24 May 2019

Nova Scotia Releases Paper on Improved Funding for Pension Plans

On May 10, 2019, the government of Nova Scotia released a paper titled "*Improved Funding Framework for Nova Scotia Pension Plans – The Road Forward*" (the Paper). The Paper provides an overview of proposed regulatory changes, changes to the funding framework for Defined Benefit (DB) pension plans, and general pension reform, and requests input on technical issues identified as potential obstacles to regulatory reform.

This *Special Notice* provides an overview of the topics in the Paper that will be of interest to pension stakeholders.

Summary

The Paper advises that DB pension plans that are currently exempt from solvency funding requirements (e.g., municipalities, universities, school boards, Specified Multi-Employer Pension Plans [SMEPPs]) will continue to be exempt but will be required to abide by enhanced going concern funding rules. **This is a new development for all these types of DB plans.**

DB pension plans that are currently subject to solvency funding are now eligible for a revised minimum funding solvency threshold of 85% of solvency liabilities, along with the enhanced going concern funding framework. However, the 85% solvency threshold is subject to meeting the member consent requirements that will be discussed in this notice. The consent requirements are a notable difference from recent new funding frameworks introduced in Ontario and Quebec.

The government is still reviewing the approach to enhanced going concern funding, with the Ontario and Quebec approaches still under considerations, and requests input in this area.

The Paper is part of a broad review of Nova Scotia's funding framework for pension plans and consultations that began with the release of a September 2017 paper, "*Pension Funding Framework Review and other issues affecting pension plans*," and a subsequent consultation period that was summarized in a second paper released in April 2018, "*Pension Funding Framework Review: What We Heard*."

Recent Legislative Reforms

The current Paper reviews the legislative reforms in *Bill 109, Pension Benefits Act (amended)* (Bill 109), which received Royal Assent on April 12, 2019. Bill 109 introduces several changes to funding in the *Pension Benefits Act*, including:

- Allowing for the establishment of "reserve accounts" to hold solvency deficiency payments and other prescribed contributions in a separate reserve account. Withdrawals from the reserve account are subject to the Superintendent's approval, and would only be allowed on plan wind-up.
- Removing the current limits on the use of letters of credit. Currently, the *Pension Benefits Act* limits the use of letters of credit to fund solvency deficiencies to a maximum of 15% of solvency liabilities.
- Allowing the discharge of liability for annuity buyouts for a DB plan that is not wound up.
- Clarifying the definition of deemed trusts under the *Pension Benefits Act*, including a provision that deems such amounts to be held separately from an employer's other assets in the event of liquidation, assignment or bankruptcy.
- Clarifying that information filed, collected by or submitted to the Superintendent in relation to a pension or a pension plan be kept confidential and not be disclosed except to members, beneficiaries, or others who are entitled to that information.

The Paper notes that the reforms in Bill 109 are anticipated to come into effect in fall 2019, and regulations are currently being developed.

Changes to Funding Framework for Defined Benefit Pension Plans

The Paper notes that while obligations to fund DB pension plans are broadly set out in legislation, there are technical details on funding requirements contained in regulations.

Solvency Funding

The Paper proposes amendments to the regulations that would permit DB plan sponsors to elect (on a go-forward basis) to permanently fund their pension plans up to an 85% solvency standard, rather than 100%. Under the new solvency funding regime, plan sponsors will be required to amortize solvency deficiencies on a five-year basis with no consolidation of the prior year's deficiencies. New plan members must be informed of the plan's solvency funding standard when joining the plan, and the election to permanently fund to the 85% level can only move forward if fewer than one-third of all eligible plan participants object to the new solvency funding standard. Regulations governing the way elections must be conducted, and the information that must be provided to plan members in advance of the election are forthcoming.

Enhanced Going Concern Funding Rules

The Paper proposes funding going concern deficiencies over a 10-year period rather than a 15-year period. Special payments will be permitted to be consolidated with prior years' deficiencies into a single schedule.

The Paper also notes that a Provision for Adverse Deviation (PfAD) must be established and applied to the plan's liabilities, but not to the current service cost. The PfAD must be funded in the same manner as any other going concern obligations.

Establishing a PfAD

The Paper proposes two different options as the required methodology for calculating a PfAD. Both options would be supplemented by an additional amount if the pension plan were to use a discount rate that exceeds a specified level, such as Ontario's Benchmark Discount Rate.

