THE CANADIAN BAR ASSOCIATION
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Ms. Diane Lafleur
Director, Financial Sector Division
Department of Finance
L'Esplanade Laurier
20th Floor, East Tower
140 O'Connor Street
Ottawa ON K1A 0G5

Dear Ms. Lafleur:

Re: Solvency Funding Relief Regulations

I am writing on behalf of the National Pensions and Benefits Law Section of the Canadian Bar Association (CBA Section) in response to the Minister of Finance's request for submissions on the draft Solvency Funding Relief Regulations (proposed regulations) under the *Pension Benefits Standards Act, 1985* (PBSA). The CBA is a national association of over 36,000 lawyers, notaries, law teachers and students. The CBA's mandate includes seeking improvements in the law and the administration of justice, and that aspect of our mandate guides the comments in this letter.

We appreciate the government's initiative to acknowledge the serious funding issues in many of the pension plans within the regulatory jurisdiction of the Office of the Superintendent of Financial Institutions, to strive to balance these funding issues with the policy objective of protecting the benefit security of pension plan members and beneficiaries and to take action in the form of regulatory changes. While the CBA Section supports this initiative, we believe that several technical improvements could be made to the draft regulations that would result in more efficient and effective regulation.

Our submission presents some introductory comments on the temporary nature of the proposed regulations and on regulatory initiatives in other Canadian jurisdictions, followed by technical commentary, and is organized according to the structure of the proposed regulations. If no comments are offered about a specific section of the proposed regulations, either the CBA Section had no particular concerns or was unable to achieve a consensus on how any concerns might be addressed.

Temporary Regulations

The proposed regulations are of a very temporary nature. They extend relief only to "initial solvency deficiencies", defined as those deficiencies identified in an actuarial report filed after the regulations come into force, in respect of the valuation of a pension plan prior to January 2, 2008. As we are already more than half way through 2006, in many cases the proposed regulations will provide relief only for two valuations, namely for those pension plans where valuations are filed as of January 1, 2007 and January 1, 2008. The deadline for filing a January 1, 2006 valuation has already passed.

Given the serious and long-term nature of the funding issues, a solution should provide more than temporary relief. There must be a larger window to properly address the funding issues and assess the effectiveness of the proposed measures. A longer-term solution could be structured in several ways. The regulations could be drafted without end dates. In particular, the end date in the definition of initial solvency deficiency in section 1(1) could be removed. Section 29, which states that the regulations cease to be in force as of February 1, 2019, could be deleted. Alternatively, or in addition to the above, the regulations could be effective only if prescribed long-term interest rates go below certain levels. This would recognize that the current funding issues are at least partly in response to the decline in long-term interest rates, as stated in the government's introductory comments:

> *In recent years, the sharp decline in long-term interest rates to historically low levels has increased plan liabilities and has led to significant solvency deficiencies for many pension plans.*

The temporary nature of the proposed regulations also contributes to uncertainty among plan sponsors, which require as much certainty as possible to plan funding and use forecasting models for this purpose. Temporary regulations provide little to assuage plan sponsors' concerns with the funding issues. We note that permanent funding measures, including those with respect to letters of credit, are being considered in Quebec.

Other Canadian Jurisdictions

Both Alberta and Quebec have introduced similar solvency funding relief measures into their pension legislation (the *Employment Pension Plans Act* and *Supplemental Pension Plans Act*, respectively) and accompanying regulations. While Quebec's rules came into effect in 2005, the draft regulations associated with Alberta's measures concerning letters of credit are still being discussed and will likely be revised.

Still, it is important to recognize the need to harmonize pension legislation whenever possible to encourage the growth and maintenance of pension plans and to reduce administrative complexity. Where we have noted differences between the proposed regulations and corresponding provisions in Quebec, at least, we hope that such differences may be reduced or eliminated. This harmonization would benefit federally regulated pension plans that may also have members subject to pension legislation in other jurisdictions. We acknowledge, though, that for those jurisdictions that have entered into reciprocal agreements with respect to the regulation of pension plans, funding rules will be determined by the jurisdiction of registration. Although there may be differences in the regulation between jurisdictions, this will not result in the assets of a plan being split in two, with one part being funded in one manner and another being funded in another manner.

