

focus

on

Pensions and Benefits

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FRASER MILNER CASGRAIN LLP

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NEWLY RELEASED CAP GUIDELINES - ARE YOU PREPARED?

On May 28, 2004, the Joint Forum of Financial Market Regulators, which has representatives from the pension, insurance and securities regulators across Canada, released the much anticipated "Guidelines for Capital Accumulation Plans". CAPs include defined contribution pension plans, deferred profit sharing plans, group RRSPs and RESPs.

The guidelines are intended to:

- outline and clarify the rights and responsibilities of CAP sponsors, service providers and CAP members; and
- ensure that CAP members are provided with the information and assistance that they need to make investment decisions in a CAP.

The guidelines represent the expectations of regulators with respect to the operation of CAPs and strongly highlight the need for proper governance of pension plans and other tax assisted investment or savings plans. They are guidelines for "best practices" but they do not have the force of law.

Even though the guidelines do not have the force of law, implementing the guidelines' recommendations could go a long way in minimizing the risks of employee lawsuits, as well as employee and retiree dissatisfaction. It is strongly recommended that these guidelines be used as a basis for developing a governance policy or plan for Group RRSPs, defined contribution pension plans and other CAPs.

If you wish to discuss these new guidelines or any other governance issues, please do not hesitate to call one of the members of our Pensions and Benefits Group.

SUCCESSFUL NEGLIGENT MISREPRESENTATION CLAIM AGAINST ADMINISTRATOR

Employers who administer registered pension plans should be concerned about the decision of the Ontario Supreme Court of Justice in *Hembruff v. Ontario Municipal Employees Retirement Board* dated March 30, 2004 ("*Hembruff*"). This case imposes a new and higher standard on employers/administrators when it comes to communicating pension plan information to members, which means that the risk of potential liability for employers/administrators has been further expanded. *Hembruff* suggests that where an employer/administrator is aware of proposed amendments to the pension plan affecting benefits and it is reasonable to conclude that decisions by plan members (e. g. whether to exercise portability rights) could deprive them of potential benefits, the employer/administrator has a fiduciary duty to disclose these proposed amendments to plan members. The decision has been appealed. If the decision is not overturned, it will be a challenge for employers/administrators to determine at what stage in the progression of a potential plan amendment the duty to disclose arises. In addition, what if a plan member relies to his/her detriment on a proposed plan amendment that is ultimately abandoned by the employer (e.g. due to policy or cost reasons or an unexpected change in circumstances)?

The eight plaintiffs in *Hembruff* were former employees of the Toronto Police Services Board who participated in the Ontario Municipal Employees Retirement System ("OMERS"). The plaintiffs left their employment in 1998 and elected to transfer out the commuted values of their pensions from OMERS; these "cash outs" were made in 1998.

In May 1999, retroactive to January 1, 1999, the OMERS' regulation was amended to provide benefit improvements to plan members. Essentially, the plaintiffs claimed that they had been deprived because the OMERS Board (the "Board"), which administers the pension plan, failed to disclose to them the proposed benefit improvements at the time they were making their decision to elect either a commuted value or a deferred pension. (The election of a deferred pension would have allowed the plaintiffs to remain plan members as of January 1, 1999 in which case they would have been entitled to the benefit improvements). The plaintiffs alleged that OMERS breached its fiduciary duty to them and made negligent representations to them, resulting in damages. The Board argued that they did not owe a fiduciary duty to the plaintiffs since none of the plaintiffs were members of the pension plan when the amendments to the regulation became effective. The Board also denied making any negligent misrepresentations.

Damages were awarded to six of the eight plaintiffs by the Court for negligent misrepresentation by the Board, and also for breach of fiduciary duty. The Court rejected the Board's argument that there was no obligation to inform members of plan improvements if they have not been finalized and were only proposed. The Court concluded that OMERS had been negligent as it did not "establish, implement and monitor a communications policy that took into account all members." Furthermore, the Court concluded that "OMERS made no effort to communicate with that particularly vulnerable group of members who were in the throes of decision-making and most in need of information affecting their financial futures."

