

Pension Lawyers Association Conference 2005

Issues Facing Pension Plans in Canada

Pension Lawyers Association
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Agenda

- Canadian Pension Environment
- Court Decisions
- Changes going forward
- Comment



THE REAL PENSION CRISIS: Short-term asset shortfalls aside, many pension plans suffer from faulty design, compounded by ineffective governance and management

National Post, 16 July 2003

PENSION PLANS IN PERIL:
OSFI; Agency puts 60 to 370 of defined-benefit plans on “watch list”

Globe and Mail, 22 May 2003

**AIR CANADA’S
PENSION DEFICIT
SOARS TO \$1.8B**

OSFI sounds alarm:
Short fall deepens
as insolvent carrier
halts contributions

National Post, 3 July 2003

***PENSION PLANS FACE
\$225-BILLION SHORTFALL***

*Demand for cash to close funding gap
may force some plans to collapse: experts
Globe and Mail, 24 May 2003*

**ACTUARIES FENDED OFF DAY OF
RECKONING OVER PENSIONS:**

“Regulators are... trying to identify the wounded so they can be shot”

National Post, 27 May 2003



**CONVERSION TO DC FRAUGHT
WITH DANGERS:**

*Legal liabilities make switch risky,
experts warn National Post, 2 March 2004*

THE GENERATION BOMB:

*The United States, Europe
and Japan are facing a
severe pension crunch
as Baby Boomers
begin to retire*

National Post, 3 March 2004



Canadian Pension System

- Why are we where we are?
- How did we get here?
- Do want to stay?
- Where can or should we be going?



Pensions are now getting a great deal of attention!

- *“ I used to spend 10 hours a year on our Pension Plan, now I spend 10 hours a week!”*

CFO of a large corporation

- Why are we where we are and how did we get here?



Regulation of Pensions in Canada

- Common Law - Trust law and Fiduciary duty,
- Legislation- Pension Standards and Income Tax, plus
- Pension Regulators – Plan Text, SIP&P



Common Law

- Pension Plans- funded usually through a Trust Deed, however, an insurance contract is possible.



Common Law Cont

- Plan Sponsors, Trustees and Administrators are held to a fiduciary standard at Common Law and this has been further encoded in Legislation - this standard applies for both trusts and contracts.



Court's application of Trust Law

- *Schmidt vs Air Products Canada Ltd* - Supreme court held that a pension trust is subject to the ordinary law of trusts -
 - - Common Law
 - - Trust Documents
 - - Legislation



Plan Sponsor/Administrator/ Trustee

- Fiduciary Duty at common law
 - Duty to adhere to the trust and the law
 - Duty to act personally – not to delegate



Plan Sponsor/Administrator/ Trustee Cont

- Duty to exercise care:
 - “person of ordinary prudence would exercise in dealing with the property of another person”
- Duty to act in good faith



Plan Sponsor/Administrator/ Trustee Cont

- Duty to inform
- Duty to act with an even hand –
impartiality
- Duty to safeguard assets of trust
- Conflicts of interest prohibited



Fiduciary Duty regarding agents

- Common Law duty to act personally and not to delegate is amended by the PBSA
- Fiduciary standards apply to the agents of the administrator or trustees
- Administrator or trustees have a duty to be satisfied re: agent's qualifications



Fiduciary Duty regarding agents cont

- Duty to supervise and monitor agents



Fiduciary duty re: investments

- Duty to safeguard and invest assets
- Assets must be invested in the best financial interests of members
- Prudent person rule – PBSA



Fiduciary duty re: investments

Cont

- “Pension assets must be invested in a manner that a reasonable and prudent person would apply in respect of a portfolio of investments made on behalf of another person to whom there is owed a fiduciary duty to make investments without undue risk of loss and with a reasonable expectation of a return commensurate with the risk”



Pension Standards Legislation (PSA)

- 9 Provincial Pension Acts
 - Ontario was first in Jan 1964
 - B.C. last in Jan 1993
- 1 Federal Pension Act- Banks, Airlines, harbour authority, transport etc.



Pension Standards Legislation (PSA) Cont

- Only Prince Edward Island has no proclaimed PSA.
- All Pension Plans must be registered under the PSA and the Income Tax Act



Multiple Jurisdiction system

- 1975-Canadian Association of Pension Supervisory Authorities (CAPSA)
 - First mandate to work towards uniformity in legislation
 - 1994, CAPSA finalized the *“Reciprocal agreement”*



Multi-Jurisdictional – Leco case

- Ontario Divisional Court's Decision
- *Held:*
 - Reciprocal Agreement did not apply to Member entitlement.
 - Member entitlements to be determined according to law of member's province of employment



Canadian Court Decisions

- Fiduciary Duty to communicate (Hembruff, Camosun College)
- Fiduciary Duty to be “fair” among beneficiaries (Neville)
- Mergers: (Buchau, Aegon)
- Surplus (Misfud, Baxter, Monsanto)
- Class Actions (Authorson)



Communication

- Hembruff v. OMERS
- OMERS developed plan to utilize excess surplus to enhance benefits
- Manner in which plan enhancements communicated “paternalistic” and “patronizing”.



Communication cont

- *Held:*
 - Board had duty to inform certain members in advance of potential changes to plan to permit them to make informed decisions
 - OMERS Board negligent in failing to establish a detailed communications policy.



