Legal Roundup
'Legal Responses To The Federal Government Pension Regulation Proposal'

Exclusive Online Article

Benefits and Pensions Monitor

www.bpmmagazine.com

The proposed changes are aimed at federally regulated private pension plans governed by the *Pension BenefitsStandards Act, 1985* (the Act), with one exception noted.

Increased Minimum Standards

Plan sponsors will be required to fully fund pension benefits on plan termination. Any solvency deficit that exists at the time of termination will be required to be amortized in equal payments over no more than five years.

Contribution holidays will only be permitted if the pension plan is more than fully funded by a five per cent solvency margin. Annual valuations will be required for pension plans in surplus.

Amendments to a plan that has, or would have, a solvency ratio of 0.85 or less will be voided.

Sponsor-declared partial terminations will be eliminated from the Act.

There will be immediate vesting of benefits.

Disclosure requirements will be enhanced. The information that must be provided in annual member statements, and the type of other information statements, will be expanded. Electronic provision of disclosure requirements will be permitted on a positive consent basis.

Funding Changes

The government will introduce a new standard for establishing minimum funding requirements on a solvency basis that will use average – rather than current – solvency ratios to determine minimum funding requirements.

Sponsors will be permitted to use properly structured letters of credit to satisfy solvency payments up to a limit of 15 per cent of plan assets.

The 10 per cent pension surplus threshold in the Income Tax Act for permitted tax sheltering will be increased to 25 per cent. This applies to both federally and provincially regulated Defined Benefit plans.

Insolvencies

A workout scheme for distressed pension plans (including eligibility for a short moratorium on special payments) will be established to help facilitate the resolution of plan-specific problems that arise in some circumstances when a particular plan sponsor cannot meet near-term funding requirements.

Defined Contribution Pension Plans And Negotiated Contribution DB Plans

Provisions of the Act and the Regulations will be revised to provide clarity on the responsibilities and accountabilities of the parties involved with DC plans, including the elimination of the requirement for a Statement of Investment Policy and Procedures for a DC plan that provides investment option to its members.

Pension plans will have the option to permit members to receive Life Income Fund style retirement benefit payments directly from a DC pension fund.

The framework respecting negotiated contribution DB plans, which are common in multi-employer pension plan arrangements, will be improved.

Investment Rules

The present pension fund investment framework, which imposes a prudent person standard supplemented with quantitative investment limits, will be amended as follows:

- Remove the quantitative limits in respect of resource and real property investments
- Amend the 10 per cent concentration limit to limit pension funds to investing a maximum of 10 per cent of the market value of assets of the pension fund (rather than the book value) in any one entity. An exception to this rule will exist for pooled investments over which the employer does not exercise direct control, such as mutual fund investments.
- Prohibit direct self-investment (e.g., an employer would no longer be permitted to invest *any* amount of its pension fund in its own debt or shares)

Other Changes

- The benefits of members who cannot be located will be permitted to be transferred to a central repository.

- The Office of the Superintendent of Financial Institutions will be given additional powers to intervene when there are concerns about the work of a plan's actuary.
- A number of other technical improvements to the Act and the Regulations will be made to align the framework more explicitly with what is seen to be the common interpretation and administration.

Borden Ladner Gervais Pension Alert

On Tuesday October 27, 2009, the federal Finance Minister, Jim Flaherty, unveiled a proposal to reform federally regulated pension plans by implementing “a balanced package of measures for the benefit of pension plan sponsors, plan members and retirees.” While Ottawa’s proposed changes are primarily aimed at federally regulated industries and their private pension plans, two of the changes (the increase to the *Income Tax Act* surplus threshold and the changes to the investment rules) will affect provincially regulated pension plans. The reform proposal outlined five key objectives.