The Court also concluded that the Board breached its fiduciary duty to provide fair and equal treatment to all members by arbitrarily choosing a retroactive effective date for the plan improvements of January 1, 1999. The Court was of the view that the Board did not fully consider the effect that the retroactive date would have on members and did not recognize that members who were in the process of making decisions about their employment and pensions could gain if they had deferred making their elections. In addition, due to the lack of service standards in processing terminations (i.e. providing quotes and complying with commuted value transfer requests) and the increased delays in processing terminations, some members who terminated employment prior to January 1, 1999 fortuitously remained plan members as of January 1, 1999. These individuals received the benefit improvements, while others who also terminated employment before January 1, 1999 did not, which meant that similarly situated members were treated unequally. Finally, the Court noted that a Senior Vice-President of OMERS treated the plaintiffs in a cavalier and condescending manner regarding the issues raised and concluded that this showed a lack of good faith.

The damages awarded to each of the six plaintiffs ranged from about \$97,000 to \$179,000 (with interest). This case emphasizes the need for employers/administrators to develop a clear and comprehensive communications policy to be followed by all individuals involved in the administration of the pension plan. Without such a policy, employers/administrators are at risk of lawsuits by current and former plan members.

Please contact a member of our Pensions and Benefits Group for assistance in reviewing or developing your communications policy and practices.

REDUCTION OF RETIREE BENEFITS TRIGGERS CLASS ACTION LAWSUIT

On January 7, 2004, the Ontario Superior Court of Justice certified a class action lawsuit commenced by a group of retired Ontario civil servants who claimed that their former employer (the Ontario Government) unilaterally cut back certain supplemental health, hospital and dental benefits they had been receiving. As a result of the restructuring of the government's benefits program, both improvements and reductions were made to the retiree benefits.

The retirees argue that they are entitled to receive the benefits that were provided to them immediately prior to June 1, 2002 and that their former employer would be violating the retirees' rights under the *Canadian Charter of Rights and Freedoms* by reducing such benefits. In the alternative, the retirees are claiming damages for breach of contract and breach of fiduciary duty. They are also claiming punitive damages relating to the alleged "arbitrary, callous and high-handed actions" of their former employer in changing their retirement benefits "at a time when the Retirees were most vulnerable to health problems and could least afford to assume increased financial burdens."

The substantive issues of the action have not yet been considered in *Kranjcec v. The Queen*, but if the retirees are successful in their claim, it will negatively impact the ability of employers to reduce retiree health and dental benefits and may also have implications for employers who have already made reductions. Given the rapidly rising costs of retiree benefits, more and more employers are considering ways to relieve the financial burden associated with the provision of such benefits to retirees.

Until this case is resolved, it will not be surprising to see other class action lawsuits launched in situations where employers have announced their intention of reducing retiree benefits or have already taken steps to do so. This decision suggests that even in situations where some retiree benefits have improved while others have been reduced, employers may not be shielded from the risk of legal action.

The last high profile court case dealing with retiree benefits was the Supreme Court of Canada's 1993 decision in *Dayco (Canada) Ltd. v. C.A.W. - Canada* ("Dayco"). The Supreme Court of Canada took the position that depending on the wording of the contractual agreement between the employer and employee (which in this case was a collective agreement), post-retirement benefits could vest in an employee when the employee retires. Once vested, such benefits cannot be changed or terminated after retirement, unless the employee consents to the change/termination or if the employer had reserved the right to change/terminate these benefits and had properly communicated this right to the employee, prior to the employee's retirement. It will be interesting to see how the *Kranjcec* case is decided in light of *Dayco*.

For advice on how to proceed in this unsettled area of the law, please contact one of the members of our Pensions and Benefits Group.

TRANSFERS OF ASSETS BETWEEN PENSION PLANS NOW RESTRICTED

Employers should be aware of the Ontario Court of Appeal decision in *Aegon Canada Inc. and Transamerica Life Canada v. ING Canada Inc.* ("*Transamerica*") and the recent interpretation of that decision by the Financial Services Commission of Ontario ("FSCO") since both impact the ability to transfer pension assets.

