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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 Position Paper

Dear Sirs:

I. INTRODUCTION

In response to your paper entitled *Pension Review Panel: Position Paper* (the "Position 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"). As you know, we provided submissions on your initial discussion paper by means of a letter dated July 4, 2008. The purpose of these Submissions is not to repeat the contents of our July 4, 2008 letter but rather to provide comments that we believe will be of assistance to the Nova Scotia Review Panel (the "Panel") in reconsidering its position on certain issues addressed in the Position Paper.

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 issues have been raised by the Panel, we have drawn upon our experience working with Canadian pension plan sponsors, administrators, joint boards of trustees, 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"). We have not attempted to address any actuarial or economic issues, but we do address certain issues relating to plan design and funding.

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.

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

We recognize that the Position Paper addresses many issues. In our view, the Panel's answers to many of the key questions demonstrate an understanding of the importance of pension reform both in terms of encouraging employers to establish and maintain registered pension plans and in terms of ensuring that the promised benefits are provided to plan members.

This Submission addresses a very limited number of issues in respect of which we believe the Panel should give further consideration to the answers set out in its Position Paper.

In particular, the Position Paper indicates that the Panel hopes its recommendations result in an increase in the flexibility and administrative ease of defined benefit pension plans in order to help avoid an acceleration of the decline in the number of pension plans. While we fully support this goal, we believe that the Panel's recommendations on the issues discussed below are likely to serve as a disincentive to employers establishing and maintaining registered pension plans, and especially defined benefit plans, in Nova Scotia due to increased cost, uncertainty and/or administrative burden. We respectfully request that the Panel reconsider its position on these issues.

3.3.2 Surplus

The Position Paper refers to statistical evidence that shows a general decline in pension plan membership with more rapid declines in defined benefit plan participation. It would appear that the Panel's overarching objective is to make recommendations that will result in an environment in which pension promises will be made and kept.

In a voluntary private pension system, it is primarily employers who decide whether to establish and maintain private pension plans, or to participate in multi-employer plans. You have noted that employers have many incentives for introducing or participating in private pension plans, namely, to attract and retain employees as well as an altruistic desire to provide retirement income security. Federal tax legislation creates a significant incentive for employers by effectively creating a tax shelter for employers and employees who participate in private pension plans; but as you have noted, the complex web of rules and regulations surrounding pensions provides a countervailing disincentive. In our view, there is no doubt that minimum standards legislation is required to ensure minimum safeguards. We agree with your observation that the primary focus of reform should be to create an environment where pension promises will be fulfilled. It is also our view that it is primarily financial considerations that cause employers to participate voluntarily in this system. Rules that detract from tax incentives should be avoided. Rules that create additional mandatory benefits should be avoided. Defined benefit promises are more likely to be fulfilled if there are sufficient assets to pay for them. Generous and conservative funding by employers is the best safeguard to ensure pensions will be paid. Disincentives to such behaviour should be avoided.

The recommendations in Sections 3.3.2(a) and (b) of the Position Paper create rules to ensure surpluses are used and rules to ensure that once a funding cushion is attained it is maintained. The *Income Tax Act* (Canada) already provides rules to limit the accumulation of excess surplus and hoarding of surplus. Since you have proposed no general rule to require plans to be 105% funded, it is

unclear to us why an employer would ever intentionally allow itself to get in the position of "orphaning" surplus within or above the collar. The rule therefore acts as a disincentive to generous and conservative funding.

Recommendation 3.3.2(c) is entirely arbitrary. It creates a mandatory defined contribution benefit where none was intended or expected and creates a clear disincentive to conservative funding. It also creates regulatory complexity and interpretive difficulties in the concept of an employer's "net contributions".

The PBA already contains a 50% rule. An employee's own contributions with interest can never be used to provide more than 50% of the employee's benefit. That is a clear safeguard to ensure employees never contribute more that 50% towards the cost of their benefits, and by extension to plan surpluses. Imposing a 50% rule on surplus withdrawals based on contributions of the sponsoring employer over a recent arbitrary fixed period of time prior to withdrawal simply penalizes employers who take a long term conservative funding approach, and provides a further disincentive to conservative funding of defined benefit plans. It also creates an additional unplanned mandatory defined contribution benefit that was not intended at the time of inception of the plan. The benefit is also not expected by employees and is entirely serendipitous.

Recommendation 3.3.2(d) also creates a serendipitous unplanned benefit on plan wind up that discourages conservative funding. It also expropriates employer property in those plans which provide for employer ownership of wind up surplus.

If actuarial science were a perfect science, there would never be any surpluses, as all employers would be able to exactly meet their funding obligations by perfectly matching funding to plan liabilities. Accordingly, the only reason plan surpluses arise is because an employer has contributed too much.