Option 1 would require that the PfAD be determined by a two-dimensional grid, which considers the ratio of the duration of assets to the duration of liabilities, a measure of interest rate risk, and the percentage of the plan's assets invested in variable income securities. This approach is similar to the methodology adopted by Quebec.

Option 2 would determine the PfAD based on the percentage of the plan's assets invested in variable income securities, plus a fixed component to apply to all plans. This approach is similar to the methodology adopted by Ontario – though Ontario has a further distinction between "open" and "closed" plans.

The Paper proposes that a three-year transition period be put in place for pension plans with increased contribution requirements as a result of whichever funding regime is chosen. The government anticipates that after an initial period of fluctuating funding costs, in the long-term, funding requirements should be less volatile and further changes such as solvency relief will be unnecessary.

Any plan electing to use the new solvency funding standard will be required to notify plan members of their intention and provide an opportunity to voice their concerns. As noted earlier, the election can only move forward if fewer than one-third of all eligible plan participants object.

Solvency-Exempt Pension Plans

The Paper notes that DB pension plans that are currently exempt from solvency funding requirements (e.g., municipalities, universities, school boards, multi-employer pension plans) will continue to be exempt but will be required to abide by the enhanced going concern funding rules. Proposed regulatory changes will allow for annual cost certificates to be used by solvency-exempt DB plans that exhibit solvency concerns – those that have a ratio of solvency assets to solvency liabilities that is less than 0.85 – with a full actuarial valuation filing every three years.

Pension plans that are exempt from solvency funding requirements will be entitled to make benefit improvements funded over five years if they meet solvency requirements.

Other Issues to Consider

It is yet to be determined if the proposed changes to the rules related to benefit improvements will apply to Specified Multi-Employer Pension Plans (SMEPPs), which are currently able to improve benefits subject to funding over five years. If the changes do apply to SMEPPs, they may impose a restriction on improvements, due to a required minimum solvency position, in addition to the application of the PfAD to plan costs.

The funding proposal features some differences from the new single-employer pension plan funding frameworks recently adopted in other Canadian jurisdictions, such as Quebec and Ontario. Quebec eliminated solvency funding targets entirely for plans with Quebec members only, and adopted a 75% solvency funding target for multi-jurisdictional plans effective January 1, 2019, whereas Ontario moved to an 85% solvency funding target. Notably, neither Quebec nor Ontario require member consent for moving to the new funding frameworks. The proposed requirement to obtain consent may present challenges for many plan sponsors.

Both Quebec and Ontario also introduced a PfAD for going concern funding (structured similar to Option 1 and Option 2, respectively), and both also require the PfAD to be added to current service costs, whereas Nova Scotia's proposal does not. Additionally, while both Quebec and Ontario strengthened the rules related to the process through which benefit improvements may be enacted and/or funded under their new frameworks, information on this is absent from Nova Scotia's proposal.

Other Regulatory Issues

The Paper also notes other pension reforms to be implemented by the government, including:

- Requiring employers who wish to take a contribution holiday to retain at least a proposed funding level of 110% on a going concern and solvency basis after the contribution holiday is taken;
- Individual pension plans established in respect of "owners or significant shareholders" will be exempt from solvency funding and certain filing requirements; and
- Federal-permitted investment rules will be incorporated so that any changes to those rules are automatically applied in Nova Scotia.

Timelines and Feedback Requested

The government has requested feedback on several technical issues, and invites comments from interested stakeholders by June 21, 2019, including:

- The types of employer contributions that should be permitted to be paid into a reserve account;
- The most appropriate going concern PfAD, including whether or not there is a preference for Option 1 or Option 2, and the rationale for that preference;
- Whether there should be a different PfAD for solvency-exempt or public-sector plans;
- The possible use of an additional PfAD to apply for pension plans using aggressive discount rates;
- A proposed three-year transition period for pension plans that must pay increased contributions under the new rules; and
- A proposed contribution holiday threshold of 110% funding on both going concern and solvency bases.

The government anticipates that the proposed reforms will be introduced and effective in the fall of 2019. Interested stakeholders are invited to submit comments by June 21, 2019. Eckler will also make a submission.

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