The *Transamerica* decision arose out of alleged breaches of warranties in a share purchase agreement. Warranties were made by the seller that all required pension plan contributions were properly remitted, that the pension plan in question was fully funded and that the seller's financial statements were accurate. After the closing, the purchaser determined that the seller had based its warranties on the combined assets of two pension plans even though the seller was not legally permitted to do so and had given the Ontario regulator an undertaking that the assets of these two plans would be administered separately. The Court found in favour of the purchaser. The seller has sought leave to appeal from the Supreme Court of Canada.

As a result of the *Transamerica* decision, FSCO has imposed a "moratorium" on most asset transfers involving Ontario registered pension plans funded through a trust. This moratorium will affect proposed pension asset transfers in, among other situations, the context of a sale of a business.

In light of the FSCO moratorium and the *Transamerica* decision, legal advice should be sought when considering an agreement that contains pension language or when dealing with a proposal to merge or transfer assets between pension plans.

DEATH BENEFITS PAYABLE TO FORMER SPOUSE

In *Ontario Teachers' Pension Plan Board v. Superintendent of Financial Services and Anne Stairs* ("*Stairs*"), the Ontario Court of Appeal was asked to interpret the pension assignment provisions of a separation agreement entered into by Ms. Stairs and her then husband, Mr. Mowbray, in 1990. At the time of Mr. Mowbray's death in 1995, he was still working as a teacher and had remarried. The Divisional Court had found that the separation agreement between Ms. Stairs and Mr. Mowbray should be honoured and that the *Pension Benefits Act* (Ontario) (the "*PBA*") specifically allowed for pre-retirement death benefits to be transferred by way of a separation agreement.

The Court of Appeal was asked to determine whether Mr. Mowbray had the right to assign only those benefits accrued during post-1986 employment, pursuant to the wording in section 48(13) of the *PBA*, or whether he was also allowed to assign benefits accrued pre-1987. The Court of Appeal was also asked whether the amount payable to Ms. Stairs was limited by section 51(2) of the *PBA*, which states that a domestic contract may not assign more than 50% of a pension benefit accrued during the period of the marriage, and was asked on which date the division of pension was to be valued.

The Court of Appeal found that section 48(13) of the *PBA* does not prohibit a member from assigning benefits accrued for pre-1987 employment along with those accrued for post-1986 employment. However, the Court of Appeal did go on to state that subsection 51(2) of the *PBA* would operate to prohibit the member from assigning more than 50% of the total pre-retirement death benefit to a spouse. The Court of Appeal also found that the valuation date for applying the 50% rule was the date of death.

Stairs highlights the complexity of marriage breakdown and subsequent pension benefit division. This complexity is heightened when a separation agreement is involved. Careful review of a separation agreement by a plan administrator at the outset of a marriage breakdown will help minimize the risk of legal action and its associated costs.

ALERT! NEW ONTARIO PENSION FEES INCREASE COST OF ALLOWING FORMER EMPLOYEES TO STAY IN YOUR PENSION PLAN

It is common for terminated employees to leave their pension benefits in their former employer's registered pension plan. Terminated employees may like the convenience and low fees of their former employer's pension plan. Unfortunately, the plan administrator (who is usually the employer) may not force a terminated employee to complete

the required forms that provide for a transfer of the benefit to another locked-in plan.

Why should a plan administrator care about transferring out the registered pension plan benefits of terminated employees? One reason is that the plan administrator continues to be legally obliged to administer the pension benefits in accordance with pension legislation and high standards of the common law. For example, the plan administrator will continue to be obliged to monitor the performance of investment managers of defined contribution accounts of their former employees.

Another reason is cost. Many trustees and other funding agents charge a per-member fee, regardless of whether the member is employed.

A *new* reason to care about how many former employees are in your pension plan is a new regulatory fee. It applies to pension plans that are subject to Ontario filing fees. Until now, plan administrators paid a \$6.15 fee only for each active member. FSCO has now added a filing fee of \$4.15 for each former member and plan beneficiary.

Employers should look at how many members of their pension plan are former employees, and consider ways to encourage them to leave the plan, since it is becoming more expensive to let them stay in the plan.

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