Technical Commentary

Our comments below are organized according to the corresponding section number of the proposed regulations.

(a) Interpretation Section

Wherever possible, the definitions in section 1 of the proposed regulations should be consistent with those in the PBSA and existing regulations.

The proposed regulations introduce a new definition of "beneficiary", which includes members, former members and other persons entitled to benefits under a pension plan. This causes some confusion because section 2(1) of the PBSA already defines "member" and "former member". Further, most practitioners consider "beneficiary" to be a person other than a plan member who is entitled to benefits such as survivor benefits.

The proposed regulations also introduce a definition of "beneficiary representative" as a union representative or court-appointed representative. In our view, the definition is too restrictive, as beneficiaries may have representatives who are not court-appointed. The definition should include "or other legal representative" to be more inclusive.

The new definition of "holder" should not be restricted to trust companies, and should include financial institutions authorized or licensed to carry on business in Canada, such as banks, insurance companies or trust companies. We elaborate on this further in our comments about letters of credit.

The new definition of initial solvency deficiency should be amended to delete the reference to the end date of January 2, 2008, in keeping with our previous comments.

(b) Application

Section 2(1) For the sake of clarity, section 2(1) should specify that the proposed regulations apply not only to pure defined benefit plans but also to those pension plans containing defined benefit provisions, such as hybrid plans and flexible plans.

Section 3 Section 3 of the proposed regulations restricts their application to pension plans established before the end of 2005. The CBA Section questions the policy rationale for this restriction. New pension plans might also benefit from the funding flexibility in these regulations. While most new pension plans are created without solvency deficiencies, there may be newly established pension plans, particularly in the context of mergers, acquisitions, amalgamations or spin-offs in which there are solvency deficiencies. We are unaware of any policy reason for the proposed regulations to not also apply to those pension plans.

(c) Part 2 - New Ten-Year Funding

Section 6(2) A pension plan's ability to amortize its solvency deficiency over ten years is contingent on no objection to such funding relief being voiced by active members, former members and certain others entitled to pension benefits under the plan.

Our members have varying views about whether or not plan member consent is necessarily appropriate with regard to funding matters. From a harmonization perspective, though, we note that the equivalent rules in Quebec provide that if all active members are represented by at least one union, those members are deemed to have consented to the funding relief provided every union that represents them has agreed to it.

There is no such provision in the proposed regulations. From the standpoint of cost, efficiency and consistency, Quebec's approach makes sense, is in keeping with the concept of the collective bargaining regime, and would reduce uncertainty for plan sponsors with members subject to the both the PBSA and Quebec's pension legislation. A concept of union consent already exists in the PBSA under the surplus withdrawal provisions in section 9.2(15), and the proposed regulations could simply cross-reference that section.

Section 7(3) Many multi-employer pension plans (MEPPs) are established under collective agreements. As such, it would be appropriate from the standpoint of cost, efficiency and consistency with the collective bargaining regime if, as suggested with respect to section 6(2), approval from active members could be sought from their representative unions. In addition, unlike similar provisions in Quebec and Alberta, there is no requirement that consent from employers participating in a MEPP be obtained. Although the lack of input from participating employers might be due to the PBSA's specific rules governing MEPPs, as well as its policy decision with respect to direct input from members, we suggest that this position should be reconsidered. In light of the key role played by participating employers and their need for certainty about their continuing responsibilities and obligations, it can be argued that some form of employer consent with respect to funding relief should be considered. However, other practitioners believe that consent should be required from participating employers only if they have an obligation to fund solvency deficiencies.

