Blake, Cassels & Graydon LLP
Barristers & Solicitors
Patent & Trade-mark Agents
199 Bay Street
Suite 2800, Commerce Court West
Toronto ON M5L 1A9 Canada
Tel: 416-863-2400 Fax: 416-863-2653

Pension & Employee Benefits Group
Reference: 99997/99993

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VIA E-MAIL – lwdpolicy@gov.ns.ca

Pension Review Panel
c/o Nova Scotia Labour and Workforce Development
Policy Division
PO Box 697
Halifax, NS B3J 2T8

Re: Pension Review Panel – Submissions in Response to Discussion Paper

Dear Sirs:

I. INTRODUCTION

In response to your discussion paper entitled *Pension Review Panel: Discussion Paper* (the "Discussion Paper"), we are pleased to provide this submission (the "Submission") on behalf of the Pension and Employee Benefits Group (the "Group") at Blake, Cassels & Graydon LLP ("Blakes"). The Group consists of 24 lawyers serving our offices in Toronto, Ottawa, Montreal, Calgary and Vancouver whose practices are devoted to pension, benefits and compensation law. The Group is supported by lawyers with pension and benefits sub-specialties in our employment, corporate tax, litigation and securities law practice groups.

We appreciate the opportunity to comment on the Discussion Paper. We are encouraged that the government of Nova Scotia recognizes the importance of continuing to review and refine its current system of pension regulation. We welcome the debate that will be generated by this process and look forward to sharing our ideas with the Pension Review Panel (the "Panel") on how the pension system in Nova Scotia may be enhanced.

Our Submission has been made from the perspective of practising lawyers in the pension law field. Accordingly, much of our Submission is focussed on the legal and regulatory issues affecting pension plans. Where non-legal questions have been posed by the Panel, we have drawn upon our experience working with Canadian pension plan sponsors, administrators, service providers, trustees and custodians, in connection with plans registered under the Nova Scotia *Pension Benefits Act* (the "PBA"), various other provincial pension standards statutes and the federal *Pension Benefits Standards Act, 1985* (the "PBSA"). Please note that we have not attempted to address any actuarial or economic issues.

The views expressed in this Submission are those of the partners in the Blakes Pension and Employee Benefits Group. We are not writing on behalf of, or to express the views of, any client of Blakes.

Following are our comments in respect of a number of issues identified in the Discussion Paper.

II. OUR RESPONSE TO KEY ISSUES RAISED IN THE DISCUSSION PAPER

We recognize that the Panel has canvassed the views of a large number of stakeholders in connection with the Discussion Paper. Accordingly, rather than attempt to answer each and every question posed by the Discussion Paper, our Submission focuses on key issues that we have identified.

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.

A. The Goal of Pension Benefits Standards Legislation

Pension plans play an important role in Canadian society by providing plan members with income during their retirement. It is our view that pension legislation should encourage employers to establish and maintain pension plans, and in particular, defined benefit pension plans. To achieve this goal, the financial risks and rewards for employers need to be reconstituted in a manner that more fairly balances the risks assumed by employers and employees. Our recommendations for achieving such a balance are set out in this Submission.

To ensure that the ultimate goal of the expansion of the number of employer-sponsored pension plans in Canada is achieved, it is fundamental that employers view pension schemes as a flexible tool to attract and retain employees which is compatible with their overall business operations. To this end, the management of pension plans should be simplified and the potential negative risks to plan sponsors reduced.

Pension legislation should not be viewed as a tool through which to make broad, sweeping social changes or to expand the rights of workers. It should provide minimum standards to ensure promises are understood by employees and to ensure the promises made can be kept.

B. Pension Standards Legislation Should Accommodate Different Plan Designs

The PBA and the *Pension Benefits Regulations* (the "Regulations") must be sufficiently flexible to accommodate different pension plan designs in order to enhance their availability and adaptability to different industries and work environments. In our experience, "one size fits all" legislation is wholly inadequate to deal with increasingly complex labour and market conditions.

It is our view that the Nova Scotia government should actively encourage employers to develop novel pension schemes. To achieve this goal, the Superintendent should be permitted, under the legislation, to grant exemptions for new plan designs. Additionally, the Superintendent should be granted increased discretion to resolve problems and/or inconsistencies which may arise in connection with new plan designs.

