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Federal Government to Overhaul Federal Pension Laws

Date: October 29, 2009

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 ("DB") plans;
- Resolution of plan-specific problems;
- Improve the framework for defined contribution ("DC") and negotiated contribution DB plans; and
- 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% of the book value of the plan's assets to 10% 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); and
- 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% of the plan's liabilities. The Government proposes to increase the surplus limit to 125% 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 PENSION 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 5%;
- 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% (or the solvency ratio is already below 85%), unless the employer immediately funds the cost of the benefit improvement; and
- Employer declared partial terminations will be eliminated.

REDUCE FUNDING VOLATILITY FOR DB PLAN 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% 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 DEFINED CONTRIBUTION AND NEGOTIATED CONTRIBUTION DEFINED BENEFIT 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; and
- 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. Hicks Morley’s Pension and Benefits Practice Group will continue to monitor these developments and will provide you with further updates as they arise.

If you have any questions with respect to how these proposed changes may affect your pension plan, please contact a member of our Pension & Benefits Group.

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