FTR Now

The Dawn of a New Day: Ontario Pension Funding Rules Are Here

Date: May 1, 2018

Effective today, May 1, 2018, the funding rules for Ontario defined benefit (DB) pension plans are fundamentally changed. Learn how they apply to your plan – and how your organization can prepare for implementation.

On April 18, 2018, the government published a number of regulations under the *Pension Benefits Act* (PBA) to support the new pension plan funding rules, which are applicable to single employer pension plans and jointly sponsored pension plans that are not listed under subsection 1.3.1(3) of the PBA Regulations. Most of these changes come into force May 1, 2018. As discussed in our recent *FTR Now* regarding target benefit plans, these rules are also expected to apply to multi-employer pension plans that do not convert to target benefit plans.

Final details of the new funding rules are set out in O. Reg. 250/18 and related regulations. While the new funding rules generally align with the government's initial proposals (Proposed Rules), discussed in our prior *FTR Now*, *Ringing in the New Year with New Pension Plan Funding Rules*, there are key differences which may have an impact on your organization. This *FTR Now* highlights the new funding framework outlined in O. Reg. 250/18, including those elements that have changed from the Proposed Rules.

Confirmed: New Solvency and Going Concern Funding Rules

Solvency Funding

As expected, the solvency funding rules applicable to DB plans have been materially altered. Solvency special payments are only required if a pension plan is funded below 85%. If a pension plan has a "reduced solvency deficiency," which is the deficiency below 85%, it must be amortized over five years, with payments starting one year after the date of the valuation report.

Letters of Credit

Letters of credit continue to be permitted to be used to fund solvency special payments up to 15% of solvency liabilities. Existing letters of credit can be reduced in respect of the portion of the solvency deficiency that is above 85%.

Going Concern Funding and Provision for Adverse Deviation

Going concern funding has also been modified as expected. If a pension plan has a going concern unfunded liability that arises in a valuation report filed after May 1, 2018, it must now be funded over 10 years (with the exception of certain benefit improvements, as discussed below), instead of 15 years, with payments starting 1 year following the valuation date. Going concern unfunded liabilities established in prior valuation reports may continue to be funded over 15 years. Going concern unfunded liabilities may be consolidated at each valuation date going forward.

The requirement to fund a provision for adverse deviation (PfAD) has been enacted on much the same basis as described in Proposed Rules. Contributions to fund the PfAD in respect of both normal costs (paid with the normal costs) and going concern liabilities (amortized over 10 years) will be required, with the PfAD determined based on a specified formula that is the sum of the following:

- A base percentage depending on whether the DB plan is open or closed to new members. O. Reg. 250/18 specifies that a closed plan is a pension plan “at least one portion of which, according to the terms of the plan, does not permit new members to join and accrue defined benefits.” It is not yet clear whether this definition is intended to capture pension plans where the DB plan is closed to just one class of employees but remains open to new members in other classes of employees.
- A percentage depending on the asset mix of the pension plan. The new funding rules set out detailed formulas for determining the asset mix of pension plans, as allocated between fixed and non-fixed income in accordance with the plan’s statement of investment policies and procedures (SIPP). A pension plan’s actual asset allocation as reported in financial statements may be used for purposes of this element of the PfAD formula in valuation reports dated prior to December 31, 2019.
- A percentage reflecting the excess of the pension plan’s going concern discount rate over a benchmark discount rate, again determined in accordance with detailed formulas set out in the new funding rules.

Reg. 250/18 also clarifies and confirms that the estimated costs of indexation and cost of living adjustments are to be included when determining normal costs and the going concern liabilities of a pension plan. However, liabilities relating to both pre- and post-retirement indexation may be excluded when determining the pension plan’s PfAD on normal costs and going concern liabilities.

Effective Date of New Rules

The new funding rules are applicable in respect of actuarial valuations dated on or after December 31, 2017. That means that the new funding rules apply to valuations due to be filed as early as September 2018. To provide pension plans with valuation dates between December 31, 2017 and March 1, 2018 more time to prepare their valuation reports based on the new funding rules, these plans have been granted a filing extension to November 30, 2018.

The content of valuation reports and cost certificates dated on and after December 31, 2017 must align with new prescribed requirements to reflect the new funding rules.

Benefit Improvement Restrictions

The long anticipated restrictions on benefit improvements when a pension plan is underfunded are effective May 1, 2018. Immediate funding in respect of a benefit improvement will now be triggered if the pension plan is not funded to 80% on both a solvency and going concern basis. This threshold is lower than the triggers that were originally set out in the Proposed Rules, which would have been 90% on a solvency basis and 85% on a going concern basis. The additional unfunded liabilities associated with a benefit improvement must be funded on a going concern basis over eight years, instead of 10 years. Originally, the government proposed that such liabilities be amortized over a shorter period (i.e. five years).

