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Blakes Bulletin

Pension & Employee Benefits

Federal Pension Reform Initiatives Now Law

Bill C-9, the *Jobs and Economic Growth Act,* (the Bill) was passed by the Senate and received Royal Assent on July 12, 2010. The Bill, which was initially introduced in the House of Commons on March 29, 2010, implements many of the significant pension reform initiatives previously announced by the Minister of Finance on October 27, 2009, as well as previously announced changes to the application of the goods and services tax (GST) to pension plan expenditures.

The Bill includes a number of significant amendments to the *Pension Benefits Standards Act, 1985* (Canada) (PBSA) that will be of primary interest to the sponsors and administrators of federally registered pension plans. The Bill, however, also contains several changes to the *Income Tax Act* (Canada) (ITA) and the *Excise Tax Act* (Canada) (ETA) that will be of interest to all plan sponsors and administrators.

While a number of the changes came into effect on Royal Assent (i.e., on July 12, 2010), many other changes will come into force on a date or dates to be fixed by proclamation. This will allow co-ordination of effective dates with the adoption of related regulations.

PROVISIONS OF THE BILL NOW IN EFFECT

The following is a high-level summary of the key pension-related provisions of the Bill that are immediately effective:

(i) Pension Surplus Threshold Increased

The 10% surplus threshold under the ITA will be increased to 25% in respect of contributions made for periods of pensionable service after 2009. The Canada Revenue Agency (CRA) 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 had not yet come into force. Note that this change will apply to all Canadian registered pension plans and not just those registered under the PBSA.

Any plan sponsor or administrator having an actuarial report for its plan prepared with an effective date of December 31, 2009, or later should ensure that its actuary consider the application of the new 25% surplus threshold.

(ii) Superintendent Has Power to Designate Actuary to Prepare Report

The federal Superintendent of Financial Institutions (the Superintendent) may designate an actuary to prepare an actuarial report for a plan where she believes it to be in the “best interests” of plan members and former members to do so. The administrator would, however, be entitled to review a draft of the report and would have the opportunity to provide comments. Once finalized, however, the plan administrator would be required to fund the plan in accordance with the designated actuary’s report.

In addition, the Bill clarifies the Superintendent’s authority to require filing of actuarial valuations and financial statements containing information required in or under the authority of the regulations under the PBSA at “any intervals or time” she so directs.

(iii) Multi-Employer Pension Plans May Be Amended to Reduce Benefits

An express provision has been added to the PBSA to permit multi-employer pension plan administrators to amend the plan or funding agreement to reduce accrued benefits, notwithstanding the plan terms, but subject to the Superintendent’s approval.

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Multi-employer pension plan administrators should determine whether such amendments are appropriate in the context of their plans.

(iv) Employers Are No Longer Permitted to Declare a Plan Partially Terminated

While the Superintendent may still order a plan to be partially terminated, employers will no longer be permitted to initiate a partial plan termination.

(v) Joint and Survivor Benefit May Be Paid in Normal Form in Certain Circumstances

In the event of marriage breakdown, if the court order or agreement does not require any part of the member's pension benefit to be distributed to the member's spouse, former spouse or former common-law partner, the plan may permit the adjustment of the benefit so as to be payable in the normal form rather than as a joint and survivor benefit.

Plan sponsors should consider whether it is appropriate to amend their plans to permit such an adjustment.

(vi) Commuted Value Transfers

Plan administrators will be required 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. This rule is expressly worded so as to also cover annuity purchases from the plan.

(vii) GST

The Bill includes amendments to the ETA that would implement proposals published in draft by the Department of Finance on September 23, 2009. The proposed changes are aimed at improving and streamlining the application of the GST to the financial services sector and will substantially change the GST rules applicable to pension plan expenses. For more information concerning the proposals announced on September 23, 2009, see our October 2009 *Blakes Bulletin on Tax* -- New GST Rules for Financial Institutions and Pension Plans.

PROVISIONS OF THE BILL THAT WILL GO INTO FORCE ON A DATE TO BE PROCLAIMED

The following is a high-level summary of the key pension-related provisions of the Bill that will come into force on a date or dates to be proclaimed:

(i) Immediate Vesting of Benefits

Plan members will be vested immediately for all service upon enrolment. Currently, vesting is required after a maximum of two years of plan membership. Given this new accelerated vesting, plan sponsors may consider lengthening the eligibility provisions of their plans. Increasing the waiting period for eligibility will reduce the costs associated with enrolling and terminating short-service employees. There has been no change to the minimum standard that the maximum waiting period for eligibility is 24 months of continuous employment

(ii) Use of Letters of Credit as a Funding Option

Properly structured letters of credit (LOCs) will be allowed to satisfy solvency funding obligations. Although not included in the Bill, the government previously announced that the maximum face value of any such LOC would be capped at 15% of the value of a plan's assets. Employers who choose to rely on an LOC instead of making solvency special payments will be required to periodically certify that any such LOCs meet prescribed requirements. Costs for obtaining, maintaining and cancelling these LOCs may not be paid from the plan.

Once this change to the PBSA has been proclaimed into force, sponsors of plans with solvency deficiencies should consider whether the use of an LOC is appropriate in the circumstances of their particular plan.

(iii) Terminal Funding

Upon the full wind-up of a plan, the employer will be required to fully fund the benefits payable under the plan. Any overpayments that result will revert to the employer. That is, such overpayments will not be classified as "surplus" and, as a result, will not be subject to the PBSA's surplus withdrawal rules.

