



Special Notice

August 26, 2010

Ontario pension law reform: stage two

On August 24, 2010, the Ontario government released a second set of proposed reforms to modernize Ontario's pension system. The proposals are based on recommendations from the Expert Commission on Pensions and reflect consultations with various stakeholders. Stage one, released in December 2009 (Eckler's *Special Notice* — [Ontario pension law reform: stage one](#)), dealt mainly with technical issues. The proposed reforms in stage two address funding rules for defined benefit (DB) plans, clarification of pension surplus rules and changes to the Pension Benefits Guarantee Fund. The proposals will permanently exempt certain multi-employer pension plans (MEPPs) and jointly sponsored pension plans (JSPPs) from solvency funding. The main changes proposed under stage two are outlined in this *Special Notice*.

Strengthening funding rules and benefit security

The government is planning the following changes to tighten the rules for valuing DB pension plans and to improve benefit security:

- current interest rates will be required to value plan liabilities for solvency; the option to use an average of solvency interest rates will be eliminated;
- smoothing of going-concern assets will be limited to no more than the last five years;
- the smoothing adjustment to assets used for going-concern and solvency valuations will be capped to within 20% of market value;
- the value of future contractual indexation will be required to be included in going-concern liabilities; excluding it from solvency liabilities will still be permitted;
- annual valuations will be triggered based on a uniform solvency funding threshold of 85%;
- funding of benefit improvements over no more than eight years on a going-concern basis; current rules permit up to 15 years;
- any benefit improvements that would reduce the going-concern funded ratio or transfer ratio below 85% must be funded by a lump-sum payment to prevent a reduction of the ratios, with any remaining cost funded over a period no longer than five years;
- permit employers to use letters of credit to cover as much as 15% of the solvency liabilities; and
- allow up to a one-year deferral of the amortization of going-concern and solvency special payments from the valuation date.

In addition, the government will be able to make regulations regarding acceptable actuarial methods and assumptions.

Contribution holidays

Contribution holidays will be permitted if:

- they are not prohibited by the plan text;
- they do not reduce the plan's transfer ratio below 105%;
- they are fully disclosed to members, retirees and other beneficiaries of the plan; and
- annual statements are filed with the regulator to confirm eligibility.

Funding requirements for MEPPs and JSPPs

The Expert Commission on Pensions recommended that MEPPs and JSPPs should be allowed more flexibility in funding due to their joint governance, risk sharing, the ability to reduce benefits and the absence of coverage under the Pension Benefits Guarantee Fund. As an acknowledgement of these differences, the government is proposing that “target benefit” MEPPs and JSPPs:

- be exempt from solvency funding requirements, provided certain criteria are met, including the ability to reduce accrued benefits; enhanced disclosure will be required; all members have to be employed in a jurisdiction that does not require solvency funding;
- fund any benefit improvements that would reduce the going-concern funded ratio below 85% over a period no longer than five years; and
- permit “target benefit” MEPPs that are exempt from solvency funding to reduce benefit levels to the greater of the transfer ratio or going-concern ratio when an individual elects to transfer a commuted value from an underfunded plan.

These proposals will be welcomed by most MEPPs and JSPPs, but the conditions attached will require enhanced disclosure to members, and clarification of benefit reduction and asset distribution processes.

Sustainability of the Pension Benefits Guarantee Fund (PBGF)

The PBGF provides protection to Ontario members and beneficiaries of privately sponsored single-employer defined benefit pension plans in the event of plan sponsor insolvency. It is intended to be self-financing through annual premiums based on the number of members and the size of the solvency shortfall. To mitigate risk and to provide a more sustainable fund, the government is proposing that:

- assessments will be increased by:
 - establishing a minimum of \$250 per covered plan;
 - raising the base per-member fee from \$1 to \$5;
 - raising the maximum per-member fee in an underfunded plan from \$100 to \$300;
- the overall assessment cap for underfunded plans will be eliminated; and
- the exclusion period from PBGF coverage for new plans and for benefit improvements in existing plans will be extended from three to five years.

These proposals are in addition to the \$500-million grant to the PBGF announced earlier this year.

Temporary solvency funding relief for universities and other broader public sector plans

The government reconfirmed its earlier August 2010 announcement on temporary solvency funding relief for broader public sector plans. A two-stage process is proposed, applying retroactively for valuations with an effective date on or after December 31, 2009. Plans can enter the first stage if they are less than 90% funded and submit a plan to the Ministry of Finance outlining how the plan can be made more sustainable. During the three-year period of this first stage, the plan can fund to a lower solvency threshold. After three years, plans which can demonstrate that sufficient steps have been taken towards sustainability will be permitted to enter the second stage, which will provide the sponsor with up to 10 years to implement plan changes and to liquidate solvency deficits. Failure to pass the sufficient sustainability test will require transitioning back to the regular funding rules. Contribution holidays and benefit improvements will be restricted while under funding relief.

Surplus ownership

The government is proposing to allow payment of surplus to the employer from an ongoing plan if the employer is entitled to it, or where the employer secures consent of 2/3 of the active and retired members, or bargaining agents. In addition, the remaining surplus must be no less than the greater of:

- 25% of wind-up liabilities, and
- twice the current service cost plus 5% of wind-up liabilities.

Payment of surplus on a plan wind-up where a sharing agreement cannot be reached will be subject to a binding arbitration process.

Other changes

In addition to modernizing the pension system, the government is also looking to provide flexibility, create more opportunities for plan innovation and reinforce the regulatory system in general. The government proposes to:

- permit defined contribution plans to pay variable benefits (similar to Life Income Funds);
- allow flexible DB plans, which give members the opportunity to purchase enhanced “ancillary” benefits without affecting their registered retirement savings plan contribution room;
- investigate other forms of “target benefit plans”, including jointly governed, single-employer plans for employees represented by unions or union-like organizations;
- allow reasonable expenses to be paid directly from the pension plan fund, unless expressly prohibited by the plan terms;
- adopt the recent changes to the federal pension fund investment rules, eliminating the 5%, 15% and 25% quantitative investment limits in respect of resource and real property investments, and continue to review the appropriateness of the 30% pension investment rule; and
- enable the Minister of Finance to enter into the proposed CAPSA Agreement Respecting Multi-Jurisdictional Pension Plans, which would provide a clearer legal framework for multi-jurisdictional plans.

The proposals included in stage two of pension reform will need to be passed by the Ontario Legislature before further details can be provided in draft regulations. The government plans to begin this next step in the fall of 2010. To date, the provisions of stage one of the reforms have been released in Bill 236, but have not yet been fully proclaimed into force, and are still awaiting completion of the required regulations.

The government is encouraging comments on the reforms. The two stages released so far cover about two-thirds of the recommendations made by the Expert Commission. The remaining recommendations will be considered in future reforms. This, coupled with the stage-two proposal to require the Pension Benefits Act to be reviewed every five years, means that pension plan sponsors should anticipate regular changes in the future. Eckler will continue to provide detailed analyses of the requirements as the regulations are released.

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