FTR Now

Towards Meaningful Solvency Funding Relief

Date: January 23, 2009

Last month, the Ontario Government announced that it will be implementing regulations to the *Pension Benefits Act* aimed at providing solvency funding relief to pension plan sponsors in Ontario.

As set out in Hicks Morley's FTR Now: *Ontario Government Announces Pension Funding Relief*, the exact details of what form the regulatory relief will take are not yet known.

In this FTR Now, we highlight a number of the temporary solvency funding relief initiatives that have been previously introduced, or are under consideration, not just in Ontario, but across Canada. It is hoped that the Ontario Government will introduce legislation that will become a model for others to follow and give Ontario employers access to truly meaningful solvency funding relief in the very near term.

CHANGE IS AFOOT

Many jurisdictions are moving to implement some form of solvency funding relief. We have reviewed the solvency funding regulations that are currently in place in provinces throughout Canada, as well as the new proposals that various jurisdictions, including the Federal Government, have announced in response to the current economic downturn. It is clear from this review that neither the Provinces nor the Federal Government see the prescription for solvency funding relief as a "one size fits all" proposition. Instead, plan sponsors in other jurisdictions have been presented with a number of options from which they can select the relief that best suits their situation.

THE GOVERNMENT'S DECEMBER 2008 ANNOUNCEMENT

The Government's announcement on December 16, 2008 was a welcome first step toward strengthening and protecting the short-term viability of the Ontario pension system. Several aspects of the Government's announcement would be welcomed by many plan sponsors, administrators and members of Ontario pension plans.

For example, the Government's proposals to consolidate previous funding schedules for all plans, similar to the Federal Government's solvency funding regulation released in 2006, will assist many plan sponsors and provide a fresh start for funding purposes. Further, the proposal to defer catchup payments for one year will provide immediate cash flow relief to plan sponsors required to file an actuarial valuation this year. The Government's proposal to permit greater flexibility in the use of actuarial gains to reduce annual cash payments is also a positive component of the package.

As well, the Government is considering adopting the revised Canadian Institute of Actuaries' Standard of Practice for Determining Pension Commuted Values for solvency valuations. Another option that has been suggested should be under consideration is a delay in any replacement of the UP-94 mortality table with a generational mortality table that might otherwise mitigate any relief the newly revised standard may provide to pension plans. The mortality table is currently scheduled to be replaced in 2011.

The central proposal contained in the Government's announcement is the provision of funding relief through the extension of the amortization periods for funding solvency deficiencies from five to ten years. The ability to access this relief will be subject to a number of conditions. Most notably, plans seeking to access funding relief will be required to obtain the consent of not just active members, but also former members and retirees. Further, the announcement called for temporary limitations on contribution holidays and accelerated funding for benefit improvements implemented during the relief period.

The relief provided to Ontario plan sponsors will certainly need to balance the urgent need for temporary solvency funding relief with the equally important need to protect the ongoing benefit security of plan members. However, the consent conditions proposed by the Government may, in practice, severely limit access to this relief for the vast majority of Ontario employers. In response to the Government's announcement on the proposed solvency funding relief, many plan sponsors have been urging the Government to consider temporary legislative relief that is meaningful and accessible and will allow employers to continue to deliver defined benefit pension benefits to plan beneficiaries not only in the short term but also over the long term.

SOLVENCY FUNDING RELIEF – SOME OPTIONS

While several provinces, such as Alberta and Saskatchewan, have proposed solvency funding moratoriums (and others have implemented moratoriums for specific types of pension plans, usually those sponsored by municipalities or universities), another form of relief that has been adopted by at least one province and proposed by a number of plan sponsors and advisors is the establishment of a temporary target solvency funding ration equal to 80% (instead of the current 100%).

As well, sponsors and advisors have proposed a number of options that build upon the Government's December 16, 2008 announcement and incorporate the concepts set out therein by expanding the range of relief to incorporate consent based and non consent based alternatives, including the following:

A. An extension of amortization periods from five to ten years, with the appropriate level of member and former member consents;
B. Where a plan sponsor can demonstrate financial strength, an extension of amortization periods from five to ten years, with notice to plan members and former members; or
C. The funding of solvency deficiencies with a letter of credit, with notice to plan members and former members.

A TIERED APPROACH – SETTING THE TARGET SOLVENCY FUNDING RATIO AT 80%

As an overall solution – the concept of phased or tiered funding has been adopted as part of systems found in the United States and the United Kingdom, as well as in one other Canadian jurisdiction to date. A tiered funding approach would see the target solvency ratio being set at 80% or some other percentage for a temporary period of time. This approach was adopted in Nova Scotia for municipal pension plans in that Province where special payments on account of a solvency deficiency are required where the solvency ratio falls below 85%. Plans that are required to make solvency special payments would still be required to amortize these payments over five years.

It has been suggested that the tiered funding relief focuses on and neutralizes the effects of the recent market downturn. A temporarily adjusted funding target would lower the threshold for special payments on account of a solvency deficiency to a level such as 80%.

Under this model, all pension plans would continue to be funded on a solvency basis over five years. From a benefit security perspective, the amortization schedule is not being doubled. Rather, solvency funding or special payments would not be required if a pension plan is funded at 80% or higher, whereas a plan that is below the 80% threshold would be required to pay special payments until the plan is funded back up to 80%.