With respect to existing plan designs, our view is that the differences between defined benefit pension plans, defined contribution pension plans and hybrid plans, such as negotiated cost plans which are prevalent in multiple employer situations, should be reflected in the PBA. As discussed in greater detail below, the PBA applies in the most part to defined benefit plans and does not

adequately take into account the structure of a defined contribution plan whereby contributions are made on a member's behalf to an investment account. As a result, we recommend that separate investment guidelines for defined contribution plans be incorporated into the PBA and that a "safe harbour" concept, also discussed below, be introduced in connection with those guidelines.

Based on our experience, it would also be beneficial to amend the legislation to include provisions specifically relating to hybrid plans. Provisions should be added to the PBA to deal with plans that have both a defined benefit and a defined contribution component; for example provisions which expressly permit the employer to use surplus from the defined benefit component of the plan to fund its contributions in respect of the defined contribution component of the same plan. The PBA should also be amended to clarify that members' defined contribution accounts will not be at risk if the defined benefit component of the plan is underfunded on wind-up. Also, if negotiated cost plans with target defined benefits are to be permitted, there should be clear rules on how they are to operate, as they fit neither within the typical model for defined benefit or defined contribution plans.

C. Changes to the Current Regulatory System

It is our view that the current regulatory system in Nova Scotia would work more effectively if the PBA was amended to provide sufficiently clear rules such that pension plan sponsors could rely on the relevant statute to determine what is appropriate rather than be forced (as a plan sponsor is under the current legislative regime) to consider case law and regulatory decisions in addition to the PBA and its regulations. While we believe the role of a pension regulator is ultimately to ensure that legislated standards are met, the regulator must be given the discretion to interpret the statute in a flexible manner which encourages employers to maintain existing plans and to implement new plans, including plans with a novel or alternative design.

One area where the PBA could provide sufficiently clear rules is in the area of payment of pension plan expenses. Specifically, we submit that the PBA should be amended to explicitly recognize the right of a plan administrator to charge its reasonable administrative expenses and third party fees and disbursements to the plan fund where these costs were incurred in the administration or investment of the pension plan or fund and to permit the amendment of the plan documentation as required to effect this result. It is submitted that such an amendment to the legislation would be consistent with the recent Ontario Court of Appeal decision in *Nolan v. Ontario (Superintendent of Financial Services*[1] ("*Kerry*") and would provide legislative certainty in an area which has historically given rise to substantial litigation.

We note that any such amendment must specifically recognize that the employer typically acts in the dual capacity as plan sponsor and plan administrator. This bifurcation of roles is both well established in the industry and recognized by the caselaw (most notably the decision in *Lloyd v. Imperial Oil Limited*[2] and *Sutherland v. Hudson's Bay Company*[3] ("*Sutherland*")). Accordingly, we submit that any amendments to the PBA specifically permit an employer to charge its own costs (as plan administrator but not as plan sponsor) to the pension fund. In our view, different treatment should not be afforded to the payment of reasonable plan expenses depending on whether the expense is incurred as a consequence of services having been provided by the employer, in its capacity as plan administrator, or by a third party service provider such as the plan actuary, accountant or an investment advisor. Additionally, expenses incurred as a plan sponsor should be permitted to be paid from the pension fund where such expenses are provided for in the documentation establishing the plan.

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1 [2007] ONCA 416. Leave to appeal to the Supreme Court of Canada has been granted.
2 2008 ABQB 379.
3 Carswell Ont 4866, (2007) 60 C.C.E.L. (3d) 64 (O.C.G.D.).

Another area where clear legislative rules would be helpful is in the area of plan mergers. In a number of recent cases, the Courts have interpreted plan documentation in the context of the nature of pension plan arrangements, generally including the long-term nature of the arrangements, the fluid nature of the beneficiary or member class and the reality of changing corporate structures (see *Buschau v. Rogers Communications Inc.*[4], *Sutherland*, and *Kerry*). These decisions support our view that plan documentation should generally, absent a clear indication to the contrary, be interpreted to permit the amendment of a plan to include new classes of members and the merger of plans and plan assets.

Further, the PBA should be amended to expressly provide for plan mergers. Merger is not a common law concept. Business corporation statues provide a mechanism for effecting corporate mergers. Pension legislation should provide a mechanism for effecting pension plan mergers. The legislation should provide reasonable minimum hurdles to ensure that benefit security is not impaired. Since full-funding provides full security of the promised benefits, surplus issues should not be a concern, and the legislation ought to specifically allow surplus to be used for so-called "cross-funding" of merging plans. This will not only facilitate business restructurings, but will in our view restore flexibility and some of the attractiveness of defined benefit pension plans. In our view, business entities should be able to merge, divide and otherwise reorganize without such action adversely affecting their financial obligations or the ability of their employees to participate in a pension plan. The PBA should expressly recognize this.

