FTR Now

Federal Pension Reform Proceeds

Date: April 5, 2010

Bill C-9, the *Jobs and Economic Growth Act*, was introduced in the House of Commons on March 29, 2010 as an omnibus bill which proposes to implement many of the significant pension reform initiatives announced by the Minister of Finance on October 27, 2009, certain measures announced in the March 4th federal Budget, as well as previously announced changes to the application of Goods and Services Tax ("GST") to pension plan expenditures. This FTR Now discusses the Bill and its application to registered pension plans.

Bill C-9 includes amendments to the *Income Tax Act* ("*ITA*") and the *Excise Tax Act* which will affect all Canadian registered pension plans. However, the reforms contained in Bill C-9 are largely aimed at federally-regulated pension plans and will amend the *Pension Benefits Standards Act* ("*PBSA*"). Specifically, the *PBSA* amendments will result in substantive benefit entitlement changes that will likely require both amendments to pension plan texts and plan administration changes. Bill C-9 provides for broader disclosure obligations and pension plan communication processes will also need to be revised to ensure compliance. Employer funding requirements are also impacted by the Bill.

The Pension and Benefits Group will be monitoring the passage of Bill C-9 and its enactment, as well as the release of draft Regulations that will provide the detai*l necessary to implement many of the reforms.*

REFORMS TO FEDERAL PENSION REGULATION

The first portion of this FTR Now will focus on the reforms to the *PBSA*, which will affect only federally-regulated pension plans. The Bill does not reflect all of the reforms announced on October 27, 2009. Many of the items in that announcement will be implemented by amendments to the *PBSA* Regulations which have yet to be published.

PLAN FUNDING

FULL FUNDING ON PLAN TERMINATION

The *PBSA* does not currently require the full pension deficit to be funded by the sponsoring employer when a pension plan is terminated in full. An employer's funding obligation in the event of a full plan termination is presently limited to the normal cost of benefits accrued to the termination date, any special payments accrued to the termination date, and any employee contributions deducted from payroll but not yet remitted to the pension fund.

Bill C-9 proposes that a plan sponsor will be required to fully fund benefits upon full plan termination (unless the plan is a multi-employer pension plan ("MEPP")). Calculation of the amount and timing of contributions required to fully satisfy the plan's benefit obligations on termination will be prescribed in Regulations. The Minister of Finance's October 27, 2009 announcement of these proposed changes indicates that employers will be required to amortize the terminal deficit over a period no longer than five years. If Bill C-9 becomes law, this will leave Saskatchewan as the only Canadian jurisdiction that does not require an employer to fully fund a wind up deficit on full plan termination.

LETTERS OF CREDIT

Recent changes to the *PBSA* and Regulations have, in very limited circumstances, allowed an employer to supply a letter of credit to the pension plan trustee instead of making special payments in respect of a solvency deficiency. Bill C-9 would

amend the *PBSA* to permanently allow qualifying letters of credit to be used in lieu of cash to satisfy special payments for ongoing plans. Regulations, which have not yet been issued, will set out the conditions on the use of letters of credit. The Government previously indicated that letters of credit will be permitted to satisfy solvency payments up to a maximum of 15% of a plan's assets.

Employers who choose to rely on a letter of credit instead of making special payments will be required to periodically certify that the letter meets prescribed requirements. The costs of obtaining and maintaining the letter of credit cannot be paid from the pension fund.

NEW SOLVENCY FUNDING STANDARD TO REDUCE DB FUNDING VOLATILITY

A significant proposed change is the introduction of a new standard for calculating solvency deficiencies, the purpose of which is to reduce funding volatility for sponsors of defined benefit pension plans. The October 2009 announcement from the Minister of Finance indicated that valuation reports would be required to be filed on an annual basis that funding would be determined based upon a three-year average of the funded ratios. The substance of the new standards will be set out in Regulations, which have not yet been issued.

