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New Brunswick Task Force on Protecting Pensions

**NATIONAL PENSIONS AND BENEFITS LAW SECTION
CANADIAN BAR ASSOCIATION**

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PREFACE

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Pensions and Benefits Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Pensions and Benefits Law Section of the Canadian Bar Association.

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New Brunswick Task Force on Protecting Pensions

I. INTRODUCTION

The National Pensions and Benefits Law Section of the Canadian Bar Association (CBA Section) is pleased to provide its views in response to the New Brunswick Task Force on Protecting Pensions invitation for submissions, released in July 2011. The CBA Section has approximately 600 members involved in pensions and benefits law from across the country, including counsel to pension and benefit administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefit consultants, and investment managers and advisors.

The CBA Section welcomes this initiative. We believe it is important that New Brunswick review and modernize its legislation.¹

Generally speaking, the submission recommends the adoption of measures that will protect plan members, while providing employers with enough flexibility to ensure a fund's viability. The discussion is organized under five major issues that are important for pension reform: harmonization, target benefit plans, minimum solvency funding, surplus use and ownership, and investment rules.²

II. ISSUES

A. Harmonization

The CBA Section recommends that New Brunswick's pension legislation be harmonized with pension legislation in other provinces, especially Nova Scotia and Prince Edward Island. Harmonization has several advantages:

¹ *Pension Benefits Act*, SNB 1987, c P-5.1

² These same issues were raised and discussed in the CBA Section's recent submission on pensions to Prince Edward Island. See *Prince Edward Island Consultation on Bill 30 Pension Benefits Act* at: http://www.cba.org/CBA/submissions/2011eng/11_05.aspx, and in the CBA Section's 2010 submission on pensions to Nova Scotia. See *Nova Scotia Discussion Paper on Pensions* at: http://www.cba.org/CBA/submissions/2010eng/10_45.aspx.

1. For multi-jurisdictional pension plans with New Brunswick members registered in other jurisdictions, harmonized legislation will mean that the costs of administration for New Brunswick members will not be significant, while those members will gain important protections for their benefits.
2. The New Brunswick government may achieve greater efficiency in fulfilling the regulatory responsibilities arising under the new legislation, limiting required government resources.
3. Larger plans that may register under New Brunswick legislation are likely to have members in either Nova Scotia or PEI. Harmonization will reduce administrative burden and complexity for these plans.

On December 1, 2010, PEI introduced its first comprehensive pension legislation.³ Nova Scotia is in the process of revising its *Pension Benefits Act*⁴. It has completed a public consultation process and has indicated that new legislation may be introduced this fall. This new legislation will be largely based on Ontario's new legislation. New Brunswick has an opportunity to harmonize its legislation with PEI, Nova Scotia, and Ontario.

The CBA Section urges New Brunswick to coordinate its development of pension standards legislation with the reform processes underway in other Atlantic provinces. Coordination will ensure that Canadian pension standards legislation is at least harmonized in these provinces.

B. Target Benefit Plans

Canadian multi-employer pension plans (MEPPs) which aim to provide target benefits continue to thrive throughout much of Canada. However, the current New Brunswick legislative environment is hostile to these plans. MEPPs registered in New Brunswick are subject to solvency funding requirements, which are counter-productive. MEPPs are not permitted to reduce accrued benefits. This creates an impossible dilemma in the absence of the ability to require contribution increases because benefits must be provided, whether or not employers pay for them. In addition, MEPPs have no authority to require employers to pay for their employees' benefits.

The CBA Section strongly supports statutory amendments to promote the establishment of Target Benefit Plans (TBPs). This will add a greater degree of flexibility for employers and plan members, which will hopefully result in greater coverage. TBPs should be available in both single employer and multi-employer situations, and should be jointly governed to provide plan members with a voice in their administration. TBPs should also be required to clearly and regularly communicate the nature

³ *Pension Benefits Act*, Bill 30 (Prince Edward Island). Passed first reading stage.

⁴ *Pension Benefits Act*, RSNS 1989, c 340.

of the target benefit to plan members to ensure that plan members have a proper understanding of the pension promise.

C. Minimum Solvency Funding

Solvency funding requirements for defined benefit pension plans is one of the major issues raised in recent consultations on pension reform. We recognize the need for minimum statutory solvency funding requirements to protect the pension benefits of plan members while, at the same time, providing certain funding flexibility to the employer.