Finally, we believe clear legislative rules are needed in the following areas:

- The PBA should contain express protections to discharge plan administrators from liability and claims by a plan member, non-member spouse and anyone claiming through them (such as a current spouse) where the administrator complies and makes payment in accordance with the PBA.

- Plan administrators would benefit from certainty and clarity in the matrimonial property regime. In our view, the entire division scheme should be set out in the PBA. The PBA should be directive, leaving no judgement calls for the members or plan administrators. Finally, any matrimonial property division regime must be cost-neutral to the pension fund.

- There is a need for clear guidance in the PBA addressing unlocatable beneficiaries. In our view, the legislation should provide clear direction to plan administrators concerning the steps that should be taken to attempt to locate beneficiaries as well as direction regarding any assets remaining which the administrator is unable to distribute, after making reasonable efforts to do so. The plan trustee and custodian constituency should be consulted for guidance in this area as well.

D. Harmonization of Pension Standards Legislation

Multi-jurisdictional pension plans are an important aspect of Canada's benefits landscape. According to Statistics Canada, 2,784 private sector pension plans (23% of all private sector plans, other than those registered with the federal Office of the Superintendent of Financial Institutions) had members in more than one province as of 2002.

Administrators of such plans must currently comply with different legislative requirements in each jurisdiction where its plan members work. Consequently, such plans are typically more complex and costly to administer, and members in the same plan may receive different benefits depending upon

[4] (2006), 269 D.L.R. (4th) 1 (S.C.C.).

where they worked. For example, Ontario and Nova Scotia members of a multi-jurisdictional plan are entitled to grow-in benefits on plan wind-up (subject to certain conditions in Nova Scotia, described below), however, they are not otherwise available to members employed in other provinces. Such differences have the potential to cause significant human resources issues. They also result in confusion and uncertainty for members and increased administrative complexity for employers who sponsor such multi-jurisdictional plans.

We acknowledge that many basic principles are common to all jurisdictions and this is to be commended, but minor variations are equally troublesome to administer, and the more minor the variation, the more likely it is to be missed in the documentation and administration of multi-jurisdictional plans. We would therefore strongly recommend that if consistency of regulation down to the smallest detail cannot be achieved, an alternative be developed for multi-jurisdictional plans that permits multi-jurisdictional plans to be exempted from the regulation of the minor jurisdiction(s) and governed by the legislation of the province in which the plan is registered.

Another multi-jurisdictional issue that should be addressed is one associated with promoting the mobility of workers within Canada. While not a major issue, many workers do move from one jurisdiction to another in the course of their careers with a single employer. The PBA appears to apply to the pension in respect of service within the jurisdiction, resulting in a checkerboard approach to benefit administration. In our experience many administrators and pension regulators do not respect the technical requirement to checkerboard. In our view, legislation ought to clearly require a final or current location approach, as that appears to be the easiest and most common way of administering and supervising plans.

In light of the foregoing, we are of the view that pension standards legislation should be harmonized across all Canadian jurisdictions to the greatest extent possible. In this regard, we believe that the Nova Scotia government should give consideration to exempting multi-jurisdictional plans from the PBA where such plans meet comparable standards in the jurisdiction of registration. In cases where an exemption is provided to a multi-jurisdictional plan, the legislation of the jurisdiction of registration will govern. This will obviate the problem associated with providing pensions for persons in multiple jurisdictions as well as the difficulties associated with properly administering the benefits of individuals who move between jurisdictions.

We also recommend that the government of Nova Scotia initiate discussions with pension authorities in other Canadian jurisdictions with a view to both developing a revised multi-lateral agreement which clarifies the procedural and administrative matters that may be determined in accordance with the law of the jurisdiction of the plan's registration, and adopting the "Model Pension Law" currently being developed by the Canadian Association of Pension Supervisory Authorities ("CAPSA"), which will propose regulatory principles, based on current pension standards and best practices, for all jurisdictions to consider. In our view, these initiatives would ease the administration burden for sponsors of multi-jurisdictional plans and ensure that all plan members receive the same benefits regardless of the jurisdiction in which they work.

E. Grow-In Benefits

We acknowledge that the Nova Scotia Government has recognized the significance of the financial burden that grow-in benefits have imposed on plan sponsors. In December 2004, the Regulations under the PBA were amended so that a 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 funds remaining after all other benefits have been paid. In explaining the changes to the Regulations, the Nova Scotia Superintendent of Pensions acknowledged the following:

> "The funding of 'grow-in' benefits increases the contributions required by plan sponsors and employees at a time when defined benefit plans are making additional payments to bring the plan to full funding, following the decline in the financial markets. This funding pressure for a benefit paid only on plan wind-up means money is set aside for an event that may never materialize."