ENHANCING MINIMUM STANDARDS

Bill C-9 also includes several important changes to the minimum standards applicable to member benefits.

VESTING, LOCKING-IN AND MINIMUM BENEFITS

Currently, vesting occurs after two years of plan membership. If a plan member terminates employment prior to the two year mark, the member is not entitled to a deferred pension benefit and may only receive a refund of his or her contributions. Bill C-9 amends the *PBSA* to require all members to vest immediately upon enrolment in the pension plan for all service, whether before or after January 1, 1987. Locking-in continues to occur after two years of plan membership. The provisions regarding the minimum pension benefit credit for defined benefits will be simplified by applying the 50% rule to benefits accrued for all years of service.

Plan sponsors may wish to consider the design of their pension plans and whether it may be appropriate to amend the pension plans to implement or extend a waiting period before employees become eligible to participate in the pension plan.

PRE-RETIREMENT DEATH BENEFITS

Bill C-9 amends the provisions applicable in the event that a member dies before retirement. The commuted value of the deceased member's or former member's benefit (or account balance, in the case of a DC plan) for all service will be payable to the member's surviving spouse, calculated as though the member had terminated employment on the date of death. If there is no surviving spouse, the death benefit is payable first to the designated beneficiary or, if there is no beneficiary, to the estate of the member or former member. Under Bill C-9, pre-retirement death benefits will be not differentiate on the basis of whether the member was eligible for an immediate pension at the time of death.

CLARIFYING MARRIAGE BREAKDOWN RULES

The most significant change to the marriage breakdown rules is the introduction of an adjustment that pension plans may make following the breakdown of a member's marriage. If no part of the member's pension benefit is required to be divided with the member's former spouse under a court order or agreement, a plan may provide that the member's pension may be adjusted to become payable in the normal form, instead of as a joint and survivor pension.

Bill C-9 also amends the *PBSA* to clarify that an administrator has a duty not only to distribute, but also to administer, the

pension benefits in accordance with an agreement or court order between former spouses that divides their family property on marriage breakdown. This reflects that, in practice, some spouses may retain their assigned portion of the member's benefits in the pension plan as a deferred pension, which the administrator is required to maintain and administer until the former spouse commences to receive the assigned benefits.

ENHANCED DISCLOSURE OBLIGATIONS

Bill C-9 will also implement a number of enhanced disclosure obligations to increase transparency for members and former members. Plan administrators will now be required to send annual statements setting out the funded level of the pension plan to deferred vested members, retirees, and their spouses. These statements may also be required to include other information that will be contained in the Regulations that have yet to be released. Members and former members will also be permitted to request copies of additional actuarial and funding related documents, such as the letters of credit described above. The *PBSA* is also amended to clarify the obligation to provide statements after a member dies.

Finally, a new requirement has been introduced regarding the provision of information on the termination of a pension plan. Where a plan is terminated, an administrator will be required to provide notice of the plan termination and a statement of benefits to each member, former member and his or her spouse.

MEASURES TO IMPROVE BENEFIT SECURITY

RESTRICTIONS ON ANNUITY PURCHASES FROM AN UNDERFUNDED PLAN

The *PBSA* currently requires a plan administrator to obtain the Superintendent's consent to commuted value transfers where the Superintendent is of the view that the transfer would impair the solvency of the pension fund. Bill C-9 will expand this rule to cover annuity purchases.

AMENDMENTS REDUCING PLAN SOLVENCY

Bill C-9 expands the circumstances in which an amendment to a pension plan will be considered void. All amendments following which the solvency ratio is below the prescribed solvency level are affected. In all such cases, the Superintendent's approval will be required in order to implement the amendment. It is expected that any benefit improvements in a pension plan with a solvency level below the threshold will be required to be immediately funded.

The solvency level has not yet been prescribed, but the October 2009 announcement from the Minister of Finance indicated that the ratio will be set at 85 percent. Once the prescribed solvency ratio is enacted, plan sponsors will be well advised to take the threshold into consideration when considering the funding costs associated with amendments.

