



## **EXCLUSIVE INTERVIEW:**

Today I'm pleased to be talking to Paul Litner, a partner and chair of the pension and benefits department at Osler. Paul has also been a member of the Financial Services Tribunal since 2002.

He is going to answer a few questions today about proposed amendments to the federal *Pension Benefits Standards Act (PBSA)* in Bill C-47, and in particular the new "safe harbour" rules.

Thanks for joining me today Paul.

**Q. Federal Bill C-47 tabled September 30, 2010 includes the first Canadian provisions providing a defined contribution (DC) safe harbour. Can you explain what a safe harbour is and why it is important for DC administrators?**

A. Sure. The term "safe harbour" is an industry term, but not really a technical term. It's a term borrowed from ERISA, the U.S. pension legislation. Generally a safe harbour is a statutory provision that provides protection to plan administrators and their delegates (other fiduciaries) against liability arising from lawsuits by plan members over the performance of investments in their individual DC accounts.

In other words, a safe harbour is essentially a statutory provision that prevents members from successfully suing a plan fiduciary, if the fiduciary does not comply with the prescribed federal rules.

The reason a safe harbour is important for DC pension plan administrators is that it provides them with some certainty. If they follow a prescribed set of rules or practices, they have the comfort of knowing they will not ultimately be liable if the results of the plan's investments don't turn out as planned, or as hoped.

So the safe harbour expressly recognizes that the legal duties applicable to plan fiduciaries are based on the prudent process they follow — more so than the ultimate result of the performance of the plan's investments.

Interestingly, even though it is a concept borrowed largely from the U.S. experience and the idea is to exempt plan administrators from liability, it hasn't necessarily operated that way in the U.S. There is actually more litigation in the U.S. based on DC plans and their investments than there has been in Canada to date. Yet they have the safe harbour and we do not.

**Q. Can you give me a few more details about the safe harbour provisions proposed in Bill C-47?**

A. As you pointed out, Bill C-47 right now is draft legislation only and when the draft was released, the government announced that there may still be more details to come in the final regulations to the legislation – so we may not have seen the final version yet.

In any event, I think Bill C-47 is important because it is the first time to my knowledge that a Canadian jurisdiction has tried to implement a form of statutory protection from liability in a member-directed DC pension plan.

Basically, what Bill C-47 does is that it expressly permits the pension plan to allow a member, a former member and their spouses and beneficiaries to make investment choices with respect to their individual accounts in a DC plan or the DC provisions of a plan. And this is express recognition in the legislation that a DC plan with member investment choice is a valid plan design feature.

That removes a potential argument by members that somehow the DC plan design was an imprudent delegation of investment management authority from the administrator to the members. Therefore the first thing it really does is take that argument off the table and recognizes the member-directed DC plan as a valid and prudent plan design.

The next thing Bill C-47 does is provide that once the plan does permit the member to direct investments, the administrator then must offer investment options of varying degrees of risk and expected return that would allow a reasonable and prudent person to create a portfolio of investments that is well adapted to their retirement needs. That wording is quite interesting to lawyers because it has not been seen in Canada before and has not really been tested in the courts or otherwise.

All I can say right now is that there seems to be two parts to the test:

- The administrator must offer investment options of varying degrees of risk and expected return, and
- The product that is offered has to allow a reasonable and prudent person to create a portfolio of investments that is well adapted to their retirement needs.

The wording of the second part seems to suggest there is a subjective component to this test. What are members individual retirement needs and how are administrators supposed to figure that out? So there are lots of questions to be answered about this wording.

If you do meet that test, then basically the draft legislation says that the plan administrator is deemed to have complied with the prudent portfolio rules in section 8(4.1) of the federal PBSA. As a result, it is a limited form of safe harbour because it doesn't apply, for example, to the standard of care in section 8(4) of the PBSA. Also:

- It doesn't necessarily exempt administrators from actions by plan members for breach of common law fiduciary duties.
- It doesn't cover things like liability for actions based on employee communications (or lack of communications) by plan members against the administrator.
- And notably, it applies only to the administrator right now, not to any agents or delegates of the administrator who also have duties.