While these amendments provide much financial relief for plan sponsors during the lifespan of a pension plan, we submit that provisions regarding grow-in benefits should be removed entirely from the PBA for three reasons: (1) grow-in benefits fail to achieve their stated purpose of providing an enhanced level of retirement income security to older or long-service members affected by a wind-up; (2) eliminating the grow-in benefit is a step toward the harmonization of pension standards across the country; and (3) eliminating the grow-in benefit may encourage the retention and establishment of defined benefit pension plans at a time when the rate of growth of such plans are in steady decline.

Failure to Achieve the Stated Purpose

According to the Financial Services Commission of Ontario (the only other jurisdiction in Canada to mandate grow-in benefits), the purpose of grow-in benefits is to provide an enhanced level of retirement income security to older or long-service members affected by a wind-up, since as a group they are more likely to face greater difficulties in finding new jobs or acquiring new skills when their employment ends. Grow-in benefits fail to achieve this stated purpose for several reasons.

First, grow-in benefits do not provide any enhanced level of retirement income security to the vast majority of older or long-service employees who lose their jobs, since eligibility for such benefits is limited to those who happen to be members of a defined benefit plan which provides enhanced early retirement benefits. Members of defined contribution plans or defined benefit plans which do not offer enhanced early retirement benefits, as well as employees who are not members of any registered pension plan, are not entitled to any grow-in benefits upon termination of employment.

Second, even in the case of a defined benefit plan which offers enhanced early retirement benefits, terminated members only qualify for grow-in benefits if they happen to lose their jobs under the "right" circumstances which result in a wind-up of the plan. For example, a member of such a plan who is terminated as part of a plant closure would generally be entitled to grow-in benefits, whereas a member of the same plan who is downsized on an individual basis would not be entitled to grow-in benefits. Such an arbitrary basis for determining entitlement to grow-in benefits cannot be justified.

Third, in our view it is inappropriate for pension legislation to mandate enhanced compensation for employees who have lost their jobs as a result of downsizings or plant closures. If protecting older and long-service workers in such circumstances is considered an important objective, it would be far more effective and appropriate to incorporate such protection into employment standards legislation where it could be more uniformly applied.

Fourth, grow-in benefits apply even where there is no job loss or pension loss, as for example, where a defined benefit plan is terminated and replaced with a group registered retirement savings plan ("RRSP") or deferred profit sharing plan ("DPSP"). In this case, the stated policy reason for the rule is not even present.

Fifth, grow-in benefits provide an additional benefit mandated by the legislation under a voluntary system in circumstances that are often uncertain or unpredictable. The provision of a defined benefit pension plan is essentially a voluntary undertaking by an employer (even where the obligation is imposed as a result of a collective or individual employment contract, the employer has agreed to it). In a voluntary system it is inappropriate and may discourage employers from setting up plans where,

once in the voluntary system, they are required to provide additional benefits. This is even more unpalatable when the imposition of the additional benefits occurs only on the happening of circumstances that are not predictable or entirely within the control of the employer. Further, since the rules in respect of when a plan wind up can be imposed by the regulator are not certain, there is additional uncertainty imposed on those employers who volunteer to enter the pension system. Such uncertainty, together with the forced provision of a benefits, is a disincentive for providing pensions that, in our view, should be eliminated.

Harmonization

To the extent that we acknowledge the harmonization of pension standards across the country to be a laudable goal, grow-in benefits should be eliminated in order to maintain consistency with the majority of Canadian jurisdictions that do not require the provision of grow-in benefits. Grow-in benefits are mandated under pension standards legislation in only one other jurisdiction, Ontario. The other jurisdictions in Canada do not mandate grow-in benefits even though significant revisions to pension standards legislation have occurred as part of pension reform initiatives in most jurisdictions since 1980, when grow-in benefits were first introduced in Ontario. Only Nova Scotia followed suit in 1988. Given the opportunity to include grow-in benefits as part of such revisions to their pension standards legislation, legislatures across the country elected not to do so. Further, we are not aware of any jurisdiction that is currently considering introducing grow-in benefits under its pension standards legislation. In a circumstance where the clear majority of jurisdictions have opted not to provide such a benefit, eliminating the grow-in benefit in Nova Scotia would be a practical and achievable step toward uniform pension standards legislation across Canada.

