FTR Now

Financial Services Tribunal Interprets the Accrued Benefit Protections of the *Pensions Benefits Act* (Ontario)

Date: August 20, 2013

On August 15, 2013, the Ontario Financial Services Tribunal ("FST") issued its decision in Royal Ontario Museum Curatorial Association v. Ontario (Superintendent Financial Services), concerning an amendment made to The Royal Ontario Museum Pension Plan ("Plan"). The Plan is a defined benefit ("DB") pension plan. At issue before the FST was whether an amendment to the Plan's definition of "final average earnings" resulted in a reduction of the amount or the commuted value of a pension benefit accrued before the effective date of the amendment, in contravention of the *Pension Benefits Act* (Ontario) ("PBA") and the Plan terms.

The FST's decision provides helpful guidance respecting the nature of changes that may be validly made to the earnings component of a DB plan benefit formula and the limitations under the PBA on making changes to accrued benefits. This *FTR Now* reviews the FST's decision and its implications for employers and plan administrators.

BACKGROUND

The Royal Ontario Museum ("ROM") maintains the Plan on behalf of both salaried and hourly employees. There are three different bargaining agents that represent hourly employees: the Service Employees International Union ("SEIU"); the Royal Ontario Museum Curatorial Association ("Association"); and, the Ontario Public Service Employees Union ("OPSEU").

The Plan had provided for benefits to be calculated based on the best 36 consecutive months of earnings prior to retirement. However, ROM unilaterally amended the Plan's benefits formula effective January 1, 2010, such that the earnings component of the benefit formula would instead be based on the greater of:

- the best 36 consecutive months of earnings for employment prior to January 1, 2010; and
- the best 60 consecutive months of employment prior to retirement (the "Amendment").

Notice of the Amendment was provided to all active members of the Plan and to the three bargaining agents in November 2009. The Association challenged the Amendment as void under s. 14(1)(a) of the PBA in December 2009. The Amendment was registered by the Financial Services Commission of Ontario ("FSCO") on January 13, 2010.

The Association subsequently pursued its challenge to the Amendment, alleging that it reduces the amount of pension benefits accrued with respect to employment before the effective date, contrary to s. 14(1)(a) of the PBA. [1] The Association did not challenge the prospective nature of the change to the earnings formula, respecting employment on and after January 1, 2010.

The Association sought an order of the Superintendent of Financial Services ("Superintendent") that the Amendment was void and could not be applied in respect of service prior to January 1, 2010. On August 8, 2012, the Superintendent issued a Notice of Intended Decision ("NOID") to refuse the Association's request to make such an order. Paragraph 12 of the NOID stated:

The Amendment preserves the highest average salary accrued under the terms of the Plan prior to the effective date of the Amendment. The change in the way pension benefits are calculated applies only to earnings after the effective date of the Amendment. Future earnings are contingent events that do not form part of the amount of the commuted value of a pension

benefit that has accrued as at the effective date of an amendment.

The Association then filed a Request for a Hearing before the FST. OPSEU and SEIU supported the Association's position, and each participated as a party at the Tribunal hearing. The ROM supported the position of the Superintendent and also had party status.

The two issues before the FST were: (1) whether the Amendment contravened the PBA; and/or (2) whether the Amendment contravened the terms of the Plan protecting accrued benefits.

NO CONTRAVENTION OF THE PBA

The Association alleged that the change to the calculation of "final average earnings" for service prior to January 1, 2010, from one based on a member's earnings over the entire period of employment, to a calculation based on a member's earnings prior to January 1, 2010, violates s. 14(1)(a) of the PBA. Section 14(1)(a) states:

An amendment to a pension plan is void if the amendment purports to reduce,
(a) the **amount** or the commuted value of a **pension benefit accrued** under the pension plan with respect to employment before the effective date of the amendment; […]

[emphasis added]

Section 1 of the PBA defines "pension benefits" as:

… the aggregate monthly, annual or other periodic amounts payable to a member or former member during the lifetime of the member or former member, to which the member or former member will become entitled under the pension plan or to which any other person is entitled upon the death of a member or former member.

The PBA does not provide a definition for the terms "accrued" or "pension benefit accrued", the meanings of which were key to the dispute.

The Association argued that for a DB plan under which the retirement pension is based on a member's earnings prior to termination or retirement, the pension benefits that have accrued to a member include the potential for future earnings to be higher. The argument was that the "accrued pension benefits" should be calculated based on service as of the date of the amendment and the *formula for calculating earnings* as of the date of the Amendment. Thus, the position of the Association was that the Amendment constituted a reduction of "accrued pension benefits" and was in violation of s. 14(1)(a) of the PBA.

In support of this position, the Association argued that members do not earn an amount of pension; rather, they accrue a set of rights, including the right to have benefits calculated on the basis of service and the *formula for calculating earnings* in effect at the time they accrue that service. Further, the Association argued that the use of earnings as of December 31, 2009 is artificial and deprives them of a significant part of the value of the pension they were promised under the terms of the Plan.