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(iv) Amendments That Reduce the Solvency Ratio of a Plan to Below a Prescribed Level Are Void

Unless permitted by the Superintendent, a plan amendment will be void if it (i) reduces the plan's solvency ratio and the solvency ratio would be below a prescribed level once the amendment is made or (ii) increases pension benefits or pension benefit credits and the plan's solvency ratio is below the prescribed level. The prescribed level will be prescribed in future amendments to the PBSA regulations, although an earlier government announcement has suggested that this level will be 0.85.

(v) Defined Contribution Pension Plans Permitted to Provide Variable Benefits

Subject to certain conditions, members may receive a variable benefit payment directly from a defined contribution pension plan. This option will permit members to receive a life income fund-type benefit directly from the plan. Plan sponsors should consider whether they wish to amend their plan to permit such benefits.

(vi) Distressed Pension Plan Workout Agreements

Subject to certain conditions, employers and plan member representatives will be able to negotiate a "workout agreement" (i.e., a funding schedule that does not comply with the PBSA's minimum funding requirements) in respect of a defined benefit plan that is not a multi-employer pension plan where the employer does not anticipate being able to meet its statutory funding requirements or is subject to proceedings under the *Companies' Creditors Arrangement Act* or the *Bankruptcy and Insolvency Act*. Any workout agreement must be approved by the Minister of Finance.

(vii) Appointment of Replacement Administrator

Where an administrator is insolvent (or otherwise unable to act), the Superintendent may remove the administrator and appoint a replacement where, in the Superintendent's opinion, it is in the best interests of the members and former members to do so.

(viii) Enhanced Disclosure Obligations

Of particular interest is a new requirement to provide former members and their spouses with an annual statement that discloses the funded level of the plan. In addition, plan administrators will be required to make additional information available to members and former members following plan termination.

(ix) Deemed Trust Provisions

The Bill extends the current PBSA deemed trust provision to (i) accrued payments under a workout agreement for distressed plans (see (vi) above), (ii) 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 (iii) any payments the employer is required to pay to amortize a wind-up deficiency. The Bill, however, includes language that appears to confirm the entire wind-up deficiency in a plan 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 under the new terminal funding provisions (see (iii) above) that have become due but have not yet been remitted to the pension fund in accordance with the regulations made for this purpose.

We will provide updates as further provisions of the Bill become effective.

OTHER FEDERAL DEVELOPMENTS

On June 25, 2010, the federal government announced that it had finalized the draft amendments to the *Pension Benefits Standards Regulations, 1985* (PBSA Regulations), which it had released for comment earlier on May 3, 2010. The majority of these amendments to the PBSA Regulations came into force on July 1, 2010.

The amendments to the PBSA Regulations set out the new minimum funding requirements for defined benefit pension plans and amend certain aspects of the federal pension investment rules. Specifically, the amendments to the PBSA Regulations will, among other things:

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- implement a new standard for establishing minimum funding requirements on a solvency basis that will use average solvency ratios over the three most recent consecutive years rather than the single current year solvency ratio and that will permit past funding deficiencies to be consolidated annually for the purpose of establishing solvency special payments;
- restrict contribution holidays to plans with a solvency margin (in excess of full funding) of at least 5% of the plan's solvency liabilities; and
- eliminate the 5%, 15% and 25% quantitative investment limits in respect of resource and real property investments.

While the new defined benefit funding rules and the contribution holiday restrictions apply only to federally regulated plans, the changes to the federal investment rules may apply to plans in other jurisdictions as most provincial jurisdictions have adopted these investment rules. However, not all jurisdictions have adopted the federal rules as amended from time to time. For example, Ontario adopted the investment rules as they read on December 31, 1999, such that the new rules will not apply automatically in Ontario without the Ontario government amending the regulations under the *Pension Benefits Act* (Ontario) to provide for this.

It should also be noted that the amendments to the PBSA Regulations do not address funding matters linked to the Bill such as the use of LOCs for funding purposes or prescribed rules for funding on plan termination. They also do not include measures for defined contribution plans, other proposed investment changes or rules to complement the new legislative provisions for distressed pension plan workout agreements. Further regulations on these and other matters related to the Bill are expected to be released later this year.

OSFI has also taken certain steps in response to the changes to the defined benefit pension plan funding provisions. Specifically, OSFI has amended the *Directives of the Superintendent Pursuant to the Pension Benefits Standards Act, 1985* (the Directives) to provide that annual valuations will generally be required, subject to certain exemptions for plans that meet the definition of a "designated pension plan" under section 8515 of the *Income Tax Regulations* and plans with solvency ratios greater than or equal to one as at certain dates. The amended Directives also require the filing of actuarial valuations as at the effective date of an amendment to a pension plan that alters the cost of benefits under the plan.

OSFI has also extended the filing deadline for filing actuarial reports for pension plans with year-end dates between December 31, 2009, and February 28, 2010, to September 15, 2010. In addition, OSFI has indicated that while plans that file their actuarial reports prior to July 1, 2010, will not be required to re-file the report, any such plans that wish to use the modified funding rules may re-file the report by December 31, 2010.

Finally, OSFI has stated that, starting in 2011, the remittance requirement for normal cost and special payments for federally regulated pension plans will change from quarterly to monthly. Employers who currently remit quarterly will need to make arrangements to adjust the frequency of their contributions and ensure that the plan custodian and investment managers are aware of the change.

For further information, please contact a member of the Blakes Pension & Employee Benefits Group.

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