Encouraging Employers to Establish Defined Benefit Plans

Finally, while the amendments to Nova Scotia's grow-in provisions (which eliminate the requirement to pre-fund such benefits) signify a reasonable middle ground for consensus, the reality remains that grow-in benefits represent a significant and onerous financial burden to employers on plan wind-up. Eliminating grow-in benefits in their entirety, as Nova Scotia has done for its multi-employer plans, would relieve employers of this additional burden and would signify a further recognition on behalf of the Nova Scotia government of the funding pressures on employers sponsoring defined benefit plans in today's economy. Such a change may in turn encourage the retention and establishment of defined benefit plans in the province.

F. Ensuring Solvency of Defined Benefit Pension Plans

There has been a significant shift toward providing pension benefits on a money purchase basis rather than on a defined benefit basis. This shift has resulted from a number of factors, including concerns relating to the potential costs of properly meeting solvency funding requirements associated with defined benefit plans and the related financial burden and risk placed on many employers, and in some cases on both plan members and their employers. We therefore think it important that government provide meaningful solvency relief as soon as practicable.

As the Panel will be aware, several pension jurisdictions in Canada, including Nova Scotia, have made changes to the solvency funding requirements imposed under pension benefits legislation. In Nova Scotia, these changes have been directed toward university, municipality, and multi-employer defined benefit pension plans. We believe that this is an important area for continued reform for all defined benefit plans. In this regard, while we do not propose to make specific proposals for new legislation, we do believe that there are a number of important general principles that should be considered in developing new legislation in this area.

First, relief measures should be permanent rather than temporary. In addressing solvency issues, the unpredictable nature of the financial environment and the long-term nature of most defined benefit pension plans must be taken into account. This strongly suggests that solvency relief measures should be structured to address not only the immediate financial issues but must also contemplate that these issues may not be resolved in the short- term.

Second, solvency relief should be based generally on the financial status of the plan, not on the financial status of the employer; although we recognize that special provisional measures may be necessary to deal with employers involved in proceedings under the *Companies' Creditors Arrangement Act* or the *Bankruptcy and Insolvency Act*. The issue of solvency relates to the pension fund as a segregated pool of assets subject to discrete liabilities. The strength of a pension plan as a going concern relative to the strength of other plans can therefore be more readily assessed on an "apples to apples" basis. The relative strength of different employers is likely to be more subjective and may depend on many factors not common to all employers, such as the type of business and the length of the business cycle. To base solvency relief on the financial vulnerability of an employer will require an opinion on the strength of the employer as a going concern which is likely to be subjective and therefore subject to a variance of opinion. If solvency relief is based on such assessments, it will likely result in greater legal complexity for both employers and the regulator, particularly if the regulator is required to exercise discretion with respect to an employer's qualification for solvency relief. This may lead to increased applications by employers, their creditors or shareholders to appeal adverse decisions, or applications by other interested parties, employees, trade unions, creditors or others to appeal decisions granting solvency relief.

Third, with respect to the time period over which solvency deficiencies should be funded, we believe that there is no single amortization period that will satisfy all stakeholders. We also believe the extension of the amortization period from five years to ten years for all sponsors of defined benefit plans would encourage sponsors to retain existing plans and establish new ones. An extension of the amortization period will arguably add an element of risk to the security of funding; however if employers are to be encouraged to establish and maintain defined benefit plans, an acceptable and reasonable level of increased risk must be considered.

We understand that some stakeholders take the position that an extension of the amortization periods should only be allowed where a plan sponsor is financially vulnerable and that there should be conditions imposed. In our view it would be best to adopt a standard of 10 years without conditions, as any conditions will result in administrative complexity and possible uncertainty for both plan sponsors and the regulators. Such conditions would provide another disincentive to the establishment and maintenance of defined benefit pension plans. Conditions can also lead to legal challenges where the conditions are uncertain, based on subjective criteria, criteria that are subject to interpretation or criteria that rely on regulatory discretion.

We note that funding of defined benefit pension plans has traditionally been viewed as a long-term proposition. Solvency funding emphasizes shorter term experience, and as such, may contribute to long term surplus. In our experience, plan sponsors would prefer to deal with surpluses rather than deficits, but not at the risk of forfeiting contributions made by them. The absence of a meaningful, condition-free extension of the amortization period particularly combined with the current legal environment which places severe constraints on the use of surplus by a plan sponsor, in our view, imposes an unreasonable financial burden on employers which endangers the survival of defined benefit plans.