1. Enhanced Protections for Plan Members

- Plan sponsors will be required to fully fund pension benefits on plan termination
- Contribution holidays will be permitted only if the pension plan is more than fully funded by a solvency margin, which will be set at a level of five per cent of solvency liabilities
- Benefit improvements would not be permitted for a plan that has or would have a solvency ratio of 0.85 or less
- Sponsor declared partial terminations will be eliminated from the act
- There will be immediate vesting of benefits
- The requirement for locking-in of vested pensions would remain at two years of plan membership
- Disclosure requirements will be enhanced by expanding the information that must be provided in annual member reports and by expanding the types of statements
- Electronic provision of disclosure will also be permitted on a positive consent basis

2. Reducing Funding Volatility for Defined Benefit Plan Sponsors

- Solvency funding will be based on the average of the solvency ratio over three years
- Annual valuations will be required
- Letters of credit will be allowed to satisfy solvency payments up to a limit of 15 per cent of plan assets
- The surplus threshold in the *Income Tax Act* will be increased to 25 per cent, after which the employer contributions must generally be suspended (this change will apply to provincially regulated plans as well)

3. Resolution of Plan-Specific Problems

- A workout scheme for distressed pension plans will be established to help facilitate the resolution of plan-specific problems that arise
- Member and retiree consent would be required when negotiating changes to pension arrangements
- Negotiated workout arrangements would also be subject to ministerial approval

4. Framework for Defined Contribution and Negotiated Contribution Defined Benefit Plans

- The act and the regulations will be revised to clarify the responsibilities and accountabilities of parties involved with Defined Contribution plans
- DC pension plans will have the option to permit members to receive Life Income Fund (LIF) style retirement benefit payments directly from the pension fund
- Employer contributions to negotiated contribution DB plans would be limited to the level negotiated in collectively bargained agreements, and boards of trustees will be able to reduce accrued benefits despite any plan terms to the contrary

5. Modernization of Pension Fund Investment Rules

- Removal of the quantitative limits in respect of resource and real property investments
- The 10 per cent concentration limit will be based on market value, with an exception for pooled investments over which the employer does not exercise direct control
- Prohibition of direct self investment

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hese changes will apply to provincially regulated plans that have adopted the federal investment rules in force from time to time.

In addition to the above mentioned reforms, other changes, such as directing benefits of unlocated members of a terminated plan to a central repository, will also be implemented to further improve the pension plan framework.

In response to Ottawa’s proposals, Ontario’s Finance Minister, Dwight Duncan, announced that Ontario would be introducing new provincial measures in November.

These new provincial reforms are aimed at enhancing protection for pension plans by creating a more harmonized system of pension regulation across the country.

Goodmans Update

October 27, the Honourable Jim Flaherty announced changes to federal pension laws. The majority of the proposed changes will only affect registered pension plans that cover employees who fall within the federal government's jurisdiction (including employees of airlines, railways, radio broadcasters, banks, ferries and shiplines).

However, there is a proposed increase to the pension surplus threshold under federal tax legislation that would impact all pension plans, including those registered in Ontario. In addition, there is a proposed change to the federal investment rules which could prompt provincial changes, as Ontario's pension investment rules (as well as the pension rules in several other provinces) currently refer to the existing federal investment rules.

Proposed Change to Tax Surplus Limit

Canadian tax laws restrict the amount of surplus that a Defined Benefit pension plan is allowed to hold. Once a pension plan reaches the maximum level of surplus allowed under the tax laws, employer contributions to the plan must generally be suspended until the plan's funded level drops to an acceptable level.

The announcement proposed that the current surplus threshold of 10 per cent be increased to 25 per cent and that this increase apply in respect of employer contributions relating to current service costs for 2010 and subsequent years. This change would allow pension plans to potentially build more of a funding buffer in the pension fund during good times, with the aim of minimizing the adverse effects experienced by pension plans during economic downturns.

Proposed Changes to Pension Investment Rules

The announcement indicated that the pension investment framework would be modernized and certain changes would be made. The quantitative limits restricting pension plan investments in respect of resource and real property investments would be removed, but pension plans would be prohibited from making any investments in the sponsoring employer's own debt or shares. In addition, the current restriction prohibiting a plan from investing more than 10 per cent of its assets in any one entity would be amended to be based on a market value test of the assets of the plan (as opposed to the book value).

Notably, the proposed changes do not include the removal of the so-called "30 per cent rule", which restricts pension plans from investing plan monies "in the securities of a corporation to which are attached more than 30 per cent of the votes that may be cast to elect the directors of the corporation". This rule has been criticized for being antiquated and not in touch with current business realities.

The current Ontario regulations incorporate the existing federal regulations. Accordingly, if these proposed changes are implemented federally, and if Ontario wishes them to apply to pension plans registered in the province, Ontario would also be required to amend its regulations.

