FTR Now

Pension Funding Reform Continues: Taking Aim at Target Benefit Multi-Employer Pension Plans

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Pension plans that meet the definition of specified Ontario multi-employer pension plans (SOMEPPs) are one step closer to having the option to convert accrued defined benefits (DB) to target benefits (TB) – and one step closer to a permanent exemption from solvency funding. If your organization participates in a SOMEPP, find out what this could mean for your organization in this *FTR Now*.

Overview of SOMEPPs

Under the *Pension Benefits Act* (PBA), SOMEPPs are multi-employer pension plans (MEPPs) in which:

- participating employers make contributions to the plan pursuant to one or more collective agreements; and
- participating employers' contributions to the plan are limited to a fixed amount set out in one or more collective agreements.

SOMEPPs are currently eligible for temporary solvency relief.

The government released a description of a proposed TB funding framework on April 4, 2018, which provides further details regarding how the new target benefit rules will apply to MEPPs. MEPPs that convert to TB plans will be exempt from solvency funding on a permanent basis.

These new details expand upon and support the target benefit provisions included in Bill 177, the *Stronger, Fairer Ontario Act (Budget Measures), 2017* (Bill 177) discussed in our *FTR Now*, Ontario's Next Wave of Pension Reform. The amendments to the PBA included in Bill 177, which have not yet been proclaimed into force, include the criteria for a plan to qualify as a TB plan and the process for existing MEPPs that provide DB pensions to convert to target benefit MEPPs (TB MEPPs) under section 81.0.2 of the PBA.

The details released also confirm that the pending new funding rules for DB plans will apply to MEPPs providing DB benefits that are not SOMEPPs. Further, all MEPPs that do not convert to TB MEPPs will be subject to the funding requirements applicable to DB plans.

The Proposed Regulations

Permanent Exemption from DB Solvency Funding

TB MEPPs would not be required to fund benefits on a solvency basis under the proposed funding framework. However, all filed valuation reports will still be required to include solvency valuations, determined as though the benefits are DB pension benefits. At a minimum, solvency valuations would need to be filed on a triennial basis. There will also be an ongoing obligation to disclose the plan's transfer ratio to plan beneficiaries.

The obligation to make special payments related to past solvency deficiencies identified in prior valuation reports for the benefits converted to TBs will be cancelled upon conversion to a TB MEPP.

15-Year Amortization Period for Going Concern Funding Deficiencies

The amortization period for funding a TB MEPP's going concern deficiency will be extended from 12 to 15 years. The proposed funding framework also includes a one-time opportunity for plan administrators to consolidate existing going concern special payments established in previous valuation reports into a new 15-year payment schedule, with new going concern special payments deferred up to 12 months after the valuation date.

PfAD and Related Contribution Requirements

As with the proposed DB funding framework for single-employer pension plans, the proposed TB MEPP funding framework includes a Provision for Adverse Deviations (PfAD). A PfAD is a funding cushion or reserve.

The PfAD would be a percentage of a TB MEPP's normal cost (excluding the costs for any future indexation). The PfAD in respect of the normal costs will be paid by the employers alongside the annual normal costs of the plan. A PfAD in respect of going concern liabilities will be funded through emerging surplus (if any) and will be aided by restrictions on benefit improvements.

The proposed PfAD for TB MEPPs will be determined as the sum of the following three components:

Fixed Component: The first component of the PfAD is a base funding requirement of 4%.

Plan Asset Mix: The next component of the PfAD is determined based on the target asset mix of the pension plan (as specified in the pension plan's Statement of Investment Principles and Procedures) and is designed to encourage plans to select investments that are "appropriate for funding long-term pension obligations." As a result, the more heavily weighted a TB MEPP plan is towards investments in non-fixed income assets, the higher the PfAD will be.