Hembruff v. OMERS (cont'd)

- found that there had been “negligent misrepresentation” and that the Board used a “duty of care” based on the special relationship
- found that the Board had failed to “act in good faith” and had failed to treat all members fairly and equitably



Hembruff v. OMERS (cont'd)

- Trustees/boards have an obligation to have a comprehensive communications plan
- must actively consider communication issues on a continual basis



Communication: Solicitor-client privilege

- Camosun College – B.C. Supreme Court
- *Held*: there is a joint interest in the proper administration of a Trust



Communication: Solicitor-client privilege

- *Held:* the Trustees cannot claim solicitor-client privilege in respect of a legal opinion as the trustees and the beneficiaries had a joint interest in the proper administration of the trust



Duty to be “fair”

- Neville v Plumbers Local
- Issues:
 - Negotiated cost plan with large funding deficit
 - Trustees reduced benefits for active members differently from retired members



Duty to be “fair”

- Active members instituted class action on basis that the duty to be “fair” is the same as the duty to treat all members equally.



Mergers

- Buschau v. Rogers
- “closed” DB plan, virtually all members retired
- Plan in surplus. Beneficiaries commenced action to terminate plan and distribute surplus



Mergers cont.

- Court held:
 - Members could terminate plan
 - Requirement that 100% of beneficiaries consent
 - Employer has a duty to act in good faith



Mergers cont.

- Employer has applied for leave to appeal to the Supreme Court of Canada
- Transamerica Life Canada Inc v Aegon Canada Inc (ING)
 - *Held*: contribution holidays were OK if no plan merger takes place



Mergers cont.

- *Held*: that funds in a trust with “exclusive benefit “ language must be kept separate on plan merger
- Leave to appeal has been denied



Surplus

- Baxter v Superintendent of Financial Services
- *Facts:*
 - Merger of an over funded and an under funded pension plan



Surplus cont

- Members contested the Superintendent's approval of the merger and asset transfer based on the fact that "a surplus" constituted "*other benefits*" in the original plan which the Superintendent had a duty to protect.



Baxter v Superintendent - cont.

- *Held:*
 - “*other Benefits*” mean “*benefits that are provided by a pension plan that are not pension benefits or ancillary benefits*” and that it excludes surplus.



Baxter v Superintendent - cont.

- The duty to protect “*other benefits*” does not prevent a plan merger and the surplus in one plan being used to fund the merged plan’s funding obligations
- Leave to appeal has been granted



Surplus

- Misfud v Owen Corning Canada
- Defined Benefit Plan
- In 1985 the Plan was amended:
 - Employee contributions removed
 - Benefits enhanced
 - Exclusive benefit clause deleted
 - Employer entitled to surplus



Misfud cont.

- Surplus began to accrue in 1986
- Employer took contribution holiday (between 1986-1999-\$26m surplus utilized)
- In 2003 surplus was \$19m
- Retired member group commenced class action claiming entitlement to surplus



Misfud cont.

- *Held:*
 - Plan was contractual, not trust
 - Employer entitled to contribution holiday
 - Retired members were bound by agreement



Misfud cont.

- Union has ability to negotiate on behalf of, and bind retired members (even though they are not technically members)
- *Schmidt* analysis



Surplus – Partial plan wind-up

- Monsanto Canada v Superintendent
- *Facts:*
 - Monsanto conducted a re-organisation and retrenched 146 employees.



Surplus – Partial plan wind-up cont.

- Superintendent refused to approve partial plan wind-up due to no provision for distribution of surplus
- Court required to interpret Sec. 70(6) of PBA



Monsanto – cont.

- *Held:*
 - Section 70(6) of the PBA requires the distribution of actuarial surplus relating to that part of the pension plan being wound-up on the effective date of the partial wind-up.



Monsanto – cont.

- Court did not indicate which party was entitled to the distributed surplus



Class actions

- Authorson v Canada (Attorney General)
- *Held:* The government is a fiduciary with respect to the funds it administers on behalf of the veterans and that it breached its obligation by failing to invest or pay interest.



Where can we go?

- Funding policy review-
 - Letter of credit (promissory note)
Butler Bros v B.C. Financial
Institutions Commission
- Investment policy review



Where can we go? Cont.

- DB Plan design strategies— sharing of risk and reward, negotiated cost, increasing move towards DC
- Multiple trusts
- Regulatory solution ideal



Where are we going?

- Guidelines for Capital Accumulation Plans-Joint Forum of financial Market Regulators
- CAPSA's Guidelines for Governance of Pension Plans and Self Assessment Questionnaire
- CAPSA's Proposed Model Pension Law



Capital Accumulation Plan Guidelines

- Released May 2004
- Voluntary
- No safe harbour for plan sponsors
- Primarily deals with investment education and communication issues



Guidelines for Governance and self assessment questionnaire

- Released October 2004
- Voluntary
- Common sense
- Refers to CAP guidelines



Proposed Model Pension Law

- Draft principles for a Model Pension law released in January 2004
- Goal
 - harmonize and simplify pension laws across Canada
 - Create a model law for consideration by Federal and Provincial governments when amending their pension legislation



Changes looking forward

- TSX Index positive for past 2 years
- Increased attention to plan governance
- Enhanced desire to reduce risk for both plan sponsor and plan member
- Questions?