Other Proposed Changes That would Affect Federally Registered Plans Only

The announcement indicated significant proposed changes that would affect only federally registered pension plans, which include:

- Requiring pension benefits to be fully funded in the event that a pension plan is terminated.
- Eliminating sponsor declared partial terminations.
- Allowing employers to take contribution holidays only where a pension plan is more than fully funded by a solvency margin of five per cent of solvency liabilities. Plans in surplus would also be required to file valuations on an annual basis to ensure that any contribution holidays taken are based on a recent determination of the plan's funded status.
- Restricting employers from amending a pension plan to provide benefit enhancements where the pension plan is significantly under funded or would be following the amendment.
- Enhancing certain member disclosure requirements in respect of the pension plan.
- Changing the vesting period from two years to immediate vesting of pension benefits for plan participants.
- Adding rules that will apply specifically to Defined Contribution pension plans. These rules will provide guidance on the responsibilities of the various stakeholders and will take into account the Guidelines for Capital Accumulation Plans released by the Canadian Association of Pension Supervisory Authorities. They will also eliminate the requirement for such plans to have a Statement of Investment Policies and Procedures.
- Adding rules that may help facilitate dealing with plan specific near-term funding issues.
- These rules would allow plan specific funding arrangements to be negotiated in respect of distressed pension plans.

Draft legislation in respect of these proposed changes has not been provided at this time and no guidance has been given as to when such draft legislation may be available.

Heenan Blaikie Pension Pulse

In a Backgrounder document, the federal government announced several proposed changes to the federal *Pension Benefits Standards Act,* 1985 (PBSA). These proposals would apply only to employers governed by federal legislation, such as employers in the banking, airline, railway, interprovincial transportation and telecommunications industries. This represents about seven per cent of pension plans in Canada, including about 400 Defined Benefit pension plans.

The government also released a proposal to amend the *Income Tax Act* relating to pension surplus, which would apply to all registered pension plans both in the federal and provincial sectors – please refer to our *Pension Pulse* dated October 27, 2009.

The most significant proposed changes to the PBSA are as follows:

- Three-year average solvency ratios will be permitted for purposes of determining minimum solvency funding requirements. Prior deficiencies may also be consolidated, providing a fresh start each year. These proposals are salutary. However, the onerous five-year funding requirement will be retained.
- The use of letters of credit will be permitted to satisfy solvency payments up to 15 per cent of a pension plan's assets.
- A 'workout scheme' for distressed pension plans is proposed. Plan sponsors who declare their inability to make required pension payments, may negotiate funding arrangements that would otherwise not comply with the PBSA funding regulations. In these circumstances, the regulator would permit short-term relief from special payments, thereby enabling further negotiations with plan members.
- Pension plan contributions will be required to be remitted monthly, rather than quarterly. This would bring the PBSA in line with most provincial pension legislation, but could cause significant cash flow concerns in the short-term.
- Pension plans will be required to be fully funded on plan termination, with any remaining solvency deficiencies to be funded over no more than five years. This brings the PBSA in line with most provincial pension legislation.
- Pension plans will have to be at least 105 per cent solvent in order for the plan sponsor to take a contribution holiday. There will also be a requirement for annual valuations to support the taking of contribution holidays.
- Amendments to pension plans that will reduce a pension plan's solvency to 85 per cent or less will not be permitted. Such amendments will be void under the legislation.
- Partial plan terminations, declared by a plan sponsor will be removed from the legislation. The federal court of appeal decided in Marine Atlantic that pension surplus does not have to be distributed to plan members in the event of a partial plan termination – please refer to our 'Labour & Employment' in the news dated July 9, 2008. The proposed change will simplify the legislation and its administration.
- Pension plan benefits will be immediately vested. The current standard under the PBSA and under most provincial pension legislation is vesting after two years of either pension plan participation or continuous service. Quebec is the only other jurisdiction that has mandated immediate vesting.
- Disclosure to plan members will be more rigorous, particularly with regard to reporting on the financial status of an employer's pension plan. There will also be a requirement for annual statements for retirees and for terminated members with deferred entitlements. Electronic disclosures will be permitted, with consent of pension plan members.
- Detailed guidance will be issued for sponsors, members, administrators, and investment managers of Defined Contribution pension plans. This follows the Capital Accumulation Plan guidelines issued by the joint forum of financial market regulators in 2004.
- Statements of investment policy and procedures will not be required for Defined Contribution pension plans.
- DC plans will be enabled to provide life income fund retirement benefits.
- The rules respecting 'negotiated contribution' Multi-employer pension plans will be specified, to clarify that an employer's contributions will be limited to whatever is negotiated, to establish criteria for the composition of boards of trustees, to specify that boards of trustees have authority to amend such plans to reduce accrued benefits subject to regulatory approval, and to enhance plan member disclosure.
- With regard to pension investment rules, the quantitative limits in respect of resource and real property investments will be removed, the 10 per cent concentration limit will be changed from a book value test to a market value test, and there will be a prohibition against direct investment in the shares or debt of the plan sponsor.
- The benefits of members upon plan termination, who cannot be located, may be transferred to a central repository. This will significantly ease the administrative burden on plan termination.
- Additional authority will be granted to the regulator when there are apparent concerns with an actuary retained by a plan sponsor.
- Other technical amendments are also proposed, including a duty on the part of the custodian of a plan's assets to notify the regulator if a plan sponsor is delinquent in remitting its contributions.