Under New Brunswick's current statutory regime, the amortization period for solvency deficiency is five years. We recommend moving to a ten-year amortization period, with appropriate member consent. This will help reduce the volatility of contributions that many employers have found burdensome. If, however, New Brunswick follows the federal lead and adopts the averaging method, a move to a ten-year amortization period will not be necessary because the averaging method effectively mitigates the volatility.

The potential risk to employees arising from this flexibility can be balanced by imposing a 5% collar that will prevent the use of any surplus from an ongoing plan, unless assets exceed 105% of liabilities. The imposition of a 5% collar is consistent with the approach adopted or proposed by other Canadian jurisdictions (e.g., Manitoba, Ontario, federal). The imposition of a collar ensures benefit security for plan members.

We also recommend that an employer be permitted to use properly structured letters of credit to fund solvency contributions. A properly structured letter of credit provides the same security for members as actual contributions, but allows an employer the flexibility to determine whether to use its capital for solvency contributions to the pension fund or to deploy the capital elsewhere in its business. In addition, a cap can be imposed on the use of letters of credit so that an employer is required to fund a part of the solvency deficiency in cash. For example, a cap can be imposed by reference to a percentage of the solvency deficiency or a percentage of the market value of plan assets.

D. Surplus Use and Ownership

The CBA Section's members act on behalf of all stakeholders in the pension industry across Canada and as such, have not yet reached agreement on the appropriate use of surplus, ownership issues, or

the appropriate interpretation of the Supreme Court of Canada's decision in *Nolan v. Kerry (Canada) Inc.*⁵

The CBA Section does, however, support the application of the following principles when considering pension reform this area:

- all stakeholders will benefit from greater clarity in surplus use and ownership matters; and
- any usage or distribution of surplus from an on-going plan should not jeopardize the funded position of the plan and the promised benefits.

In addition, we refer to the discussion above on the imposition of a collar on the use of an ongoing plan's surplus.

E. Investment Rules

Except in New Brunswick and Quebec, Canadian pension plans are subject to investment rules under Schedule III of the federal *Pension Benefit Standards Act*⁶, either through incorporation or incorporation by reference. Most investment restrictions under New Brunswick's Act are inspired by the rules under Schedule III. These restrictions attempt to: 1) control self-interested actions of the employer and other participants in the pension investment process; and 2) avoid concentration of investment through the 10% limit of one investment in total book value of the plan and through the 30% limit on voting shares.

Again, the CBA Section believes that New Brunswick's pension legislation should be harmonized with that in Nova Scotia and PEI. For harmonization purposes it may be desirable to incorporate the investment rules of Schedule III in New Brunswick's legislation. In any event, we make the following comments on the current investment rules.

1. Self-interested actions

One area that merits continued regulation beyond the general prudent investment rule is self-interested actions of the employer and other participants in the pension investment process. When an employer is under financial pressure, it may be tempting to push the prudence limits for personal benefit. Employees who are administering the pension plan are not well-positioned to resist

⁵ [2009] 2 S.C.R. 678.

⁶ *Pension Benefit Standards Act*, 1985, RSC 1985, c 32.

pressure from their employer. Restrictions and bright line tests are appropriate to control self-interested actions.

It would also be appropriate to maintain a bright line test for investment in securities of the employer and affiliates, as Quebec has done. Consideration should be given to setting the limit lower than 10%, in accordance with current views on prudent diversification. To allow practical administration of investments, this limit should not restrict investment in arm's length funds that comply with National Instrument 81-102⁷ or similar rules, or in foreign arm's length funds. To avoid creating complicated compliance issues, holdings by these funds of employer and affiliate securities should not be subject to the new limit.

The CBA Section believes that controlling self-interested actions is an important objective of pension investment regulation. We recommend that the investment rules set a limit below 10% on investment by a pension fund in securities of participating employers and affiliates, other than indirect investment through arm's length funds.

2. Concentration: the 10% limit

Section 44(10) of New Brunswick Regulation 91-195⁸ prohibits loans or investments greater than 10 percent of the total book value of the plan's assets to any one person or to a combination of related persons, subject to a few prescribed exceptions. Pension fund investing has evolved in recent years making this limit either too generous or too restrictive, depending on the perspective.

