referring to the <u>current plan text</u> and not requiring an historical review of the plan documents. This is consistent with the Report of the Expert Commission on Pensions (the "Expert Report"), see section 4.10.5. The threshold funding level of 105% together with the required disclosure should increase the security of benefits and while reference to current plan documents increases the efficiency by not requiring historical reviews and potentially time consuming and expensive litigation. Where an employee group wishes to restrict the right to contribution holidays that restriction should be included within the current plan documents.

But new section 55.1 of the PBA in Bill 120 could be interpreted as making the ability to reduce or suspend contributions dependent on the current and historical plan documents—section 55.1(3) provides that contribution holidays are not permitted if "the documents that create and support the pension plan or the pension fund prohibit the reduction or suspension". Incorporating a provision into the PBA which requires a full analysis of historical plan documents to support contribution holidays will likely result in onerous new regulatory requirements and additional costs for plan sponsors. 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.

3. SURPLUS WITHDRAWAL (BILL 120 S. 26-29)

The surplus withdrawal provisions of Bill 120 are generally very helpful and assist in achieving the Government's goal of providing more legal certainty, "while continuing to allow payment to an employer where there is entitlement or a surplus sharing agreement". However, we do have a few technical concerns that require further clarification.

On review of new sections 79(3.1)(b) and 77.11(5), it is not clear in the context of a partial wind up that the member and former member consent requirements in section 77.11(5) 2 and 3 are limited to those members and former members who are affected by the partial wind up. As drafted, these provisions could be interpreted as requiring the requisite level of consent of not only those affected by the partial wind up, but of all members and former members of the plan. If this is indeed the intention of the Government, this requirement would be a significant departure from the current surplus withdrawal rules on partial windups since surplus attributable to a portion of a plan being partially wound up would have to be distributed across the entire plan membership to obtain the requisite level of consent to a surplus sharing agreement. It is possible that some unaffected members and former members could repeatedly benefit from surplus distributions should their plan be partially wound up multiple times. We do not believe that this is the intention of the Government and request that these provisions be clarified to ensure only the consent of those members and former members affected by the partial wind up is required .

New sections 79(3)(b) and 79(3.1)(b) provide that the Superintendent shall not consent to the payment of surplus to an employer unless, among other things, the payment of surplus to the employer on the wind up or partial wind up of the plan "is authorized in a manner described in section 77.11". The use of the word "manner" suggests the consent process in section 77.11(5). To avoid any uncertainty in this regard, the reference to "manner" in these sections should be deleted and instead they should simply refer to the payment being made under or in accordance with Section 77.11.

New section 77.12 provides a binding arbitration process for surplus distribution. However, it does not clearly address the basis for that arbitration. It should not be arbitration as to legal entitlement to plan surplus as this should remain with the Courts, which is the appropriate forum to determine this technical legal issue. In addition, we are concerned as to whether an adequate period of time will be prescribed under section 77.1(1) before arbitration can be invoked. Surplus sharing agreements take considerable time to negotiate. As such, we suggest a period of at least two years from the date of wind up. We also suggest that the prescribed time period under section 77.12 be subject to an extension on application to the Superintendent under new section 105(1). Finally, sections 77.12(4) and (7) give the Superintendent the power to propose that arbitration be used and to appoint an arbitrator. 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.

4. PLAN MERGERS AND SPLITS (BILL 120 S. 26(1))

The common law principle of tracing trust assets on the transfer of pension assets has been well established in the Canadian pension cases. The concept of tracing protects all interests in the pension assets.

It would appear that new subsection 77.11(4) intends to override the tracing principle. Statutorily removing existing rights would not seem to be well advised as it would be expected to deter pension transfers. Transfers of pension assets on a sale of a business are usually in the interests of plan members but are not required by law. Any deterrent is likely to result in a reduction in the number of such transfers which are undertaken.

The Expert Report expressly considered pension transfers and recommended (see Recommendations 5-17 to 5-20) that where the 5% security margin is satisfied and notice is provided, cross-funding after the transfer (merger or split) is to be permitted without any override of the common law tracing principle.

As the Government knows, the Expert Report attempted to create a calibrated balance, and one which many single employer pension plan sponsors did not feel adequately protected their interests. Accordingly, a further erosion of plan sponsor rights is likely to be viewed very negatively.

In any event, the drafting of subsection 77.11(4) should, at a minimum, be revised to make it clear that it only applies (i) to asset transfers completed after the proclamation of this subsection, and (ii) to surplus withdrawal rights and not to any right to take contribution holidays or charge plan or fund expenses.

5. LETTERS OF CREDIT

We have a number of questions about the intended operation of the Letter of Credit provisions. First, what was the Government's thinking behind having the administrator hold the Letter of Credit (vs. the trustee holding the Letter of Credit, as has been done in other jurisdictions)? We raise this only to note that there may be a risk to the benefit security in an insolvency should there be an argument that the letter of credit is part of the administrator's assets, which would not be the case if it were held by the trustee of the pension fund.

Also, we question what is envisioned by the reference to the administrator holding the Letter of Credit "in trust for the pension plan" in s. 55.2(8)? Has there been confirmation that this language is superior to the deemed trust language in the context of a bankruptcy?

Is it envisioned that the administrator will receive the proceeds of a Letter of Credit on a draw-down and then make a contribution to the plan of those proceeds or is the thought that the financial institution will pay directly to the fund? Depending on the answer, has any thought been given to any Income Tax Act (Canada) issues such as whether this is a permissible contribution?

6. SOLVENCY FUNDING EXEMPTIONS

The Explanatory Note to Bill 120 indicates that the intent of Bill 120 is to enable "pension plans that are jointly sponsored pension plans on August 24, 2010 to cease requiring contributions to be made for solvency deficiencies". Although not part of Bill 120, we understand from the Government's prior announcement that certain "target benefit" MEPPs, would also be exempt from solvency funding requirements.

As noted in our prior submission on PBA reform, we support the government's proposal to exempt JSPPs and target benefit MEPPs from solvency funding requirements, which promotes flexibility in plan funding and properly recognizes that funding rules should be modified to accommodate different plan designs. However, we recommend that the exemption be structured in a way that plans with similar risk profiles (and/or design features) to JSPPs and MEPPs would also be able to qualify for the exemption.

First, we are concerned that the solvency funding exemption that is being proposed for JSPPs may be too narrow (i.e., if it is restricted to plans that were JSPPs on August 24, 2010). Second, the definition of target benefits (in section 39.2 of the PBA) should have some flexibility built in such that target benefit plans are not confined to the unionized sector. For instance, we suggest that section 39.2 could be amended to refer to "collective agreements or other prescribed agreements", which would allow regulations to be inserted to cover other acceptable arrangements for the non-union sector. Solvency funding exemptions should also be available to other types of plans that may not fall within these definitions, but which share similar characteristics to such plans (e.g., joint governance, risk sharing and/or the absence of PBGF coverage). It is important that the standard for extending exemptions from solvency funding requirements be flexible and capable of being extended to different types of plans, and not closed based on current definitions in the PBA. Also, the test for a plan to obtain solvency relief (presumably to be determined in future regulations) should be based on the underlying criteria articulated in the Expert Report, and not solely based on how a plan is labelled or defined for PBA purposes.