These proposed changes represent a move in the right direction on the part of the federal government. The proposals, of course, would affect only a small percentage of pension plans and pension plan members in Canada. Many of the changes also, are quite technical in nature, rather than the sort of large-scale changes needed to restore confidence in the pension regulatory system and, in particular, to encourage participation in DB pension plans in the private sector.

Hicks Morley FTR Now

By: Natasha D. Monkman and Terra L. Klinck

On October 27, 2009, the Honourable Jim Flaherty, Minister of Finance, announced proposed changes to the federal *Pension Benefits Standards Act, 1985* (PBSA) and the associated Regulations. The PBSA and Regulations apply to pensions provided to employees employed in shipping, railway, air transportation, radio broadcasting, banks and other businesses within the legislative authority of the Parliament of Canada. While the majority of the proposed changes only apply to federally regulated registered pension plans, some changes will have a broader application.

The proposed changes are broadly based on five principal objectives:

- Enhance protections for plan members
- Reduce funding volatility for Defined Benefit plans
- Resolution of plan-specific problems
- Improve the framework for Defined Contribution and negotiated contribution DB plans
- Modernize the pension fund investment rules

Amendments Applying To All Canadian Registered Pension Plans

As part of the package of proposed pension reform measures, the Federal Government is proposing to modernize the federal investment rules and to increase the amount of surplus that can be held in pension plans. Both of these changes will be of interest to all employers who maintain a registered pension plan.

Since all but two provinces (New Brunswick and Quebec) have adopted the federal investment rules, the changes to these rules will apply to many provincially registered pension plans. Proposed changes to the quantitative investment limits, which supplement the overarching prudent pension investment standard, include:

- Removal of the current quantitative limits in respect of resource and real property investments
- A change to the limit on investing the assets of a pension plan in a single entity from 10 per cent of the book value of the plan's assets to 10 per cent of the market value of the plan's assets. An exception to this rule will apply for pooled investments over which the employer does not exercise direct control (i.e., mutual fund or pooled investments)
- A prohibition on any direct self-investment, meaning that employers will no longer be permitted to invest any pension plan assets in their own debt or shares.

The changes to the federal investment rules will automatically apply to pensions registered in British Columbia, Alberta, Manitoba and Saskatchewan because each of these provinces has adopted the federal investment rules as changed from time to time. Investment regulations will need to be amended in Ontario, Nova Scotia and Newfoundland before the changes are effective in those provinces.

Another proposed change applicable to all pension plans will increase the amount of surplus a pension may accumulate. Currently, the *Income Tax Act* requires employers to suspend contributions to a pension plan where the surplus held in the pension fund exceeds 110 per cent of the plan's liabilities. The Government proposes to increase the surplus limit to 125 per cent starting in 2010. The purpose of this is to allow employers to maintain a cushion of surplus, reducing the likelihood of funding deficiencies solely as a result of market downturns. It is, however, unlikely that plan sponsors will take advantage of this increased contribution room unless the legislative regime governing surplus entitlement is also overhauled.

