FTR Now

Solvency Funding Relief is Here

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This week saw the culmination of many months of work by the Ontario and Federal Governments with respect to solvency funding relief measures. As of yesterday, June 24, 2009, both sets of solvency funding relief regulations have been enacted. The new regulations attempt to balance the goals of maintaining benefit security for employees and retirees, and preserving the financial condition of corporations. This is accomplished by reducing contributions for pension solvency deficits to allow more resources to be put toward operations. The solvency relief measures included in both the Ontario and Federal Regulations provide a number of options to plan sponsors in respect of solvency deficiencies in recognition of the fact that each sponsor may have different priorities and restrictions. Plan sponsors now have a number of options available and will need to consider the disclosure, communication, and filing requirements associated with each of the options.

ONTARIO ENACTS SOLVENCY RELIEF PROVISIONS

The Ontario Government has enacted the long awaited amendments to the *Pension Benefits Act Regulations* (the "Regulations") providing solvency funding relief to sponsors of defined benefit pension plans. Under the amendments to the Regulations, the administrator of an eligible plan may choose one or more of three funding options in the first filed valuation report with a valuation date between September 30, 2008 and September 29, 2011 (the "solvency relief report").

APPLICATION

The relief is available as a one time election and if a plan administrator does not elect a relief option when the solvency relief report is filed, the plan administrator will not be permitted to make a relief election at a later date. For solvency relief reports with valuation dates between September 30, 2008 and November 1, 2008, the Regulations have been amended to extend the timeline for filing a valuation report from 9 to 10 months. If an administrator has already filed a report with a valuation date between September 30, 2008 and November 1, 2008, the administrator can refile the report and make an election upon the subsequent refiling.

THE RELIEF OPTIONS

When filing a solvency relief report with a valuation date between September 30, 2008 and September 29, 2011, a plan administrator for an Ontario-registered defined benefit pension plan may elect to take advantage of one or more of the following three options:

1. Defer, up to one year, the start of special payments required to liquidate any *new* going concern unfunded liability or *new* solvency deficiency determined in the solvency relief report. Jointly Sponsored Pension Plans ("JSPPs") are not permitted to elect Option 1.
2. Consolidate special payments for pre-existing solvency deficiencies into a new five-year payment schedule that starts on the valuation date of the solvency relief report.
3. With the consent of members and former members, extend the period for liquidating the new solvency deficiency from 5 years to a maximum of 10 years. The consent requirements do not apply to jointly governed plans such as multi-employer pension plans (which have member representation on the Board or Committee administering the plan).

A plan administrator can elect to combine the effects of the three relief options. Each option has varying rules and requirements that will be discussed in more detail below. Of particular note, Option 1 and Option 2 do not require the consent

of members and former members. Option 3, on the other hand, can only be accessed with the consent of members and former members.

In all cases, any actuarial gains in future solvency valuations may be used to reduce or eliminate any solvency special payments determined in the solvency relief report. Gains cannot be used to reduce or eliminate special payments if no relief option is elected. In that case, they can only be used to reduce the amortization period.

OPTION 1 – DEFERRAL OF THE START OF NEW SPECIAL PAYMENTS

Plan administrators can elect to defer, up to one year, the start of special payments required to liquidate any new going concern unfunded liability or new solvency deficiency determined in the solvency relief report. This option is not available to excluded plans, which includes plans that are not up to date with their current special payments, plans that are qualified as Specified Ontario Multi-Employer Pension Plans, plans that are established after September 29, 2008 (unless established due to a merger or a split of existing plans), as well as certain other pension plans. JSPPs are also excluded from electing Option 1.

If a plan administrator elects Option 1, special payments in respect of new solvency deficiencies or new unfunded liabilities may be deferred for 12 months from the valuation date. Therefore, if a solvency relief report has a valuation date of December 31, 2008, no special payments are required to be made in respect of new deficiencies revealed in the report until December 31, 2009. Originally, the Ontario Government announced that only the “catch up” payments in respect of the period between the valuation date and the filing of the report would be deferred. The final version of the Regulations provides more relief by deferring the start date for new special payments altogether.

