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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

February 2, 2004

Mr. Brian FitzGerald
One Balmoral Avenue
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Toronto, ON
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Dear Mr. FitzGerald:

I am writing further to our recent discussion in which you told me that you would be filing an affidavit in support of a motion for leave to appeal the decision of the Ontario Court of Appeal in *Transamerica Life Canada v. ING Canada Inc.* ("Transamerica") to the Supreme Court of Canada. As we discussed, The Association of Canadian Pension Management ("ACPM") shares your view that this case should be heard by the Supreme Court. I am therefore writing to confirm ACPM's view that the case raises issues of national importance, not just for Ontario plans. The implications are only just now beginning to be realized by employers across the country.

<u>History and Purpose of ACPM</u>

The ACPM is a national association with membership from over 400 pension plans, covering some three million members across Canada. The Association is dedicated to the growth and health of the retirement system in Canada. Our advocacy activities are based on the following three principles:

- Clarity in pension legislation, regulation and arrangements;
- Good governance and administration, and
- Balanced consideration of stakeholder interests.

The ACPM has no interest in taking sides with either of the particular employers in this case. Our purpose in writing this letter is to explain why we believe that the Transamerica Decision raises issues of national and public importance.

A. Pension Plans Support Canadian Employers and Employees

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Canada's private pension system is founded primarily on the defined benefit pension plans of private sector employers. The plans themselves are largely a reflection of how Canadian business has evolved over the last half century. In particular, just as Canadian corporations have grown, amalgamated, reorganized, and bought and sold businesses, so too have their pension plans been merged, assets transferred, and related employers and additional employees added and subtracted in response. This has particularly been the case since the 1980's.

Until *Transamerica*, these pension plan asset transfers, mergers, and reorganizations have been conducted on a relatively routine basis. Regulatory approval has been sought and obtained, and there has been relatively little litigation relating to these activities.

More importantly, both employers and employees, as well as legislators and regulators, considered the requirements of the regulatory consent process to adequately protect members' benefits.

This has now been changed by *Transamerica*. The Ontario Court of Appeal's decision means that principles of common law entitlement to pension surplus, as well as common law trust principles, will supplant the current legislative and regulatory regime regarding asset transfers between pension plans. This will have a chilling effect on asset transfers and mergers -- past, present, and future -- to the detriment of employers and employees and pensioners across the country. It will also have significant and far-reaching implications for defined benefit pension plans generally, including funding and plan changes. We explain why below.

B. *Transamerica* Casts Doubt on Solvency of Pension Plans and Employers: Previously Approved Mergers and Asset Transfers

1. Validity of Corporate Financial Statements is in Doubt

We estimate that there are at least several hundred, if not thousands, of employers in Canada who currently maintain pension plans that have received assets from one or more other defined benefit pension plans at some time in the past, either as a result of corporate mergers and acquisitions or internal reorganizations. We believe that many of the original plans and trusts which held these assets contain "exclusive benefit" terms. In many of these plans, the employers will have taken contribution holidays from time to time during the past few decades, based upon actuarial recommendations relating to the plan's assets as a whole. In these cases, we expect that the corporate financial statements were prepared on the basis that the actuarial surplus was available and that no part of the plan's assets were to be held for the exclusive benefit of any particular group of members or former members.

The validity of the mergers, and subsequent funding recommendations, are likely now in doubt and open to challenge. If challenged successfully, employers would presumably be found to have

breached the underlying trust agreements (by taking contribution holidays in the merged plans) and the financial statements would also presumably be found to have been in error. The results could be horrendous in that many plans that have been operating successfully would have to be segregated with potential adverse consequences for both employees and employers.

2. Funding and Changes to Pension Plans Have Become Uncertain

We anticipate that actuaries will now have to qualify their funding recommendations because they are unlikely to know the full history of the plan, and whether there is any trust language that would prohibit part of the plan's assets from being considered in determining the employer's contribution obligations.