Amendments Applying To Federally Regulated Pensions Plans
Enhanced Protections For Plan Members

One of the most significant proposed changes to the PBSA will require plan sponsors to fully fund pension benefits on a plan termination. A solvency deficiency existing at the time of termination will be required to be amortized in equal payments over no more than five years and will be considered an unsecured debt of the company until satisfied. This measure is intended to improve benefit security for members by eliminating the possibility, which exists under the current rules, that a pension plan could be voluntarily terminated at a time when plan assets are not sufficient to pay the full amount of promised benefits. The proposed change will bring the PBSA rules regarding termination funding in line with the rules applicable in all other provincial jurisdictions, except Saskatchewan.

The PBSA will also be amended to provide immediate vesting of a member's entitlement in a pension plan. Currently, the PBSA requires full vesting after two years of plan membership. Existing eligibility and locking-in rules will not be changed.

Another significant proposal will require enhanced member disclosure, including annual information regarding the funded status of a DB pension plan and the investment of a plan's assets. In addition, an obligation to provide annual statements to former members and retirees has been introduced. Finally, the PBSA will be amended to expressly permit the use of electronic communications, where a member provides positive consent.

In addition to these significant benefit security changes, the Government has also advised that the PBSA and the Regulations will be amended as follows:

- Employer contribution holidays will be limited to situations in which a plan is fully funded with a "solvency margin" of five per cent
- Plan amendments which introduce benefit improvements will be void in cases where the amendment will cause the solvency ratio of the plan to drop below 85 per cent (or the solvency ratio is already below 85 per cent), unless the employer immediately funds the cost of the benefit improvement
- Employer declared partial terminations will be eliminated

Reduce Funding Volatility For DB Sponsors

Another very significant proposed change is the introduction of a new standard for calculating solvency deficiencies. The going-concern funding standard will remain unchanged.

Under the proposed new standard for calculating minimum solvency funding requirements, special payments will be based on the solvency ratio of the plan over a three year period. The year in which the current valuation is performed and the previous two years will be used to determine the average solvency ratio, using the market value of the plan's assets in each valuation. The proposal also provides that past solvency deficiencies will be consolidated each time a new valuation is prepared. In order to implement the new solvency funding standard, the PBSA will be amended to require annual actuarial valuations.

The proposed solvency deficiency calculations are unique – no other Canadian jurisdiction has adopted similar rules.

The Government is also proposing to permit the use of letters of credit on a permanent basis to satisfy solvency payments, up to a limit of 15 per cent of a plan's assets.

Resolution Of Plan-specific Problems

One of the unique changes proposed by the Government will amend the PBSA to create a "workout scheme" for distressed pension plans, to resolve plan-specific problems that arise when a plan sponsor cannot meet funding requirements. A workout scheme will permit sponsors, plan members (and unions) and retirees of a distressed plan to negotiate funding arrangements that do not strictly comply with the funding regulations in order to facilitate a restructuring of the pension plan.

Under the workout scheme, the employer will be eligible for a short moratorium on special payments. During the moratorium period, the parties (i.e., the employer, members, retirees and applicable unions) will be at liberty to negotiate changes to their pension arrangements, including the schedule of special payments. Member and retiree consent will be required in order to move ahead with the changes to the pension arrangements and the negotiated workout scheme will also be subject to Ministerial approval.

Framework For DC And Negotiated Contribution DB Plans

The Government is also proposing to amend the PBSA and the Regulations to provide much needed clarification with respect to the framework for DC and negotiated contribution defined benefit plans ("NCDB") (which are generally multi-employer pension plans where the level of contributions are collectively bargained). The PBSA will be amended to provide measures specific to both types of plans, reflective of their differences from single employer DB plans.

In particular, the Government has proposed the following changes regarding DC plans:

- Explicit guidance will be provided on the responsibilities and accountabilities applicable to employers, administrators, members and service providers (the CAP Guidelines will be considered the best practices benchmark)
- SIP&Ps will no longer be required for CAP-style DC plans
- DC plans will have the option to permit members to receive variable benefits directly from a DC plan

The Government is proposing to include specific rules in the PBSA and Regulations for NCDB plans. Most significantly, employer contributions will be limited to the level negotiated in the collective agreement, and accrued benefits provided under NCDB plans may be reduced if the plan is underfunded. These proposed changes along with a number of other technical changes will bring the PBSA in line with the rules applicable to NCDBs in other jurisdictions.