Plan administrators are not required to obtain the consent of members or former members in order to elect Option 1. However, within 60 days of the start of special payments required under the solvency relief report, the plan administrator must provide enhanced notice to the eligible members and eligible former members. An eligible member is considered a member whose pension benefit includes a defined benefit, other than those members who have transferred their entitlements out of the plan or have died prior to the date the notice is sent. Similarly, an eligible former member is a former member whose pension or pension benefit includes a defined benefit, other than, those former members who have transferred their entitlements out of the plan or have died prior to the date the notice is sent. It is important to note that members’ spouses and beneficiaries do not have entitlements to receive notice nor is their consent required in order to extend the amortization period.

The enhanced notice must contain the following information:

- a description of the option or options that have been elected;
- the transfer ratio of the pension plan at the valuation date;
- the estimated annual contributions that would have to be made if no election was made;
- the estimated annual contributions that will be made as a result of the election; and
- an explanation as to how benefit security may be affected as a result of the election.

OPTION 2 – CONSOLIDATION OF EXISTING SOLVENCY DEFICIENCIES INTO A NEW FIVE-YEAR PAYMENT SCHEDULE

Plan administrators may also elect to consolidate special payments for pre-existing solvency deficiencies into a new five-year payment schedule that starts on the valuation date of the solvency relief report. This option is not available to the excluded plans listed above.

To the extent that the solvency special payments have been made between the valuation date and the filing date and exceed those special payments that would be required under the solvency relief report as a result of electing Option 2, the excess

can be used to reduce subsequent contributions made up to the date at which the next actuarial report is filed.

When Option 2 is elected, there are conditions on the ability to amend the pension plan. If the plan is amended to increase pension benefits or ancillary benefits, any resulting increase in the going concern unfunded liability must be liquidated over five years, beginning on the valuation date of the actuarial report in which the increase in the going concern unfunded liability was determined. This accelerated funding requirement for the going concern unfunded liability remains in effect until the consolidated prior solvency deficiency has been fully liquidated by payments over the new five year amortization schedule.

As with Option 1, no member or former member consent is required. However, within 60 days of the start of special payments required under the solvency relief report, the plan administrator must provide the enhanced notice to the eligible members and eligible former members containing the same information as set out above.

OPTION 3 – EXTENSION OF AMORTIZATION SCHEDULES BY UP TO FIVE YEARS FOR NEW SOLVENCY DEFICIENCIES

Option 3 will permit the extension of the period for funding any new solvency deficiency from 5 to a maximum of 10 years, with the consensus of eligible members and former members. Option 3 is not available to the excluded plans listed above. As with Option 2, if a plan administrator elects to extend the amortization period for a new solvency deficiency, there will be conditions on the ability to amend the pension plan. If the plan is amended to increase pension benefits or ancillary benefits, any resulting increase in the going concern unfunded liability must be liquidated over five years, beginning on the valuation date of the actuarial report in which the increase to the going concern unfunded liability was determined. The accelerated going concern funding requirement applies for plan amendments that become effective before the end of the fifth year of the extended amortization schedule. Amendments can be made in the later years of the amortization schedule without attracting this condition.

THE CONSENT PROCESS

In order to access relief under Option 3, a plan administrator must obtain the requisite level of consent from eligible members and eligible former members, which is deemed to be obtained where no more than one third of the eligible members *and* eligible former members object to the election. Where a bargaining agent represents some or all of the eligible members, it is the bargaining agent’s consent that must be obtained for those members. Notably, bargaining agents are not permitted to consent or object on behalf of eligible former members. However, if an eligible member retires between the valuation date of the solvency relief report and the date the information forms are sent to members, the bargaining agent may continue to represent those individuals for the purpose of determining consent.