Non-fixed income (NFI) assets will include all equities and employer-issued securities. However, the regulations may specify characteristics of investments that do not qualify as fixed income assets for purposes of the PfAD calculation. In addition, 50% of alternative investments will be considered non-fixed income assets for purposes of the PfAD calculation.

Fixed income assets will include bonds, cash, term deposits, short-term notes and treasury bills, GICs and insured contracts, such as annuities held as plan assets. Investments that have both fixed and non-fixed income, such as mutual funds or balanced funds, will be allocated depending on the nature of the securities held by the specific fund.

This component of the PfAD calculation is determined based on the following table:

% of NFI assets	NFI Component for TB MEPPs
0%	0%
20%	1%
40%	5%
50%	7%
60%	9%
70%	11%
80%	13%
100%	18%

Discount Rate: The final component of the PfAD calculation will be determined based on the TB MEPP's going concern discount rate. The discount rate is an actuarial assumption relating to the assumed rate of return on the plan's assets. An additional amount will be added to the PfAD if a TB MEPP's discount rate exceeds a benchmark discount rate (BDR). The BDR (which is the same formula as the one proposed under the DB funding framework) will be the sum of (i) the government of Canada long bond yield in the month of the valuation, (ii) the proportion of the plan's asset mix allocated to non-fixed income multiplied by 5%, (iii) the proportion of the plan's asset mix allocated to fixed income multiplied by 1.5%, and (iv) 0.5% for diversification.

Contribution Sufficiency Test

A new contribution sufficiency test would be used to ensure that contributions to a TB MEPP meet a minimum threshold. It contemplates:

- the normal cost of the plan
- the PfAD in respect of the normal cost
- going concern special payments set out in previous valuation reports that remain payable, and
- going concern special payments determined in the most recent valuation report.

Where a TB MEPP's negotiated contributions do not satisfy the contribution sufficiency test, the new rules would require that benefits be reduced. However, details of the rules related to benefit reductions will be the subject of a further consultation.

Benefit Improvements

Under the proposed funding framework, a TB MEPP will only be allowed to improve accrued benefits if the plan has sufficient excess assets. This means TB MEPPs will only be permitted to improve benefits if *after the improvement* the plan will still be fully funded on a going concern basis and have a fully funded PfAD.

Section 14.0.1 of the PBA, when proclaimed into force, will allow the government to prescribe circumstances under which a benefit improvement under a TB MEPP will be void.

Commuted Values (CVs)

Due to the fact that benefits provided under TB MEPPs are not guaranteed, the funding framework proposes to use modified rules to calculate a TB MEPP plan member's CV. Under the proposed funding framework, CVs in TB MEPPs would incorporate the plan's going concern assumptions and the plan's going concern funded ratio when calculating the value of a member's benefit entitlement. However, it is anticipated that the modified rules would not take effect until corresponding changes to the Canadian Institute of Actuaries' Standards of Practice have been finalized.

Transition

In order to account for collective bargaining cycles, contribution increases may be phased in over a three-year period in the event that total contributions under the TB MEPP funding framework (i.e. the total of normal cost requirements, including PfAD contributions, and going concern special payments) will exceed those currently required under the SOMEPP or DB funding rules, as applicable.

The government also filed Ontario Regulation 192/18, which comes into force July 1, 2018, to facilitate the transition from SOMEPPs to TB MEPPs. Temporary SOMEPP funding regulations will be extended to expire the earlier of (i) one year after section 81.0.2 of the PBA comes into force; and (ii) January 1, 2024.

Next Steps for Plan Administrators and Employers

Comments on the proposed regulations outlined above are due May 4, 2018.

Other matters related to the TB framework, including funding and governance policies, eligibility requirements, the process to reduce accrued benefits and conversion rules, will the subject of subsequent regulatory postings by the government.

We continue to monitor developments around this issue and will provide you with updates when they are available. Should you have any questions or require further information, please contact Natasha Monkman at 416-864-7302 or your regular Hicks Morley lawyer.