**Q. Now that's really interesting. You commented that ERISA not in fact been a solution, but has perhaps been the cause of a lot of litigation. I also recall it has hundreds of pages of regulations, so can we really compare the provisions in Bill C-47 to those in ERISA?**

A. Other than the loose terminology that they all have been described as a form of safe harbour, not really. To be fair, this is just the statutory provision — we haven't seen the regulations yet. It may be the regulations will pick up in full or in part, some of the requirements in the CAP Guidelines that exist in Canada.

But so far the rules here are much less prescriptive. I'd also note that there is really nothing in here that provides relief around the default investment option. In the U.S., ERISA and other statutes were amended as a result of the *Pension Protection Act* a couple of years ago to provide plan administrators with a form of safe harbour if they use a target date fund (or other approved forms of default funds) as the default investment option in their plan.

Clearly Bill C-47 doesn't address the plan's default option. It doesn't provide any form of express relief for using target date or lifecycle funds.

**Q.I see that in a April 30, 2010 brief to the federal Department of Finance, the Association of Canadian Pension Management (ACPM) advocates for a safe harbour. So presumably the ACPM also supports similar amendments to provincial pension standards statutes.**

**Why do you think none of the provinces have gone this route and incorporated a safe harbour into their pension reform initiatives?**

A. That's a good question. Although I can't speak for people at the ACPM as a whole, I believe the ACPM advocates for safe harbour provisions generally. And again, I think the rationale of the ACPM as a whole on the part of their members, is to promote certainty. People want certainty.

One could argue right now that under the common law if you follow prudent practices and the CAP Guidelines vis à vis the investment options you offer, how you select and manage their performance and you communicate with employees, you should have no liability for those actions. But the ACPM and other interested persons really want the certainty of a statutory safe harbour.

Why the legislators or regulators have not stepped up to the plate by now to do that, I can only speculate. One possibility is that it is just not in our nature as Canadians. I mentioned earlier that the Americans are more litigious, even with safe harbours. Perhaps because we haven't had a whole bunch of lawsuits over DC plan investments, the legislators just don't see the need for it in this case.

I've also heard some of the regulators suggest that they would be reluctant to implement a safe harbour for DC investments just as a matter of risk. It is too risky for them to step in and give some kind of blanket exemption from liability. And I think lastly, it is probably that there is just not enough widespread agreement about what options or processes would constitute prudent investment practices leading to an exemption from liability. Again, I'm just speculating.

**Q. In your Osler Pension Blog dated October 8, 2010 you suggest that one way to flesh out regulations regarding the safe harbour and other areas might be to adopt certain aspects of the Canadian Association of Pension Manager's (CAPSA) Capital Accumulation Plan (CAP) Guidelines.**

**Does this make sense? My perception is that many stakeholders don't want to see the CAP Guidelines codified because then they may be too rigid, and you would have to get all the provinces on board at the same time – which has never happened in the past and in my view will never happen again.**

A. Well, you raise some good points there Sheryl. I think first of all there are varying opinions on whether it would be a good thing to adopt CAP Guidelines into regulations. My view is it couldn't hurt, because what I think we have is a set of guidelines that regulators expect all parties to comply with. And then you have a duty at common law to do what is prudent and reasonable.

It is likely in my view that those guidelines will become best evidence of what is prudent and reasonable in the circumstances. So in a nutshell, what I'm saying is I think those guidelines are going to have a way of creeping into the law anyway, so enshrining them in regulation would add clarity.

But I understand why some may not agree with that because the CAP Guidelines are supposed to be best practices and encourage people in the industry to strive towards those best practices. The minute you enshrine them in legislation, they become in effect minimum standards that you have to comply with and that's what many are trying to avoid.

And I take your point that it will likely be difficult to achieve consensus among jurisdictions in Canada. That's a problem we always face in Canadian pension legislation. All I can say is if it starts with one, hopefully the others over time will follow suit. Furthermore, the Joint Alberta/BC expert panel also recommended that there be a limited form of statutory safe harbour in relation to DC pension plans. So you might well see draft legislation in those jurisdictions also tackling this issue.

**Thanks for chatting with me today Paul. It will be interesting to see how this all plays out.**

**My pleasure, Sheryl.**

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