All eligible members who are not represented by a collective bargaining agent, all former members and all bargaining agents must also be provided with Notices of Objection that they may complete and return if they wish to object to the funding of the plan in accordance with this relief option. Bargaining agents must respond on behalf of their eligible members within 45 days. Members can have no less than 45 days to respond from the date the information form is sent by the administrator. If less than one third of the eligible member and former members object, the Regulations will deem consent to be obtained and the plan may be funded in accordance with Option 3.

All eligible members, eligible former members and bargaining agents must then be provided with enhanced notice in the form of an information statement containing specific information required by the amended Regulations. In addition to the information required to be provided in the enhanced notice under Options 1 or 2, members, former members and bargaining agents must also be informed of their right to object to the election for Option 3. If there is a collective bargaining agent, members and former members must also be informed if the union has objected or chosen not to object on behalf of the members it represents and that if the union objected, that the objection does not represent objections on behalf of more than one third of the aggregate number of members and former members.

PROGRESS REPORT

If the plan administrator obtains the required consent and begins funding the pension plan in accordance with Option 3, the plan administrator must provide members and former members with an annual progress report. The progress report must update members and former members regarding the transfer ratio of the pension plan, the required contributions to be made according to the solvency relief report and provide explanations of how the benefits of the members and former members may be affected as a result of funding in accordance with Option 3. For eligible members, the progress report may be included in the annual statement, but plan administrators will be required to create and send the updates to former members as well.

OTHER CHANGES TO THE ONTARIO REGULATIONS

In addition to the establishment of the three solvency funding relief options, the Regulations have also been amended to address the use of the new commuted value standards, new rules regarding contribution holidays, transfer ratios, and locked in accounts. This update summarizes the changes to commuted value standards and transfer ratios as they will be of interest to plan sponsors facing solvency funding concerns.

COMMUTED VALUE STANDARDS

The Regulations have been amended to confirm that the revised Standard of Practice for Pension Commuted Values (Section 3800) published by the Canadian Institute of Actuaries, which took effect April 1, 2009, may be used for the purpose of a solvency valuation with a valuation date on or after December 12, 2008. However, the revised standards cannot be used to determine commuted values for individuals prior to April 1, 2009.

CHANGES REGARDING TRANSFER RATIOS

The Regulations have also been amended to restrict the payment of commuted values where the transfer ratio is less than one. The prior approval of the Superintendent must now be obtained to transfer any part of the commuted value where the transfer ratio is less than one and the administrator knows or ought to know that, since the last valuation report, the transfer ratio has declined by 10 per cent or more.

FEDERAL PENSION FUNDING RELIEF MEASURES NOW IN EFFECT

On June 12, 2009, the Federal Government announced the coming into force of the *Solvency Funding Relief Regulations, 2009* (the “Federal Regulations”) that provide temporary solvency funding relief for federally regulated defined benefit pension plans. The regulations, which were published in the *Canada Gazette* on June 24, 2009, are now in effect and have been revised in a number of respects from the draft regulations published in April.

Federally regulated pension plans account for approximately 7% of private pension plans in Canada and are governed by the *Pension Benefits Standards Act* (“PBSA”) and regulations thereunder. The Federal pension legislation and these new regulations relate primarily to companies operating in the inter-provincial transportation, banking and telecommunication industries. In 2006, the Federal Government was one of the first Canadian jurisdictions to introduce pension funding relief for defined benefit pension plans. The 2006 regulations provided funding relief in respect of solvency deficiencies identified in valuation reports prepared up to January 1, 2008. Approximately 75 federally regulated pension plans took advantage of the funding relief made available during this period.

APPLICATION OF THE FEDERAL REGULATIONS

The new Federal Regulations apply to new solvency deficiencies reported in the first actuarial valuation report filed after June 12, 2009 with a valuation date between November 1, 2008 and October 31, 2009. The Office of the Superintendent of

Financial Institutions ("OSFI") recently announced that filing of actuarial reports that would otherwise be required to be filed by June 30, 2009 may be delayed until August 14, 2009 in order to allow for the preparation of reports which take in account the funding relief initiatives introduced in the new regulations. In addition, OSFI announced that actuarial reports not required to be filed, but that are voluntarily filed to take advantage of the new regulations, may be filed in respect of a plan year end between November 1, 2008 and October 31, 2009, by December 31, 2009 or 9 months after the plan year end.