Finally, we note that current wind-up practice can also expose defined benefit pension plans to funding risk. Specifically, we note that the annuity market in Canada is not large enough to handle significant one-time annuity purchases, and some types of annuities are difficult to purchase (*e.g.*, indexed pensions). In our experience, these issues often result in plan wind-ups being protracted

thereby exposing the plan to additional market risk. However, solvency valuations are required to measure liabilities under the unrealistic scenario that all obligations are settled at once. Allowing alternative methods of settling plan obligations on wind-up should be explored.

G. Treatment of Pension Fund Surplus

In connection with the discussion of funding of defined benefit plans is the issue of allocating surplus accumulated in a pension fund. We note that the current allocation of risks and rewards in fact discourages plan sponsors from funding pension plans above the legislated minimum requirements and encourages plan sponsors to adopt conservative investment strategies. Under the present legislative regime, plan sponsors are responsible to make up any shortfall in the plan but often have to distribute all or a portion of the plan surplus to members and beneficiaries. In many instances, the plan sponsor's use of the plan surplus is limited to improving benefits, or if the plan permits, taking contribution holidays.

It is our view that regulatory changes should be implemented which encourage employers to over-fund pension plans. This can be addressed at the provincial level by amending the PBA to expressly:

- grant employers the exclusive right to surplus ownership on plan wind-up;
- grant employers the right to take contribution holidays;
- permit ongoing surplus withdrawals without member consent;
- permit plan sponsors to merge registered pension plans and their underlying funds; and
- permit plan expenses to be paid from the plan fund.

Current statutory requirements for employer funding and the 50% rule ensure that such rules will not effectively result in employers using employee money to pay for plan benefits. Such rules will enable the private voluntary pension system to be returned to an environment where employers manage surpluses, not deficits, and are rewarded for good plan and fund governance.

Encouraging short-term overfunding of pension plans, and exclusive rights to surplus, will enable plan sponsors to accommodate business cycles, and will reduce long-term financial risk to plan participants.

We note that the *Income Tax Act* (Canada) currently prohibits employer contributions where a plan has an actuarial surplus of more than 10% of actuarial liabilities. In our view, it would be helpful for the Nova Scotia government to urge the federal government to amend the *Income Tax Act* (Canada) to permit employers to fund pension plans above this 10% ceiling. Should this change be made, and the PBA be amended to permit surplus withdrawals from ongoing plans, a regime will be created which favours funding beyond minimum levels thereby improving overall benefit security for plan members.

H. Quantitative Limits Imposed on Pension Fund Investments

Under the PBA, the assets of a plan must be invested in accordance with Schedule III to the PBA's regulations ("Schedule III"), which mirrors the investment rules provided for in Schedule III to the PBSA. The PBA imposes both qualitative and quantitative restrictions on pension plan investments.

Certain of the quantitative limits impose complexities and costs on pension funds which we believe can undermine investment performance and the prudent management of investments, potentially to the detriment of plan members, employers and plan administrators. We believe these quantitative restrictions should be eliminated.

The restrictions that we would like to focus on are the 30% voting rule[5] and the quantitative limits relating to investments in real property and Canadian resource properties.[6] Although not explicitly addressed in the Discussion Paper, we expect that the Panel may hear from other organizations and stakeholders about these and other quantitative limits imposed under Schedule III.

Subsection 11(1) of Schedule III provides that the administrator of a pension plan must not, directly or indirectly, invest the monies of the pension fund 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% voting restriction does not apply to investments in special purpose corporations which are established and operate as an investment corporation, a real estate corporation or a resource corporation under PBSA Schedule III.[7]

An investment corporation is essentially subject to the same 30% voting limit[8] and the types of investments that may be made by a real estate corporation and a resource corporation are limited under the legislation. Consequently, there are many types of investments where the 30% voting limit can be a potentially serious practical constraint including, for example, some private equity investments and some infrastructure investments.

Subsection 10(1) of Schedule III provides that the administrator must not directly or indirectly, invest the monies of the pension fund in real property or Canadian resource properties, if at the time the investment is made,

(a) the book value of the investment in any one parcel of real property or Canadian resource property exceeds 5% of the book value of the plan's assets;

(b) the aggregate book value of all investments in Canadian resource properties exceeds 15% of the book value of the plan's assets; or

(c) the aggregate book value of all investments in real property and Canadian resource properties exceeds 25% of the book value of the plan's assets.

The 30% voting limit appears to be based on the premise that a pension plan should always be a passive investor. We believe this concept and its application to managing risk and facilitating the types of long term rates of return required for defined benefit pension plans is either out of date or too simplistic. In our experience, pension funds have no interest in the day to day management of a business but they may well need the ability to affect the composition of a board of directors of an

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5 Schedule III, section 11
6 Schedule III, section 10
7 Schedule III, subsection 11(2)
8 Schedule III, sections 2, 12(1)(c), 13(1)(c) and 14

investee corporation in order to safeguard the pension fund's investment, particularly in connection with venture capital , infrastructure and other private equity investment opportunities.