"DEEMED TRUST" PROVISIONS

The *PBSA* "deemed trust" provisions deem certain amounts to be held in trust by an employer for the benefit of pension plan beneficiaries. The deemed trust provisions are intended to provide priority to pension plan beneficiaries over an employer's other creditors.

Bill C-9 provides that additional amounts will be subject to the *PBSA* deemed trust. These amounts would include: (1) accrued payments under a workout agreement for distressed plans; (2) the amount payable by an employer if an issuer of a letter of credit has failed to honour a trustee's demand for payment; and (3) any payments the employer is required pay to amortize a wind up deficiency. With regard to the latter amounts, the entire wind up deficiency is not immediately subject to the deemed trust. Rather, the deemed trust would apply to an employer's payments to amortize a wind up deficiency as they come due (to the extent that they are not paid).

EXPANDED POWERS OF SUPERINTENDENT

Bill C-9 proposes a number of amendments to the *PBSA* that would expand or clarify the authority of the Superintendent in specific areas.

POWER TO REPLACE PLAN ADMINISTRATOR

Bill C-9 will give the Superintendent broad authority to remove and replace a plan administrator where the administrator is insolvent, is unable to act, or the Superintendent is of the opinion that it would be in the plan beneficiaries' best interests to do so. The reasonable fees and expenses of the replacement administrator would be payable from the pension fund.

POWER TO REPLACE ACTUARY

Bill C-9 will give the Superintendent the authority to designate an actuary to prepare an actuarial report or termination report where the Superintendent feels that this is in plan beneficiaries' best interests.

The administrator will be entitled to review a draft of the designated actuary's report and would have the opportunity to provide comments. Once finalized, the plan administrator would be required to fund the plan in accordance with the designated actuary's report.

Bill C-9 also provides that the administrator must pay the reasonable fees and expenses of the designated actuary associated with preparation of the Superintendent-commissioned actuarial report out of the pension fund. The mandatory language appears to be intended to override plan or trust language that would otherwise prohibit the payment of administrative expenses from a pension fund.

POWER TO ORDER FULL WIND UP

Under the amended *PBSA*, the Superintendent will have the authority to declare a full plan wind up if benefits cease to be credited to plan members.

ELIMINATION OF EMPLOYER-DECLARED PARTIAL WIND UPS

Under Bill C-9, only the Superintendent can declare a partial wind up of a pension plan. Employers will no longer be permitted to declare partial wind ups.

CLARIFYING MULTI-EMPLOYER PENSION PLAN ISSUES

Consistent with one of the objectives stated in the Minister of Finance's October 27, 2009 announcement, the *PBSA* will provide greater clarity to the application certain rules and minimum standards for federally-regulated MEPP's. Bill C-9 amends the definition of a MEPP to clarify that MEPPs can be established pursuant to (i) a collective agreement;(ii) agreements between participating employers; (iii) statute; or (iv) regulation. Bill C-9 also amends the *PBSA* to clearly provide that participating employers are required to pay into the pension fund **only** those contributions that they are required to pay under the collective agreement, agreement between participating employers, statute or regulations. This reaffirms that federally-regulated MEPPs are not subject to the same solvency funding requirements applicable to single employer pension plans.

The *PBSA* will also expressly permit the administrator of a MEPP to amend the plan to reduce accrued pension benefits, notwithstanding any language in the plan text to the contrary that would purportedly limit the ability to reduce benefits. An amendment that reduces benefits will continue to require the approval of the Superintendent.

PAYMENT OF VARIABLE BENEFITS FROM A DC PLAN

Bill C-9 includes amendments to the *PBSA* which will allow a defined contribution ("DC") pension plan to offer a RRIF-type of benefit directly from the pension fund. DC pension plans typically resulted in transfers to retail retirement savings vehicles or annuity purchases. Under Bill C-9, if a plan chooses to permit it, a DC member or former member who has reached early retirement age may elect to receive a variable benefit directly from the member's DC account in the manner allowed under the *Income Tax Regulations*. This allows the member or former member to access the funds in his or her DC account, subject to maximum and minimum annual limits, while the DC account remains in the plan fund.