MEPPs are a unique form of pension plan, with distinctive characteristics. It can be argued that solvency funding has no relevance for MEPPs and the focus should instead be ongoing-concern valuations. This view is based upon the premise that MEPPs do not depend on the existence of any single employer and as a result, any single employer insolvency will generally not result in even the partial wind-up of a MEPP.

Section 8(1)(j) Section 8(1)(j) provides that objections to a pension plan sponsor's funding relief proposals must be sent to the administrator "not less than 21 days after the provision of the information under this section". However, it is unclear exactly when the relevant information is provided to plan members, former members and others. Particularly in the case of former members and other beneficiaries who may not have provided current contact information to pension plan administrators, the existing wording of this section could give rise to disputes with pension plan administrators as to when the 21 day period starts to run, and such disputes would be likely to lead to additional delays. The CBA Section suggests that additional clarity should be provided by the proposed regulations as to the deemed delivery of required information.

Section 8(1)(k) Section 8(1)(k) states that if a pension plan avails itself of funding relief under the proposed regulations, any plan amendments increasing pension benefits "will be restricted for the first five years". What is meant by the term "restricted" is unclear. In contrast, Quebec's rules with respect to funding relief include specific funding requirements if a plan is to be amended to provide additional benefits. In fact, the Regulatory Impact Analysis Statement for the proposed regulations indicated that plan improvements would be restricted "unless the improvements were pre-funded to not worsen the solvency deficit of the plan".

We suggest either that the term "restricted" be clarified or that specific funding rules be included in the final version of the proposed regulations. It is also unclear as to the meaning of the phrase "first five years", that is, when the five-year period begins. Further, the phrase "increase the pension benefits" is imprecise from a funding standpoint, and it may be more accurate to refer to plan amendments that result in increased liabilities for the plan.

Generally, the notice under section 8 does not apply to letter of credit arrangements. As such, neither would the restriction on plan amendments. We presume this distinction was intended, but suggest that appropriate revisions to the proposed regulations should be made. In addition, the restriction on plan amendments and the presumed requirement that benefit improvements have to be pre-funded could negatively impact collectively bargained flat benefit plans when further benefit rate increases are negotiated.

Section 8(2) — Section 8(2) requires that a plan sponsor's information about its proposals for funding relief also be provided to a "beneficiary representative", which in most cases will be a union. We presume that the provision of information to a beneficiary representative is in addition to, and not in lieu of the information to be provided to members, former members and other pursuant to section 8(1). The wording should be strengthened to reflect the true intent.

Section 13(2) — The phrase "funding ceases" is presumably intended to mean "funding under this Part ceases". We recommend the wording of this section be clarified.

Section 13(3) — We recommend the same changes as suggested above for section 13(2).

(d) Ten-Year Funding with Letters of Credit

We preface our remarks in this section by noting that CBA Section members' views vary as to whether or not letters of credit are appropriate for purposes of funding defined benefit pension plans.

Section 19(c) — Under subparagraph (v), the letter of credit automatically renews unless the issuer notifies the holder of the non-renewal not less than 90 days before the expiry date. We question the practical reality of issuers' reactions to having to make such decisions so far in advance. This requirement could result in an employer having to pay the applicable fees more than 90 days in advance. As well, the proposed notification timing could conflict with the requirements for filing an actuarial report.

Section 20(2) — Under section 20(2), a letter of credit need not be renewed if an actuarial report shows that the initial solvency has been completely liquidated; however, the face amount of a letter of credit may only be reduced under section 24 of the proposed regulations when there does not appear to be any reduction in the solvency deficiency due to good investment performance, for example. The CBA Section suggests that it would be appropriate to include a reduction in the solvency deficiency, as one of the circumstances in which a letter of credit face amount can be reduced.

Section 21(1)

Section 21(1) specifies that, if a letter of credit is being used for purposes of funding relief, the employer or pension plan administrator "shall enter into a trust agreement with the holder regarding the letters of credit…". This language implies that a new and separate trust agreement must be entered into to hold a letter of credit. While this step might provide additional security to pension plan members whose plans are funded through a group annuity contract as opposed to funds held pursuant to an existing trust agreement, we oppose the requirement that a separate trust agreement be entered into by those plans already funded through a trust arrangement. Quebec rules do not require a trust agreement to hold a letter of credit.

