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RECENT DEVELOPMENTS IN PENSION PLANS:

REFORM OF FEDERAL PLANS / NEW QUEBEC REGULATION RESPECTING BILL 30

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ON OCTOBER 27th, THE HONOURABLE JIM FLAHERTY, MINISTER OF FINANCE, ANNOUNCED AN IMPORTANT PLAN TO REFORM FEDERALLY REGULATED PENSION PLANS[1]. THIS REFORM PLAN IS THE RESULT OF EXTENSIVE CONSULTATIONS THAT BEGAN IN JANUARY 2009 WITH THE RELEASE OF A DISCUSSION PAPER ENTITLED *STRENGTHENING THE LEGISLATIVE AND REGULATORY FRAMEWORK FOR PRIVATE PENSION PLANS SUBJECT TO THE PENSION BENEFITS STANDARDS ACT, 1985*. ACCORDING TO THE MINISTER, THE GOVERNMENT IS PROPOSING "A BALANCED PACKAGE OF MEASURES FOR THE BENEFIT OF PENSION PLAN SPONSORS, PLAN MEMBERS AND RETIREES".

A reform of federally regulated pension plans has been long awaited. Indeed, few major changes have been made to the legislative and regulatory framework applicable to such plans since 1987. While certain measures proposed in the reform plan are identical or similar to rules already contained in provincial pension legislation[2] others are genuinely new and unique[3].

The five principal objectives of this reform plan as well as the main measures proposed in order to meet these objectives are briefly described below[4].

1. ENHANCE PROTECTIONS FOR PLAN MEMBERS

- Any deficit that exists at the time of plan termination will have to be amortized in equal payments by the plan sponsor over a maximum period of five years. Thus, a plan sponsor will have to fund any deficit existing on plan termination, which is not the case under the current federal rules. This new obligation imposed on the plan sponsor will be considered as an unsecured debt in the event of the plan sponsor's bankruptcy.

[1] That is to say, pension plans subject to the *Pension Benefits Standards Act, 1985* (the "PBSA").

[2] For instance, the plan sponsor's obligation to make up the deficit existing on plan termination and the immediate vesting rule in effect in Quebec since 2001.

[3] For instance, the new solvency standard that will be introduced.

[4] Numerous amendments to the PBSA and the *Pension Benefits Standards Regulations, 1985* (the "PBSR") will be necessary in order to implement the various proposed measures.

- Employer contribution holidays will not be permitted if the plan's surplus is less than the new solvency margin that will be established. This solvency margin will be set at 5% of solvency liabilities.
- Any benefit enhancement that would lower the plan's solvency ratio below 85% will be null and void unless it is authorized by the Superintendent or the plan sponsor immediately funds the cost of the enhancement in question.
- Plan sponsors will no longer be able to declare partial terminations. Only the Superintendent will have this power. According to the reform plan, this measure is intended to rectify the "present inequity that treats leaving members differently depending on how their employment tenure ends".
- There will be immediate vesting of benefits, that is to say, effective immediately upon membership in the plan. As it now stands, a member must generally complete two years of membership before accrued benefits are vested. If the member ceases employment before having completed this two-year period, he or she is then only entitled to a return of his or her contributions plus interest.[5]

[5] However, the new immediate vesting rule will not have any impact on the two-year waiting period which an employee must usually complete before being able to actively participate in the plan.

- The requirements concerning disclosure to plan members will be enhanced. For instance, the annual statements sent to members will, among other things, include a summary of the plan's investment allocation and ten largest investment holdings as well as the total contributions made by the employer for the reporting year. An annual statement will also have to be sent to retirees and former members.

2. REDUCE FUNDING VOLATILITY FOR DEFINED BENEFIT ("DB") PLAN SPONSORS

- A new solvency standard for determining funding requirements will be introduced. This new standard will provide for the use of an "average solvency ratio", which will be defined as the average of the solvency ratios over three years (that is, the current year and the previous two years). These three solvency ratios will be determined by using the market value of plan assets. To comply with this new solvency standard, annual actuarial valuations will be required.
- The reform plan also provides that past deficiencies will be consolidated each year to determine the amount of special solvency payments. The amortization period for solvency deficiencies will, however, continue to be five years.
- Plan sponsors will be permitted to use letters of credit to satisfy their special solvency payments up to a limit of 15% of plan assets.
- Because of the provisions of the Income Tax Act (the "ITA"), employer contributions are, at the present time, generally suspended where the plan shows a surplus greater than 110% of the liabilities. This 110% limit will be increased to 125% which, in principle, should allow plans to maintain a larger surplus cushion to protect against economic downturns. As this involves an amendment to the ITA, it will apply to both federal and provincial pension plans.