The restrictions will not apply to pension plans if the amendment supporting the improvement was filed prior to May 1, 2018, or implements a benefit improvement agreed to in a collective agreement before May 1, 2018 if the collective agreement is in place immediately before that date. The restrictions will also not apply to any benefit improvement required by law.

Contribution Holidays Framework

O. Reg. 250/18 also prescribes the details to support the provisions of the PBA that govern, and will now further restrict, contribution holidays. Previously, contribution holidays could be taken by applying actuarial gains to reduce contribution obligations when a pension plan is funded to 100% on both a solvency and going concern basis.

Under the new funding rules, contribution holidays may be taken in respect of normal costs or the PfAD on normal costs, if there is “available actuarial surplus” (and no special payments are required or deferred in respect of the pension plan). Determining whether there is available actuarial surplus will differ depending on whether the pension plan is a public sector pension plan, with available actuarial surplus being the lesser of:

(i) the excess of assets over going concern liabilities, the PfAD and the prior year credit balance, and

(ii) for public sector pension plans, the amount if deducted from assets that would reduce the solvency ratio of the plan to 1.05, or, for any other pension plan, the amount if deducted from assets that would reduce the transfer ratio of the plan to 1.05.

The Proposed Rules originally indicated that employers who take a contribution holiday would be limited to using no more than 20% of available surplus that is available each year. This restriction was not adopted in the final rules.

If a contribution holiday occurs in respect of plans other than designated plans or individual pension plans, the employer must file a cost certificate within 90 days of the pension plan's year end and notice must be provided to the plan members and any unions that represent the members of the plan.

Pension Benefits Guarantee Fund Assessments

As previously reported, one of the complementary reforms the government introduced alongside the new funding rules is the enhancement of Pension Benefits Guarantee Fund (PBGF) coverage up to the first $1,500 of monthly benefits. In conjunction with these enhancements, the government also introduced a new formula, effective January 1, 2019, for calculating the assessments employers must pay into the PBGF and assessments will be higher going forward. The assessment formula has been adopted as proposed.

The government had also proposed to eliminate an employer's ability to fund PBGF assessments from a pension plan's surplus. One change in the final rules is that employers will, in fact, be permitted to continue paying PBGF assessments from the pension fund. Under the new rules, to be eligible to pay PBGF assessments from the pension fund, no special payments must be owing or deferred, there must be available actuarial surplus (as discussed above) and the employer will be required to file a cost certificate and distribute notices to plan members and unions representing the members of the plan.

Enhancing Disclosures to Members

As expected, pension plan administrators will be required to include prescribed disclosures to plan members regarding the new funding rules in the first annual or biennial statements issued after a valuation report is prepared under the new funding rules. Annual and biennial statements will also need to include information going forward regarding whether any special payments are required to liquidate any reduced solvency deficiency (if the plan is funded less than 85%) and any going concern unfunded liability.

Effective January 1, 2019, O. Reg. 250/18 also introduces a new requirement for annual and biennial statements to include an estimated transfer ratio of the pension plan up to the end of the period covered by the statement. This is in addition to the existing requirement for statements to identify the transfer ratio of the pension plan as at the date of the last filed valuation report.

Pension Plan Text

Within 12 months of the date the first valuation report using the new rules is filed in respect of a pension plan, the pension plan must be amended to specify the obligation of the employer (and members, if applicable, in the case of a jointly sponsored pension plan) to contribute in respect of

the PfAD in respect of normal costs, additional going concern liabilities associated with a benefit improvement and any reduced solvency deficiency.

Statement of Investment Policies and Procedures

O. Reg. 250/18 also includes a new requirement for SIPPs. Specifically, if not already included, SIPPs must identify a target asset allocation for every asset class specified in the PBA Regulations. Plan administrators must review their SIPPs to ensure that they comply by listing target asset allocations for every prescribed class.

Transitioning to the New Rules

Increased contribution obligations that arise as a result of the new funding rules may be phased in over three years.

Notably, there are additional transition rules applicable to pension plans in the broader public sector, particularly those that previously sought temporary solvency funding relief. A number of corresponding regulations were also published by the government to make conforming changes in respect of various pension plans that have previously obtained plan-specific solvency funding relief.

The new funding rules dramatically impact the pension funding landscape in Ontario and will require careful review by plan sponsors and plan administrators. If you have any questions regarding the new funding rules, please contact any member of our Pension, Benefits & Executive Compensation practice group.

The article in this client update provides general information and should not be relied on as legal advice or opinion. This publication is copyrighted by Hicks Morley Hamilton Stewart Storie LLP and may not be photocopied or reproduced in any form, in whole or in part, without the express permission of Hicks Morley Hamilton Stewart Storie LLP. ©