A former member (or surviving spouse) must be permitted at least once per year to transfer the remaining amount to a prescribed plan, such as a locked-in registered retirement savings plan, or to purchase a life annuity.

The October 2009 announcement suggested a more comprehensive overhaul of the provisions affecting DC plans and further changes specific to DC plans are expected to be published in the coming months.

DISTRESSED PLAN WORKOUT SCHEME

The distressed plan workout scheme is a new set of provisions which allow federally-regulated plan sponsors and members and other "beneficiaries" (defined to mean retirees, deferred vested former members, and other persons entitled to benefits) to agree to funding arrangements that do not comply with the *PBSA*'s minimum funding rules. This scheme applies only to prospective special payments, and not normal cost contributions. The employer will generally be eligible for a short moratorium on special payments while the parties negotiate.

Employers who are in the process of being liquidated or are bankrupt are not eligible for the scheme. Plans that have been wound up in full are also excluded. To qualify, employers must make a declaration containing the information specified in the *PBSA* which essentially provides that it is insolvent or otherwise unable to make the required contributions to the pension plan. That declaration must be filed with the Superintendent and the Minister of Finance with a copy of the employer's resolution authorizing the declaration, plus additional documents to be prescribed by Regulation. Notice must also be given to the members and beneficiaries in accordance with the rules to be set out in the Regulations.

The employer must apply to court to appoint representatives to act on behalf of the "beneficiaries" and the non-unionized members. The employer bears the cost of this application, as well as the reasonable fees and expenses of the appointed representatives which cannot be paid out of the pension fund. The employer will be required to provide the representative(s) with prescribed information.

Once the declaration is filed, a negotiation period is triggered. During the negotiation period, the Superintendent cannot revoke a plan's registration or order a wind up. Special payments can be deferred during the negotiation period unless the employer is undergoing a court-supervised restructuring under either the *Companies Creditors Arrangement Act* or the *Bankruptcy and Insolvency Act*. The deferred payments become due immediately if, during the negotiation period, the plan is wound up, the employer commences a court-supervised restructuring, the workout agreement does not address the payment of the deferred amounts, or the parties fail to reach a workout agreement by the end of the negotiation period.

Once an agreement is reached by the employer and the member and beneficiary representatives, the non-unionized members and beneficiaries are provided with an opportunity to object to the agreement. If more than one-third of the members or one-third of the beneficiaries object to the agreement, it will fail. If an agreement is reached and required consent is received, the proposed funding schedule must be submitted to the Minister of Finance for approval.

Additional details about the operation of the distressed plan scheme will be outlined in the Regulations.

CHANGES AFFECTING ALL REGISTERED PENSION PLANS

The Bill includes an increase to the amount of surplus that can be retained in a registered pension plan before contributions must be suspended, and also introduces extensive changes to the application of GST input tax credits ("ITCs") to pension plan expenses. These changes impact all registered pension plans, not only pension plans sponsored by federally-regulated employers.

SURPLUS CUSHION UNDER THE *INCOME TAX ACT*

Currently, the *ITA* precludes an employer from contributing to a defined benefit pension plan once that plan's assets total 110% of its liabilities, valued on a going-concern basis. Some in the industry see the current restriction on contributions above the 110% threshold as providing insufficient protection to pension plan stakeholders against significant market downturns or a plan sponsor's unforeseen financial difficulty.

Bill C-9 contains amendments to the *ITA*, first announced by the Minister of Finance in October 2009 to increase the pension surplus threshold from 110% to 125%. This change may allow plans to build larger surplus cushions to hedge against future market downturns or financial difficulties. However, an employer's ability to access this surplus if it is not required to fund pension benefits will continue to be subject to the terms of the individual pension plan and the governing pension legislation.