The FST disagreed, concluding that s. 14(1)(a) of the PBA only prohibits the reduction of the "amount" of a pension benefit accrued based on employment before the effective date of an amendment. To assist with its interpretation, the FST referred to its earlier decision in *McGrath v. Superintendent of Financial Services* ("*McGrath*"). *McGrath* involved an amendment to the formula for calculating the CPI adjustment for retired members. In *McGrath*, the FST concluded that the "amount" of pension benefits must be calculated as of the effective date of the amendment in order to determine whether an amendment complies with the requirement that the amount of accrued benefits not be reduced.

The FST also considered actuarial evidence and Canadian jurisprudence supporting the position that "accrued benefits" are calculated on a point-in-time basis, based on earnings and service current at the time of calculation. The FST accepted that it is possible for a benefit to have accrued even though it may not be susceptible of precise calculation at a particular time, but

that the Association did not establish that members have an accrued entitlement to a pension based on the earnings formula in place prior to the Amendment.

The FST distinguished the language of s. 14 of the PBA from the parallel language of the *Employment Pension Plans Act* (Alberta) ("EPPA"), considered in the 2010 decision of the Alberta Court of Appeal in *Halliburton Group Canada Inc. v. Alberta* ("*Halliburton*"). In *Halliburton*, the Court of Appeal upheld a finding of the Alberta Superintendent of Pensions that an amendment to freeze earnings under a similar DB formula was in violation of the EPPA. The FST rejected the application of *Halliburton* to the PBA, citing differences in the relevant legislative provisions, including that the EPPA protects "a person's benefits in respect of employment" whereas the PBA protects "the amount of pension benefit accrued". The FST then noted the limited application of *Halliburton* based on the specific language of the plan text in question.

Accordingly, the FST concluded that the PBA only protects the *amount* of a pension benefit accrued as of the effective date of an amendment. The *amount* is to be calculated as of the date of the amendment, based on service and earnings up to that date.

NO CONTRAVENTION OF THE TERMS OF THE PLAN

The FST also dismissed the Association's allegation that the Amendment is contrary to the terms of the Plan, and therefore in violation of s. 19(3) of the PBA which requires that a pension plan be administered in accordance with its own terms. Section XIII of the Plan permits amendments to the Plan within certain limitations. Section XIII(1)(b) of the Plan states:

Although the Plan is intended to be permanent and to continue indefinitely, the [ROM] may, at any time, amend the Plan by resolution of the Board. No such amendment shall:
[…]
(b) reduce accrued benefits except upon termination of the Plan …
[..]
Notwithstanding the above, the [ROM] may retroactively amend the Plan to the extent necessary to register it under the appropriate provisions of the *Income Tax Act*.

The FST held that the language in Section XIII(1)(b) of the Plan effectively provided the same level of protection against Plan amendments as the protection provided by s. 14(1)(a) of the PBA, and so dismissed the Association's argument that the Amendment was a violation of the Plan. The FST noted, however, that pension plans may provide more protection than the statutory minimum standard against changes to plan terms, and that other cases will have to be determined on the specific plan amendment language.

IMPLICATIONS

This FST decision confirms FSCO's position that the PBA restrictions on amendments do not preclude amendments to earnings formulae that freeze earnings at the date of the amendment. An "earnings freeze" can be accomplished without running afoul of s. 14(1)(a) of the PBA since benefits based on future (or projected) earnings are not considered to be accrued benefits that are protected by that statutory provision.

The decision also supports the long-standing industry interpretation that the accrued benefit provisions of the PBA do not prohibit changes to earnings definitions (whether to the types of compensation that is included, or to the averaging period adopted). This conclusion should apply equally to ongoing DB plans and to DB plans that are frozen or converted to defined contribution plans.

Finally, the decision confirms that the result reached in the *Halliburton* case will not generally apply to Ontario pension plan members. However, as the decision concerns only the Ontario PBA, the legal effect of similar amendments to multi-jurisdictional plans must be reviewed based on the pension standards legislation in each other applicable jurisdiction.

As with other adverse amendments, an amendment which freezes earnings must satisfy the PBA notice requirements, and care must be taken to ensure that such amendment does not violate the terms of the plan or the terms of applicable collective agreements.

As of the date of writing, it is not known whether the Association will appeal the FST's decision. If you have any questions about this decision and its implications, please contact a member of our Pension, Benefits and Executive Compensation group.

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[1] The SEIU and OPSEU also filed grievances under their respective collective agreements, alleging that the Amendment violated the terms of the agreements. The SEIU grievance was dismissed by Arbitrator Raymond on June 22, 2011, and the OPSEU grievance was dismissed by Arbitrator Saltman on January 18, 2013.

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