As with the Ontario Regulations, the new Federal Regulations also provide plan sponsors with a number of options to address solvency deficiencies.

OPTION 1 – EXTENSION OF SOLVENCY PAYMENT PERIOD BY ONE YEAR

The new Federal Regulations permit solvency funding using a 10 year amortization schedule without member consent and without posting a letter of credit for the first year after filing the valuation. For example, for plans using a December 31st valuation date, the 10 year amortization schedule applies to the year January 1, 2009 to December 31, 2009. After that time, if solvency funding is to continue using a 10 year amortization schedule, member and former member consultation and consent or a letter of credit is required to be posted, both as described below. Where a plan sponsor chooses, or is not able to take advantage of, the 10 year amortization schedule after the first year, a new 5 year period (starting at the end of the first year) is established to make the remaining special payments toward the 2008 solvency deficiency. Therefore, at a minimum, the new regulations allow for solvency special payments to be reduced for the first year for all federally regulated pension plans along with a deferral of the remaining payments. In order to benefit from this funding relief, there cannot be any outstanding payments due to the pension plan as of the date of filing of the actuarial report.

OPTION 2 – EXTENSION OF SOLVENCY PAYMENT FUNDING PERIOD TO 10 YEARS BEYOND 2009

The Federal Regulations provide that the 2008 solvency deficiency can continue to be amortized and funded over 10 years after the 2009 year only if either:

- less than one third of the members *and* less than one third of the non-member beneficiaries of the plan object by the end of the year, or
- a letter of credit to cover the difference between the payments required under the usual 5 year and new 10 year amortization schedules is obtained.

As a condition of extending the amortization period with consent, the Federal Regulations provide that any amendments to improve benefits will be subject to restrictions in 2009 and for the first 5 years of the 10 year amortization period.

A. MEMBER AND BENEFICIARY SUPPORT

In order to extend the 10 year amortization schedule beyond the first year, one option is to seek the support of members, retirees and other beneficiaries. The procedure described in the Federal Regulations involves the administrator of the plan providing information about the plan's funded status, the difference in the amount of the special payments to be made to the plan, the difference in benefits if the plan were to be terminated, the restriction on benefit improvements and the potential consequences of funding over the extended period to all members (or where unionized, to the trade union with bargaining rights) and other beneficiaries (primarily retirees, deferred vested members and surviving spouses). After providing at least 30 days for members, trade unions, and other beneficiaries to consider the proposal, if less than one third of the active members and less than one third of the other beneficiaries do not object, the proposal can be put into effect.

In order to take advantage of funding over a 10 year amortization schedule, the plan administrator is required to make a filing with OSFI within 60 days of the year end of the 2009 plan year. The filing is to include confirmation that corporate authorization to adopt a 10 year amortization schedule has been obtained in the form of a resolution of the board of directors,

a statement certifying the disclosure to members and beneficiaries has taken place, and a statement confirming that the requisite level of consensus was obtained in that process.

Since the beneficiary consent requirement is independent of the active member consent requirement under the Federal Regulations, there is a need to satisfy the concerns of retirees as well as the concerns of active employees. Obtaining the consent of the beneficiary group may be more difficult given the different objectives of the two stakeholder groups and the lower importance that retired and terminated members may attach to the sponsor's desire to direct funding from the pension plan to sustaining current business operations.

B. LETTER OF CREDIT

Plan sponsors will have the option to fund the 2008 solvency deficiency over a 10 year period without the consent of members and beneficiaries as described above, if the sponsor obtains a letter of credit for the differential between the payments required by adopting a 5 year versus a 10 year amortization schedule. The 2006 regulations required that the issuer of the letter of credit be given an acceptable rating by one rating agency. The requirement under the Federal Regulations is that the issuer must have acceptable ratings by two rating agencies.