If an employer contributes too much, the Panel's recommendation to share surplus effectively exposes a portion of the employer's more conservative contribution pattern to forfeiture by requiring the employer to provide a benefit equal to 50% of its over contribution. In other words, these rules not only provide a disincentive to conservative funding but also create additional mandatory benefits that effectively require all defined benefit pension plans to provide additional, albeit conditional, defined contribution benefits. The mandatory benefit is not tied to any intent or design initiative, it is paid based only if certain circumstances are in existence at a particular time. As such, it operates more like a lottery than a retirement income security device. It denies employers the right to establish a pure defined benefit plan by requiring them to pay defined contribution benefits if the employer's funding approach has been too conservative.

3.5 Partial Wind-ups

We agree that the notion of partial wind ups should be eliminated from the PBA. However, the Panel's proposal to require immediate funding of deficits associated with the benefits of departing employees could be a financial disaster for some employers, especially in the event of a mass termination of

membership. The financial consequences of immediate funding of a significant portion of a pension fund in the context of a mass lay-off, downsizing, sale or simply a conversion from a registered pension plan to a group RRSP or DPSP with no loss of employment will provide a significant disincentive to establishing or maintaining defined benefit pension plans.

Given that the current partial wind up rules allow for related funding deficits to be amortized over five years, we fail to understand why the funding of a deficit should be accelerated in respect of departing employees simply because the notion of partial wind-ups is eliminated. We strongly suggest that at least a five year amortization period apply in respect of the funding of any deficits associated with departing employees.

3.7 Governance

In Section 3.7 of the Position Paper, the Panel recommends that all pension plans be required to prepare a governance plan that meets the "generally accepted practice in the Pension Industry" and file such plan with the Superintendent. In addition, the Panel recommends that such plan be reviewed and either accepted or rejected by the Superintendent based on whether the plan satisfies the generally accepted practice in the pension industry. Further, any failure to follow such a governance plan is to be "deemed to be evidence of lack of prudence" by the plan administrator.

There is no question that good pension plan governance is important and should be promoted. However, we have serious concerns that the recommendations in Section 3.7 will result in considerable uncertainty and confusion for both plan administrators and the Superintendent. There are no clear pension industry standard practices for preparing a written pension governance plan. As such, to expect plan administrators and the Superintendent to apply such an arbitrary standard to preparing and evaluating such a plan is an unreasonable expectation.

Even more concerning is the Panel's recommendation that failure to comply with such a governance plan be deemed to be evidence of a lack of prudence by the plan administrator. The risk of liability flowing from a failure to adhere to a governance plan will undoubtedly result in plan administrators preparing very general and ambiguous governance plans which will essentially render them meaningless and thereby fail to achieve the policy objectives behind this recommendation.

Whether a particular action or inaction was prudent is a legal determination to be made after consideration of all of the applicable facts and circumstances. It is not appropriate for the PBA to deem an action or inaction imprudent simply because it was not in strict compliance with the terms of a governance plan.

In addition, the requirement to file a governance plan with the Superintendent and have the Superintendent accept or reject such plan imposes additional regulatory compliance that is not required in any other Canadian jurisdiction. Not only will this further tax the limited resources of the Superintendent but it will likely be viewed as another administrative burden that serves as a disincentive for employers to establish and maintain registered pension plans.

As explained on page 3 of the Position Paper, one of the key objectives of the Panel is to eliminate unnecessary rules and regulations. For the reasons set out above, we submit that the requirement to file pension governance plans with the Superintendent is an unnecessary regulatory burden.

3.7.1 Advisory Committees

Section 3.7.1 of the Position Paper contains a number of recommendations with respect to advisory committees. We have a number of significant concerns about these recommendations and, based on these concerns, we urge the Panel to reconsider its position on advisory committees and suggest leaving the PBA provisions governing such committees unchanged.

Our first concern relates to the recommendation that advisory committees be entitled to "reasonable" access to plan actuaries and other professionals so that they can communicate with them independent of the plan sponsor. It is not clear whether the Panel is suggesting that the committee be given the right to retain its own independent professional advisors or merely be allowed access to the advisors already retained by the plan sponsor. It is also not clear as to what "reasonable" access means or who is to make this determination.

If the intention is to allow the committee access to the plan sponsor's advisors, this could in many situations result in unworkable conflicts of interest for the advisors. For example, a lawyer retained by the plan sponsor to provide advice about its pension plan would not be in a position to also provide advice to an advisory committee of employees that is questioning actions or inactions of the sponsor.

On the other hand, if the intention is to allow the committee to retain its own advisors, this will result in significant additional costs. As you can appreciate, in many circumstances, legal and, to some extent, actuarial advisors could not properly advise an advisory committee about a pension plan without understanding the plan and its history. For very complicated plans and plans with lengthy histories, this could result is very significant fees being incurred merely to bring the advisor up to speed on the plan, even before determining whether there are any issues of concern. Creating this type of second layer of professional review over a plan would, in the vast majority of cases, prove unnecessary and add little or no value to the administration and governance of the plan.

Our second concern is the recommendation that the costs incurred by the committee consulting with its advisors be paid for out of the plan. In the case of defined contribution plans, many plan members are likely to object to having their account balances debited to pay the costs of the committee's professional advisors. Presumably even employees who vote against establishing an advisory committee for a defined contribution plan would be required to pay their pro rata share of the committee's advisors' fees. In the case of a small defined contribution plan where there are few members to share the cost, each member's share of the committee's advisors' fees could be a material amount.