Negotiating pension trust arrangements often involve considerable time and expense for a pension plan sponsor. As well, the additional cost of maintaining a separate trust arrangement could be a significant burden on plan sponsors, as trustees usually impose minimum fees for each trust arrangement.

Finally the state of the law with respect to separate trust arrangements under one pension plan is currently in doubt. A recent decision of the Ontario Divisional Court, *Nolan v. Ontario (Superintendent of Financial Services) and Kerry (Canada) Inc*. [2006] O.J. No. 960, held that, in the context of a conversion of a pension plan from defined benefit to defined contribution, the funding vehicles were separate and resulted in separate pension plans with one registration number. It is conceivable that a court could similarly conclude that the letter of credit trust, and any other trust arrangements under the pension plan, are separate and distinct, calling into question the ability of funds secured through the letter of credit to actually be used for their intended purpose. To clarify what appears to be the legislative intent, the CBA Section recommends specifically stating that the use of a separate trust or other instrument to hold a letter of credit will not, in and of itself, create a separate pension fund or pension plan. We also recommend that the proposed regulations be amended to provide that an employer or pension plan administrator can simply amend an existing trust agreement to hold a letter of credit, rather than establishing a separate arrangement.

It may also be useful to make the proposed regulations more flexible by referring to financial institutions generally, rather than trust companies. Otherwise insurance companies could be at a competitive disadvantage and pension plans that are currently funded though insurance contracts could find the addition of a letter of credit to be overly burdensome.

Section 21(2)(e)

Section 21(2)(e) may cause concern to holders of letter of credit as their actions are measured by the open-ended event of "becoming aware of a default". This could suggest an obligation by the holder to take positive steps to become aware of a default, which would be too onerous.

In our view, the wording of section 21(2)(e) should be amended to ensure that the holder and the employer have complete certainty about the events of default and exactly when a demand for payment under a letter of credit is to be made.

Section 21(2)(f)(g) Holders must clearly understand their administrative obligations regarding letters of credit. Equally important is that an employer is able to decide to use a letter of credit with a full understanding of the terms of a demand for payment. Any uncertainty leaves open the possibility that a holder, out of an abundance of caution and in a legitimate attempt to ensure compliance, could make a demand for payment of a letter of credit in a situation that the proposed regulations were not intended to address. The financial consequences to an employer, given the estimated size of some of the letters of credit, could be considerable. On the other hand, the holder can provide an additional check and balance on the employer, who is often also the plan administrator.

Paragraphs 21(f) and (g) could be combined to clarify that the holder does not have an independent obligation to consider whether the circumstances for calling on the letter of credit have been met, but rather to act in accordance with, and to rely on, notice provided in this case by the administrator. As currently worded, the holder appears to have an obligation to determine whether or not a demand can be made even though the holder may have insufficient information to make such a determination.

Another view is that the holder should have an independent obligation to safeguard against conflicts of interest, particularly in cases in which the employer and the plan administrator are the same.

Section 22(1) The filing obligations imposed on an administrator in section 22(1) and (2) do not make it clear whether the Superintendent intends to simply lodge the documents provided, or whether a review process is also contemplated. If a review process is contemplated, we are concerned about the potential results if the Superintendent identified a deficiency. By the time of filing, the letter of credit structure would already be in place.

Section 25(1) The reference to “special payments” in this section should be clarified. We presume that in determining a plan’s solvency ratio or transfer ratio, the base amount of any letter of credit should be included in the pension plan’s asset. However, the existing wording is unclear in this regard.

I trust that these comments will be helpful and would be pleased to discuss our recommendations with you further at your convenience.

Yours truly,

(Original signed by Mark Newton)

Mark Newton
Chair, National Pensions and Benefits Law Section