It is possible to circumvent the 30% voting limit by establishing more costly and complicated ownership structures that would otherwise not be required if the 30% voting limit did not exist. This involves additional expense to establish initially, and to maintain on an ongoing basis. These expenses are an unnecessary drain on plan resources.

In a global market place where investors are competing for good long term investment opportunities, the 30% voting constraint puts regulated pension funds at a disadvantage compared to less constrained Canadian and international investors. We understand that a number of other important pension jurisdictions outside Canada do not impose the same or a similar limitation including, for example, Australia, the United Kingdom and the United States.[9]

The percentage limits imposed under Section 10 of Schedule III appear to be based on the premise that there is something more inherently risky about real property and Canadian resource properties compared to all other potential types of investments for pension funds. It is highly questionable whether such a sweeping assumption makes any sense in today's investment environment. The limits on Canadian resource properties seem to create a disincentive to investing in Canadian resource properties compared to non-Canadian resource properties. We are not aware of any policy justification for this differentiation.

For the reasons discussed above, we believe that the 30% voting rule and the real property and Canadian resource property limits impose structural and compliance constraints that put Nova Scotia regulated pension funds at a disadvantage compared to other less regulated investors and pension funds outside Canada which are not subject to these constraints. If these quantitative restrictions are eliminated (which we think they should be), it is important to remember that pension plan members and contributing employers would continue to be protected by qualitative restrictions imposed by the PBA, particularly the requirement for preparation of, and compliance with, a written statement of investment policies and procedures ("SIP&P"), conflict of interest/related party restrictions under Schedule III, and regulatory oversight by Nova Scotia's Department of Environment and Labour, Office of the Superintendent of Pensions.

I. Phased Retirement

In light of the recent amendments to the *Income Tax Act* (Canada) and in order to further promote the goal of harmonization of pension standards across Canada, we submit that the PBA be amended to permit phased retirement in a manner that is consistent with the recently introduced changes to the PBSA, and to the greatest extent possible, the recently proposed changes to British Columbia's *Pension Benefits Standards Act.* Specifically, the PBA should be amended to permit, but not require, employers to offer phased retirement to older employees, thereby providing employers the option to determine whether the potential savings gained from retention of staff outweighs the cost of providing additional phased retirement benefits.

J. Defined Contribution Plan Issues and the Implementation of "Safe Harbour" Rules

In our view, there are significant problems and gaps in Nova Scotia concerning the regulation and governance of defined contribution pension plans that the Panel should address. Examples of areas where, in our view, the current statutory and regulatory regime under the PBA does not adequately address defined contribution pension plans are as follows:

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[9] *Survey of Investment Regulations of Pension Funds*, Organization for Economic Co-operation and Development, July, 2007

- The statutory provisions setting out the requirements to provide plan members with certain prescribed information fails to satisfactorily address defined contribution pension plans. In fact, a number of the disclosure concepts set out in the Regulations are irrelevant, as a practical matter, to a defined contribution pension plan.

- Under the PBA, the assets of a plan must be invested in accordance with Schedule III. It is not clear how the quantitative investment restrictions set out in Schedule III apply to defined contribution pension plans which provide a variety of investment options. Specifically, should those limits be met at the plan level (this would appear to be the better literal reading of the Regulations), or should they apply at the member account level?

- The requirements for a plan sponsor to establish a SIP&P do not satisfactorily address defined contribution pension plans. In fact, a number of the concepts set out in the Regulations regarding the SIP&P are irrelevant, as a practical matter, to a defined contribution pension plan. Given the fundamental importance of the SIP&P for the operation, investment and administration of a pension fund, in our view it is important to consider appropriate additions to the Regulations and possibly also regulatory guidelines aimed specifically at the preparation of a SIP&P for a defined contribution pension plan.

- The provisions of the PBA relating to wind-ups are clearly drafted with defined benefit plans in mind and a number of the requirements are either impossible to apply or are onerous in the case of a defined contribution pension plan.

We also submit that the Nova Scotia government should legislate a "safe harbour" in connection with the selection of investments for defined contribution plan members. If a safe harbour were to be made available in this regard, it would be necessary to clearly set out the regulator's expectations of administrators and employers when providing investment choices to members. This exercise would, however, provide employers/administrators, members, and regulators with certainty as to expectations and requirements. In effect it replaces an uncertain, and possibly open-ended exposure to legal liability, with one that remains fiduciary in nature, but provides certainty and limitations where minimum standards derived from industry best practices are followed.