In the case of a defined benefit plan, it is the employer who ultimately bears the cost of the committee's advisors' fees being paid from the plan in the form of increased employer contributions. Requiring employers to pay the fees of lawyers and actuaries who are retained to look over their shoulder in terms of how the plan is being administered will not be viewed favourably by employers and will undoubtedly prove to be a strong disincentive to establishing and maintaining defined benefit plans.

Our third concern is the Panel's suggestion that a plan amendment should receive less scrutiny from the Superintendent if the amendment has been approved by an advisory committee. The Position Paper states that where an advisory committee approves of an amendment, the Superintendent should accept the amendment provided that it does not "conflict with the regulations". By this we assume the Panel means that the amendment does not contravene the requirements of the PBA or its regulations. If that is the case, we fail to see how a "longer process" should be required for approval of amendments which are not pre-approved by an advisory committee since confirming that an amendment does not contravene the PBA and its regulations is the Superintendent's only obligation with respect to reviewing plan amendments.

Our fourth concern relates to the statement in the Position Paper that "sponsors" would benefit from this proposal by no longer having to disseminate information to employees. Instead, it is proposed that the sponsor would provide information to the advisory committee, which would then provide it to employees. We strongly disagree with this recommendation. First of all, the Panel appears to be confusing the role of a plan sponsor with that of a plan administrator. It is the administrator, in its capacity as a fiduciary, that has the obligation to provide information to plan members under the PBA. As such, the administrator is responsible for the contents of all such communications and can be liable for any misrepresentations. If an advisory committee were to provide information to plan members, it would presumably do so as agent of the plan administrator. This would not only potentially expose the administrator to liability for any errors or misstatements made by the committee but could also expose the committee members to personal liability for such actions. Exposing committee members to potential personal liability would likely make it very difficult to find members willing to serve on such a committee.

Finally, the Panel has recommended that advisory committees be elected by the employees. In our experience, there are many practical difficulties with electing pension committees. Most problematic is convincing employees to vote. We are aware of situations in Quebec where employers have made extensive and costly arrangements to hold a vote of plan members to elect a pension committee, only to find that no more than a handful of employees bother to show up. In this type of situation, the elected members do not truly represent the plan membership as a whole. A further problem is finding members who are willing to sit on a committee for no additional compensation while potentially exposing themselves to personal liability. Due to these types of difficulties and all of the other concerns noted above, it is our view that advisory committees in Nova Scotia should not be given an enhanced role in plan administration.

3.8 Role of Regulators

We agree entirely with the Panel's view that self-review of decisions by the Superintendent is inappropriate. However, unless the NSLRB is partitioned to ensure that only adjudicators with expertise in pensions will hear pension cases, and only adjudicators with expertise in labour issues will hear labour cases, we would strongly recommend that the Superintendent's decisions be appealed directly to the courts, rather than the NSLRB. In our view, there is no doubt that there will be many cases that will end up in court anyway, with one of the central issues being the degree of deference to be accorded by a reviewing court to any decision of the NSLRB in dealing with pension issues. It may be no solution to simply add pension expertise to the NSLRB, as that may raise concerns about its expertise on labour issues. If the role of the NSLRB is to be expanded, labour lawyers in certain cases

will no doubt argue the NSLRB's existing labour law expertise has been diluted, as it now deals also with pension issues, and may demand a lower standard of deference on appeal to a court.

Appeal from a pension regulator directly to a court is not unusual. This is the structure followed under the federal PBSA. That structure preserves a high degree of deference to decisions of the regulator, which will likely reduce the likelihood and incidence of appeals.

3.12 Vesting

In Section 3.12 of the Position Paper, the Panel recommends requiring immediate vesting. In our view, the Panel should reconsider this recommendation and leave the current PBA vesting rules unchanged.

Plan sponsors impose vesting requirements under their pension plans both as a tool to retain employees and to avoid having to incur actuarial and other administrative costs associated with determining the defined benefit entitlement of a terminated short service employee. In some cases, the cost of determining a short service employee's benefit can exceed the value of the benefit itself. Requiring immediate vesting will serve as a further disincentive for employers to establish and maintain registered pension plans, particularly defined benefit pension plans.

III. CONCLUSIONS

We appreciate the opportunity to comment on the Position Paper and hope that you find our Submissions helpful. We understand the challenging political dynamics involved in changing pension legislation and hope that politicians are willing to 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.

In our view, the thrust of minimum standards legislation ought to be to avoid the creation of disincentives to participation in a voluntary system. In this connection the legislation ought not to punish generous and conservative funding by employers by causing overfunding to be expropriated. It should not create mandatory defined contribution benefits (out of surplus), where such benefits were not promised nor expected. In our view the purpose of the minimum standards in this context ought to be to ensure the pension promise is fully disclosed, that it is well-funded, that the funding is secure, and that the promise is enforceable by an expert regulator with clear objective powers.

Blakes would welcome 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 Position Paper.

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

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