Other Proposed Measures

The Government has also proposed a litany of other significant amendments to the PBSA and Regulations. Of particular note:

The proposed changes will provide the Minister with the authority to sign on to the proposed Agreement Respecting Multi-Jurisdictional Pension Plans created by the Canadian Association of Pension Supervisory Authorities;

Benefits of members who cannot be located following a plan termination will be permitted to be transferred to a yet to be named central repository;

The schedule applicable to employer contributions will be changed to monthly payments (instead of quarterly).

The Government has not yet tabled the legislation or published draft regulations that will be required to give effect to the proposed changes and has not yet given a timeframe in which it expects to have these changes in force.

Osler Pension & Benefits Law

By: Michel Benoit

Finance Canada Minister Jim Flaherty released a series of proposals designed to improve the legislative and regulatory framework for federally regulated pension plans. No indication was given as to the timing of the amendments to the *Pension Benefits Standards Act, 1985* (PBSA) and the *Pension Benefits Standards Regulations, 1985* (PBSA Regulations) that will be required to implement the proposals. The proposals contain a host of measures which appear to be designed to provide "something for everyone". The press release does not mention any willingness on the part of the government to seek further input from stakeholders.

Five objectives are being pursued by the proposals.

- **Enhanced Protection for Plan Members**

Plan sponsors will be required to fully fund pension benefits on plan termination over a five-year period. It should be noted that the wind-up funding obligation will be considered an unsecured debt of the company, thus ranking on the same footing as any other unsecured creditor in the event of a bankruptcy. This change brings the PBSA into line with the requirements in most other Canadian pension jurisdictions.

Contribution holidays by plan sponsors will not be permitted unless the plan has a solvency surplus of five per cent or more.

Benefit improvements which would reduce the solvency ratio of the plan to less than 85 per cent will not be permitted and plan sponsors will be required to file annual actuarial valuations.

Employer declared partial terminations will be eliminated thus ensuring that employment terminations, whether voluntary or not, will be treated the same way.

Vesting of benefits will be immediate on commencement of plan participation. However, the two-year waiting period currently allowed before participation begins will be maintained.

Enhanced disclosure of information will be required to provide plan members with greater understanding of the plan's financial situation.

- **Reduced Funding Volatility**

A new solvency standard will be introduced which will allow plan sponsors to measure their solvency funding requirements using the plan average solvency ratios over the last three years based on the market value of assets. Past deficiencies will be consolidated each year and the solvency deficit amortization period will remain at five years.

Letters of credit will be permitted in lieu of actual solvency payments up to a maximum of 15 per cent of the plan's assets.

The 10 per cent surplus threshold under the Income Tax Act will be raised to 25 per cent beginning with 2010 current service contributions thus allowing a greater amount of employer contributions to be made. It should be noted that the increased threshold should apply to all registered pension plans, whether federally or provincially regulated.

- **Resolution of Plan-Specific Problems**

A framework will be available to sponsors and members of plans where the sponsor is unable to meet the statutory funding requirements. The framework will permit all stakeholders to agree to a "workout scheme" that would allow the company to benefit from a short moratorium on deficit payments and the members to agree to change the pension arrangements. Any such workout would be subject to member and retiree consent and Ministerial approval. It would appear that the recent arrangement arrived at between Air Canada and its unions and retirees is the source of this proposal.

- **Enhanced Framework for Defined Contribution and Negotiated Contribution Defined Benefit Plans**

The PBSA and PBSA Regulations, which currently do not adequately address DC plans, will be amended to clarify the duties and responsibilities of sponsors, members, administrators and investment providers. DC plans will also be allowed to pay Life Income Fund-like retirement benefits, thus allowing plan members to benefit from the investments of the pension plan instead of personally assuming the risk of investments.

Negotiated Contribution Defined Benefit Plans will be subject to an improved framework, which will include greater clarity about employer contribution obligations, and explicit trustee authority to reduce accrued benefits subject to Superintendent authorization.

- **Modernization of Investment Rules**

Much needed changes to the current investment rules are proposed including removing quantitative limits on resource and real property investments, determining the 10 per cent concentration limit by measuring the plan's assets according to market value instead of book value, and prohibiting investments in employer shares or debt.

- **Other Measures**

A number of technical housecleaning measures are also proposed to better align the PBSA and PBSA Regulations with current interpretation and policy.