3. FACILITATE RESOLUTION OF PLAN-SPECIFIC PROBLEMS

- A workout scheme will be introduced to allow the different parties concerned (namely the sponsor, plan members/union(s) and retirees) to resolve problems that may arise where a plan sponsor cannot meet its obligations regarding the funding of the plan. According to the reform plan, this new scheme will only be used in some very limited circumstances, that is, in cases where it is imperative to move away from the legislative and regulatory framework in order to protect the company and the benefits of members/retirees.

- This scheme will allow plan sponsors to benefit from a short-term moratorium on special payments to amortize the deficit(s). During this moratorium, the parties concerned will be able to negotiate modifications to the terms of their plan including the special payment schedule. The modifications thus negotiated between the sponsor, plan members/union(s) and retirees will be subject to Ministerial approval.

4. IMPROVE THE FRAMEWORK FOR DEFINED CONTRIBUTION ("DC") PLANS AND NEGOTIATED CONTRIBUTION DEFINED BENEFIT PLANS

- The PBSA and the PBSR are aimed primarily at DB plans. The reform plan provides that the provisions of the PBSA and the PBSR will be revised to improve and clarify the framework applicable to DC plans and to negotiated contribution defined benefit plans[6].
- In the case of DC plans, the obligations and accountabilities of plan sponsors, members, administrators and investment providers will be clarified[7].
- In addition, DC plans will have the option to permit members to receive their pension benefits in the form of life income fund (LIF) payments directly from the plan fund. This will enable members to continue having their pension savings managed by the plan instead of having to transfer them to another arrangement and thus to assume "greater personal responsibility for the management of the funds".
- Insofar as negotiated contribution defined benefit plans are concerned, the legislative and regulatory framework governing them will be improved in order to, among other things, specify that employer contributions are limited to those negotiated in collective agreements and that the Board of Trustees has the power to amend the terms of the plan so as to reduce accrued benefits[8] where negotiated contributions are insufficient to meet funding requirements.

5. MODERNIZE PENSION FUND INVESTMENT RULES

- The reform plan also proposes various amendments to the investment rules, including repeal of the quantitative limits applicable to investments in natural resources and real estate. The rule that prohibits a pension fund from investing more than 10% of plan assets in any one entity will be amended to provide that this 10% limit must be calculated by using the market value of the assets instead of their book value[9]. Lastly, it will be strictly prohibited to invest any amount of the pension fund in the company itself (for instance, in the plan sponsor's shares).

OTHER MEASURES

In addition to the foregoing, various other measures will be implemented to improve the legislative and regulatory framework applicable to federal pension plans, including, in particular, the following:

- amend the definition of "former member" so that members who have transferred their benefits to a new plan no longer have a say in future distributions of the fund's surplus;
- empower the Minister to enter into agreements with the provinces regarding the administration of multi-jurisdictional plans;
- require that payments owed to the pension plan be made monthly instead of quarterly.

With this reform plan, the Minister of Finance is proposing certain measures that will please members and retirees and others that intend to satisfy employers.

[6] That is to say, plans that pay defined benefits provided for by means of contributions negotiated under a collective agreement.

[7] The *Guidelines for Capital Accumulation Plans* published in 2004 by the Canadian Association of Pension Supervisory Authorities will be taken into account as part of this exercise.

[8] Subject to approval by the Superintendent.

[9] An exception to this new rule will be provided for certain investments, such as those in mutual funds.

As for what is to come, the published reform plan does not indicate when the various required amendments to the PBSA and the PBSR may be adopted. It will be interesting to see how the various stakeholders will receive this reform plan and if all the proposed measures will eventually be adopted or if some of them will be dropped along the way.

OTHER RECENT NEWS: THE QUEBEC GOVERNMENT HAS FINALLY PUBLISHED ITS REGULATION TO IMPLEMENT CERTAIN MEASURES INTRODUCED BY BILL 30

On October 21st, the Quebec government published the *Regulation to amend the Regulation respecting supplemental pension plans*, the main purpose of which is to implement, as of January 1, 2010, certain measures which Bill 30[10] added to the *Supplemental Pension Plans Act* (the "SPPA"). In this respect, it is germane to point out that Bill 30 substantially amended the provisions of the SPPA regarding funding and solvency.

Included among the rules of application set out in the new regulation are those that will allow the implementation of the following two measures introduced by Bill 30:

1. the putting into place of a provision for adverse deviation (PFAD) to cover the risk associated with economic downturns;
2. the possibility for the employer to use letters of credit to fund all or part of its special contributions to amortize a solvency deficit.

[10] *Act to amend the Supplemental Pension Plans Act, particularly with respect to the funding and administration of pension plans*, S.Q. 2006, c. 42, adopted on December 13, 2006.

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