In our view, investment guidelines for defined contribution plans should include specifications regarding:

- the minimum number of investment options for plan members;
- the ability to have a default option and the criteria for determining the default option;
- the range of investment options offered to plan members;
- the ability for plan members to switch their investment selections;
- the information provided to plan members regarding their investment selections; and
- the decision-making tools to be provided to plan members.

We note that the experience in the United States indicates that there are some practical issues relating to a "safe harbour" that will need to be addressed, including the following:

- Some of the "safe harbour" requirements may be difficult to describe with clarity. However, this is no reason not to attempt to describe them.

- Under ERISA, there is a distinction between investment information and investment advice. Distinguishing information from advice can be a difficult distinction to make. Guidance is required to assist in making this distinction.

- Moreover, any "safe harbour" requirements that are developed should consider the interests of plan members and should reflect the principle that if a "safe harbour" is granted, the "safe harbour" requirements should be sufficiently clear and comprehensive to justify the grant of a "safe harbour".

If a "safe harbour" is available in the above-noted circumstances, administrators and employers will be encouraged to comply with the specified, minimum requirements required to obtain its protection and it will be considerably easier for the pension regulator in Nova Scotia to monitor compliance, whether through an audit or filing process. In our view, more employers are likely to migrate to regulated registered pension plans, rather than group RRSPs or DPSPs, if such rules are developed.

Finally, in light of the *Kerry* case in Ontario (which has been appealed to the Supreme Court of Canada), we submit that the PBA should be amended to expressly permit an employer to use defined benefit surplus, if any, in its pension plan to meet its contribution obligations under a defined contribution component in the same registered pension plan. A codification of this principle, would provide added clarity and certainty for plan sponsors, which in turn will encourage the establishment and maintenance of pension plans, including defined benefit plans.

K. Tax-Free Savings Accounts and Group RRSPs

Tax-free savings accounts ("TFSAs") and Group RRSPs should not, under any circumstances, be regulated under provincial pension standards legislation. Doing so would unnecessarily increase the complexity and cost of administering such arrangements and would result in reticence on the part of employers to offer such arrangements to their employees.

In our experience, many employers that choose to offer Group RRSPs, rather than defined contribution registered pension plans, do so in order to avoid the additional complexity and cost of maintaining a plan that is subject to pension standards legislation. Assuming that the Canada Revenue Agency also allows for TFSAs to be established on a "group" basis, such arrangements may also be attractive to many employers for the same reason. However, should such arrangements become subject to registration under the PBA, the benefits that many employees currently enjoy through participating in such group plans (such as lower investment management fees and contributions via payroll deductions) may well be lost if fewer employers are willing to provide such plans.

In addition, Group RRSP are subject to the Guidelines for Capital Accumulation Plans[10] (the "CAP Guidelines") and, as such, are already required to be administered in accordance with best practices standards. Group TFSAs, under which the employer selects the investment options, will also most likely be subject to the CAP Guidelines. In our view, additional regulation of these types of plans under pension legislation is unwarranted and would be a significant disincentive for employers to offer such arrangements to employees.

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10 Issued by the Joint Forum of Financial Market Regulators on May 28, 2004.

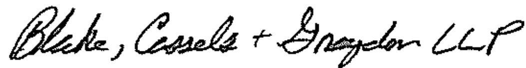
III. CONCLUSION

We applaud the decision of the Nova Scotia government to review and consider the current model for pension regulation in the province. We understand the political dynamics involved in changing pension legislation. We are certain that the pension industry welcomes the Panel's review of the difficult issues raised in the Discussion Paper, and we appreciate this opportunity to provide our views to the Panel. It is our hope that politicians will make the hard choices that are required to balance the system and to provide encouragement to employers to establish and maintain defined benefit pension plans.

Blakes looks forward to ongoing discussions with the Panel as its deliberations continue. We offer the information and expertise we have available to help address the issues that the Panel has identified in the Discussion Paper, as well as other issues that may be raised during any subsequent consultation process.

If you would like clarification or elaboration of any of our comments or if we can provide any further assistance, please contact Randy Bauslaugh (416-863-2960 – randy.bauslaugh@blakes.com) or Jeff Sommers (416-863-2534 – jeffrey.sommers@blakes.com).

Yours very truly,



BLAKE, CASSELS & GRAYDON LLP
Pension & Employee Benefits Group