These changes will apply to contributions made after 2009 for periods of pensionable service after 2009. The Canada Revenue Agency has stated that an actuarial valuation report with an effective date of December 31, 2009 or later may reflect the new threshold despite the fact that the amendment is not yet in force.

GST AND PENSION PLAN EXPENSES

Bill C-9 includes amendments to the *Excise Tax Act* (the "*ETA*") which will substantially change key GST rules applicable to pension plan expenses.

NEW REBATE SYSTEM FOR GST/HST ON PENSION-RELATED EXPENSES

Bill C-9 contains provisions which would implement proposals published by the Department of Finance on September 23, 2009 and will be effective for fiscal years commencing after that date. These proposals were based on earlier proposals first published in 2007. If passed, the decision last year of the Federal Court of Appeal in *General Motors of Canada Limited v. The Queen* will be effectively overturned. In that case, the Court confirmed that General Motors itself could claim input tax credits ("ITCs") for GST that it paid to investment managers relating to the pension fund, contrary to the longstanding position of the Canada Revenue Agency.

Under the new rules, an employer will not be able to directly claim ITCs on most pension-related expenses, including fees for investment advice, because the "pension entity" and not the employer will be deemed to have paid all GST (or HST, when that tax becomes effective in Ontario on July 1, 2010) on pension-related expenses. In most cases, the "pension entity" will be the trust governed by the pension plan or a corporation established solely to administer the pension plan.

Similar to the rebate structure currently in place for multi-employer pension plan trusts, the "pension entity" will generally be eligible for a rebate of 33% of the GST/HST that it has paid or is deemed to have paid on plan expenses each claim period. The rebate will be available regardless of whether the pension entity is a GST-registrant and regardless of the type of plan expenses (i.e. the old distinction between "employer expenses" and "plan trust expenses" will be eliminated). Plans sponsored primarily by listed financial institutions will not be eligible for the 33% rebate.

The employer (or the participating employers, if more than one) and the pension entity will be able to file a joint election to transfer some or all of this 33% rebate to the employer(s), provided that each electing employer is a GST-registrant. The ability to transfer the 33% rebate to an employer will be limited to the extent that the employer is not exclusively engaged in what the *ETA* defines as "commercial activities".

Special transitional rules will apply to rebates relating to periods before July 1, 2010, when the HST becomes effective in Ontario.

GST/HST WILL APPLY TO INVESTMENT MANAGEMENT SERVICES

Bill C-9 also contains amendments first published by the Department of Finance on December 14, 2009 (the "December 2009 Proposals") that will expressly narrow the kinds of services that fall within the *ETA*'s definition of GST/HST-exempt "financial services". In particular, investment management services, with or without discretionary authority over the managed assets, will be subject to GST/HST. Taxable investment management services will include services that involve portfolio management, administration, research, analysis and advice as well as services that involve determining which assets or liabilities to buy or sell or acting to realize performance targets. Although the amendments will be retroactive to 1990 (the year when the GST became effective), they will not affect payments for which no GST was charged that were made on or before December 14, 2009.

The Department of Finance and the Canada Revenue Agency have both indicated that the December 2009 Proposals are meant only to clarify the law and not to impose new taxes. In practice, however, the December 2009 Proposals could result in employers or pension funds having to pay GST/HST on some investment management services that have been treated as tax-exempt "financial services" in the past.

CONCLUSION AND NEXT STEPS FOR EMPLOYERS

Bill C-9 passed first reading in Parliament on March 29, 2010. It is not known when the Bill will become law and it is possible that revisions may be made before it becomes law. Employers will want to track the passage of the Bill and to review and understand the supporting Regulations when they are released. Our Pension & Benefits Group will keep you apprised of these developments over the months ahead.

If you have any questions about how Bill C-9 may affect your pension plan and administrative responsibilities, please contact any member of the Pension & Benefits Group.

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