Should the plan sponsor "default" (for example, terminate the plan, become bankrupt or file for protection under the *Companies' Creditors Arrangement Act* during the relief period), the trustee of the plan would make a demand for payment from the financial institution issuing the letter of credit and the face value of the letter of credit must be paid into the pension fund. The letter of credit would also be payable on the demand of the trustee if the letter of credit is not renewed or replaced on its expiry date. If the financial position of the pension plan improves due to changes in the economy, plan sponsors will be able to reduce or eliminate the letters of credit to the extent that they are no longer required.

OPTION 3 – ASSET SMOOTHING AND DEEMED TRUST

In addition to providing for direct solvency funding relief, the Federal Regulations provide some relief in the valuation of assets in turbulent market conditions. Typically, actuarial reports filed under the PBSA Regulations are permitted to value the pension assets using an asset smoothing methodology over no more than a five year term to stabilize short-term fluctuations in the market values of pension assets. If an asset smoothing method is used, the resulting asset value cannot exceed 110% of the actual market value of assets on the date of the report.

Where a pension plan is using one of the above solvency relief measures, an actuarial report prepared as of a date between November 1, 2008 and October 31, 2009 may use an asset smoothing method with a cap of 115%, rather than 110% of the actual market value of pension assets on that date. This leeway is only granted for the purposes of calculating funding obligations under the new solvency relief measures. An actuarial report prepared on this basis is required to disclose the special payments that would have been required if the actuarial report had been prepared in accordance with the PBSA General Regulations. Additionally, all other requirements of the PBSA tied to the solvency ratio of a pension plan are required to be calculated in accordance with the PBSA General Regulations and cannot take into account the additional leeway for asset smoothing.

The difference between the special payments required to be made under the PBSA Regulations using a 110% smoothing maximum and the amounts required to be paid using an asset smoothing methodology up to 115% will now be subject to a deemed trust and are required to be funded in the event of a default. Notably, the draft regulations published in April provided for the deemed trust provisions to apply more extensively to the difference between 5 year and 10 year special payment requirements described under Option 2 and now only are to apply in the event of adopting a 115% asset smoothing methodology.

FURTHER DETAILS

From an implementation perspective, if the 10 year funding schedule described in Option 2 is to be used, notice and the actuarial valuation is required to be filed with the Superintendent along with a form to be developed by OSFI. Different provisions apply to Crown corporations and multi-employer pension plans which have not been summarized here.

CONSIDERATIONS GOING FORWARD

With the enactment of the solvency funding relief regulations in Ontario and at the Federal level, plan sponsors and administrators must now start the process of selecting the appropriate options for their situation. Where this will require the consent of members, former members and unions, communications will be very important. In particular, both solvency relief programs require plan sponsors to engage their collective bargaining agents as trade unions are empowered to object on behalf of their members.

Under both the Ontario and Federal Regulations, any objection to a 10 year amortization proposal by a trade union is considered to be an objection on behalf of all plan members in that bargaining unit. The consensus conditions contained in both sets of regulations will make it very difficult to obtain relief beyond the first year window without the consent of trade unions. Plan sponsors considering making a proposal to adopt the 10 year amortization schedule will want to begin planning how to communicate with bargaining agents and other members, including making a determination as to whether the scope of the disclosure required by the regulations is likely to be sufficient to obtain consensus. If not, consideration should be given to what further information may be necessary to both assist members and their bargaining agents to understand the funding requirements under the legislation and to allow them to understand the reasons why relief is necessary for the plan sponsor. This may require providing financial or planning forecasts to explain how the corporation and its employees may benefit from the funding relief. If pension funding has not before been the subject of union negotiations, additional consideration about the scope and conditions of providing this information may be necessary.

If you are considering taking advantage of any of the solvency relief options enacted by the Ontario or Federal Governments, the members of Hicks Morley's Pension & Benefits Practice Group would be pleased to assist. If you have any questions regarding the options available or the communications that will be required, please contact a member of our Group.

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