If this kind of relief were to be offered, it is likely that the Government would impose a number of conditions. These may include requiring the plan sponsor to pay the full actuarial cost of any plan improvement to the pension plan prior to the effective date of the amendment, if the amendment adversely affects the solvency ratio of the pension plan. This relief could be applicable to all Ontario plan sponsors for actuarial valuations filed within a specified period of time or it could be designed similar to the other options discussed above, under which a plan sponsor could elect to take advantage of the relief.

A) 10 YEAR AMORTIZATION PERIOD WITH MEMBER CONSENT

If the Government were to proceed with regulations implementing this option, that action would be consistent with relief provided by the Federal Government, Newfoundland, Manitoba and proposed by Alberta and Saskatchewan, for plan sponsors who file an actuarial valuation revealing a solvency deficiency after September 2008. In that case, it seems likely that amortization periods would be extended from five to ten years.

For plans other than jointly sponsored pension plans, the Government has indicated that an election to access this relief would require consent of members and beneficiaries. It is not known what level of consent will be required. One option is that a simple majority of individuals with entitlements under the pension plan, in the aggregate, or the members' collective bargaining agent, must consent. It would seem to make sense to adopt the Federal Government approach under which those members who object to the election of the plan sponsor to fund the solvency deficiency over an extended period would be asked to submit their objections to the plan sponsor within 30 days of receiving notice of the plan sponsor's intention to make the election.

B) 10 YEAR AMORTIZATION PERIOD WITHOUT MEMBER CONSENT

As an alternative to an extended amortization period based on member consent, plan sponsors may wish to urge the Government to consider other options that do not necessarily rely upon obtaining the consent of members. Indeed, the pension plans sponsored by many financially solvent and viable employers have been similarly negatively affected by the economic downturn. These employers may well be in a position to establish that an extended amortization period in respect of specified solvency deficiencies presents no risk to benefit security.

In that case, the extended amortization period could be made available to employers (without the consent of members) who can establish ongoing evidence of their financial strength. This alternative has not yet been adopted in Canada, but there is precedent for such a scheme in the United States and the United Kingdom and may be known and understood by global employers with operations in Ontario. The United States proposed (although it was never enacted), in the *Pension Security & Transparency Act, 2005*, that plans sponsored by companies who were considered at risk would be required to fund their plans over shorter period than plans sponsored by companies that exhibited strong financial health. Currently, in the United Kingdom, the Pension Regulator specifically requires that the employer's financial position must be considered when developing a "recovery plan" to pay down solvency deficiencies. Generally, where an employer can establish a strong financial position, the Trustees of the pension plan can accept a recovery plan with amortization periods upwards of ten years (or more).

One approach to this would be that employers in Ontario seeking to access relief would be permitted to prove their financial strength by disclosing the following information to the regulator:

- cash flow forecasts for the current year and for the next two to three years;
- any pending corporate transactions;

- any expenditure commitments over the proposed amortization period, and/or;
- a strong rating from an accepted credit rating agency.

It would likely be necessary, and desirable, to accompany this kind of approach with written notification to members.

Plan sponsors accessing this relief would likely be required to provide ongoing evidence of their financial position.

C) FUNDING OF SOLVENCY DEFICIENCIES WITH LETTER OF CREDIT

The letter of credit option has previously been made available in the Federal jurisdiction, British Columbia, Alberta, Quebec and Newfoundland. Under this option, plan sponsors have been permitted to fund solvency deficiencies using a letter of credit obtained from an issuer with a satisfactory credit rating, as determined by an acceptable ratings agency.

Plan sponsors funding a solvency deficiency using a letter of credit have not, in those jurisdictions, been required to obtain the consent of members or former members. Instead, members and former members have been notified in writing of the plan sponsor's election to fund the pension plan using a letter of credit. The jurisdictions that have adopted letter of credits have required that the letter of credit be an irrevocable and unconditional standby letter of credit that is issued in Canadian currency. If Ontario took a consistent approach, the letter of credit would be made out to the benefit of a fund holder (as determined by section 54 of Regulation 909), in trust, for deposit into the pension fund. The other jurisdictions have required that the issuer cannot be the plan sponsor or affiliated with the plan sponsor. It would also be prudent to require that the letter of credit must be in accordance with the rules of International Standby Practices ISP98 of the International Chamber of Commerce, and meet all the requirements of the *Income Tax Act* (Canada).

CONCLUSION

The Government's announcement signals that it understands the current crisis that plan sponsors are experiencing and provides an opportunity to enact robust forward looking relief that will be meaningful to Ontario employers who sponsor defined benefit pension plans. This is also an opportunity for creative solutions that will provide long-term growth and strengthen the Ontario defined benefit pension sector and support to employers who continue to sponsor these pension plans.

The Government will no doubt be considering and reviewing the experience of other jurisdictions and the variety of forms of solvency relief that have been enacted, not just in Canada but in the United States and the United Kingdom. Within Canadian jurisdictions, there are examples of many different types of solvency funding relief, proving that solvency funding relief is not, as stated above, a “one size fits all” proposition. If you are interested in learning more about the various types of solvency funding relief that has been enacted or is currently proposed in other jurisdictions, Hicks Morley’s Pension & Benefits Group has created a comprehensive overview chart detailing the solvency funding relief initiatives across the country. Please click here to view and print the chart.

If you intend to make your views about solvency funding relief known to the Government, the Pension & Benefits Group would be pleased to work with you to develop submissions or to brief members of your organization on the proposed legislation. If you have any questions, please click here to contact one of the members of our Pension & Benefits Group.