It is too generous because it appears to condone as prudent the investing of up to 10% of a plan's assets in securities of a single company. Most prudent pension investment advisors would consider this limit to be too high.

However, the limit is also considered too restrictive for purposes of investing in funds or funds of funds, which may be cost effective for smaller pension funds and which has now become a common practice.

The 10% rule no longer appears necessary or appropriate because plan administrators must exercise prudence in selecting an investment fund. Quebec replaced the 10% limit from its investment rules in 2000 (except for securities of the employer and affiliates), with a general diversification requirement.

⁷ Canadian Securities Administrators created National Instrument 81-102. It can be found on New Brunswick's Securities Commission Website: <http://www.nbsc-cvmb.ca> under Laws and Policy; Regulatory Instruments; Rules, Policies, Orders; Category 8 – Mutual Funds.

⁸ New Brunswick Regulation 91-195, pursuant to the NB *Pension Benefits Act*.

The CBA Section recommends eliminating the 10% limit.

3. Concentration: the 30% limit

Investment regulation may include regulation of pension funds, as institutional investors, that have the potential to affect capital markets and the Canadian economy. For example, the existing 30% limit on voting shares in s. 44(12) of New Brunswick Regulation 91-195⁹ appears to be intended to prevent pension funds from controlling the companies in which they invest, rather than ensuring the funding of pension benefits.

Pension funds play a significant role in Canadian capital markets. Internationally, some commentators have called for reform of the way pension funds invest to generally enhance the operation of capital markets. However, few commentators have called for specific investment rules for pension funds. Rather, they generally propose improved governance processes and reporting.

Considering that other participants in capital markets are subject to less regulation than pension funds, it is not clear that regulation of pension funds as institutional investors is necessary or desirable. Pension funds are already subject to securities regulation regarding their interests in public companies.

The CBA Section recommends reliance on securities regulation, rather than pension legislation, to regulate pension funds as institutional investors.

4. Prudent Investment Approach

During the 1990s pension investment regulation across Canada shifted from lists of permitted investments to a prudent investment approach with a few specific rules. The prudent investment approach is currently reflected in s. 17(1) of New Brunswick's *Pension Benefits Act*.¹⁰

This approach gives pension plans considerable flexibility to adapt their investment strategies to evolving financial markets. New financial instruments have arisen and their use by pension funds has become increasingly accepted as prudent. With the rapid development of these changes, the flexibility of the prudent investment approach has been particularly valuable.

A few quantitative limits are unlikely to be the basis for meaningful regulation of investment. If more refined investment rules were developed, it would be difficult and expensive for a pension regulator

⁹ *Ibid.*

¹⁰ *Supra* note 1.

to maintain sufficient financial and investment expertise to proactively provide meaningful investment oversight to pension plans within its jurisdiction.

The general prudence principle may be regarded as vague and lacking in guidance. However, every pension plan must prepare and review, at least annually, a written statement of investment policies and procedures which should confirm the application of the principle in that particular pension plan.

The CBA Section recommends continuing to require the prudent investment standard as the principal rule for pension fund investment, and that pension plan administrators prepare and maintain a written statement of investment policies and procedures properly tailored to each plan.

5. Members-directed Defined Contribution Plans

Where a pension plan permits members to make investment decisions, investment regulations should protect the members as investors by facilitating prudent decision-making without dictating investment choices. The CBA Section believes the existing investment rules do not achieve this objective. In 2004, the Canadian Association of Pension Supervisory Authorities (CAPSA) adopted the *Guidelines for Capital Accumulation Plans* (CAP Guidelines).¹¹ Although they do not have the force of law, they are generally considered to be “best practices” by plan sponsors and service providers. The CAP Guidelines provide information and tools to assist members in making appropriate investment decisions for account balances.

The CBA Section recommends that, to facilitate member investment decisions in capital accumulation plans, investment rules should be expanded to legislatively protect the members as investors by facilitating prudent decision-making and promoting the CAP Guidelines.

III. CONCLUSION

The CBA Section trusts these comments will assist the New Brunswick Task Force on Protecting Pensions in its work on this important initiative. We would be pleased to respond to questions and to provide further information regarding any of the issues addressed in this submission.

¹¹ See: <http://www.capsa-acor.org>.