Not only will this create uncertainty among employers as to their contribution requirements, but it will also cause them to reconsider any future changes to their pension plans. In particular, employers will not increase pension benefits or make any other plan changes that impose additional costs if they do not know whether all of the plan's assets will be available to fund them. Similarly, employers will not know if or when they can add new members or related employers to their plans.

3. Solvency Concerns

We are also concerned that the Ontario pension regulator, the Superintendent of Financial Services (Ontario), will be compelled as a result of *Transamerica* to require employers to "close" the parts of any pension plans that are subject to "exclusive benefit" trust language and to fund the "closed" part of the plan separately from the remainder of the plan. If this is imposed retroactively, this could affect the solvency of many pension plans, and possibly also the employers that sponsor them. Even if this is imposed only prospectively, we expect many employers, when faced with the administrative burden and additional costs of doing this, will simply wind up their plans.

C. *Transamerica* Will Have a Chilling Effect on the Future of Defined Benefit Pension Plans: Effect on Pending and Future Asset Transfers and Mergers

The *Pension Benefits Act* (Ontario) requires the Superintendent of Financial Services to consent to any transfer of assets from one pension plan to another (other than individual transfers). In doing so, the Superintendent has a statutory duty to protect the interests of various pension plan members and former members.

As a result of the Court of Appeal's decision in *Transamerica*, in order to satisfy the Superintendent that members' benefits are protected, employers will need to undertake a review of the historical trust terms of all of the plans involved in an asset transfer or merger, as well as

the predecessor plans and any plans from which they received assets, to determine whether there are any "exclusive benefit" or other trust terms that will require assets and liabilities of either the exporting or importing plans to be "closed" to all participants other than those it had immediately prior to the asset transfer or, in other words, whether there is an exclusive class of plan members and corresponding assets. In short, employers will need to undertake the type of detailed trust law analysis previously reserved for surplus entitlement matters. This will apply whether or not any of the plans to be merged has surplus assets.

We anticipate that the Superintendent will be able to approve very few asset transfer or merger applications without finding that one or more parts of a plan must be considered "closed". The time, effort and cost required to obtain regulatory approval will also increase substantially.

In the context of corporate mergers and acquisitions which, it must be acknowledged, are now typically multi-national, the possibility of the buyer and seller agreeing to transfer Canadian pension assets or pension plans (the latter for the purpose of subsequent merger with the buyer's existing plans) in these circumstances is practically nil. The parties to the transaction will quite rightly view this process as too difficult, expensive, and time-consuming and the results as too uncertain with the result that plan members' benefits will be reduced and employees' rights prejudiced.

The accrued pensions of the employees affected by the transaction may be frozen in the seller's pension plan until the employees reach retirement, or at least will not grow as much as they would otherwise. This can have a substantial detrimental effect on the value of the employees' pension benefits upon retirement. The value of the pension earned under the seller's plan plus the value, if any, of the pension earned under any plan that the buyer may put in place will seldom be as great as, and may be significantly less than, the value of the pension that an employee would earn if assets and liabilities in relation to his accrued benefits were transferred to the buyer's plan. This is because the pension earned under the seller's plan will not take into account any benefit improvements or wage increases that occur subsequent to the sale. Similarly, the pension earned under the buyer's plan will not take into account the service of the employee with the seller in calculating the employee's pension. Together, these factors will in most cases significantly reduce the value of an employee's pension upon retirement.

In the context of corporate reorganizations, which are often the motivating force behind asset transfers and pension plan mergers between related employers or the same employer, the results will be similar. It is unlikely that an employer or related group of employers would wish to merge their pension plan assets if they cannot take advantage of the economies of scale. On the other hand, it may well not make sense from a human resources, commercial, or administrative perspective to concurrently maintain a number of separate pension plans. The alternative is to wind them up. The net result, therefore, is that both employers and employees will be adversely affected. This is not in the public interest.

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We sincerely hope these remarks will be of assistance to you in this matter.

Yours very truly,

ASSOCIATION OF CANADIAN PENSION MANAGEMENT

Per: