

**Strengthening the Legislative and Regulatory Framework
for Private Pension Plans Subject to
the *Pension Benefits Standards Act, 1985***

**Financial Sector Division
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Consultation Paper**

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1. Introduction

Private employment-related registered pension plans form one component of Canada's retirement income system. Many of these plans are regulated under federal or provincial pension standards legislation and are registered pension plans (RPPs) under the *Income Tax Act*. To qualify as RPPs, pension plans must be registered with the Canada Revenue Agency and meet the requirements of the *Income Tax Act*. As an RPP, a pension plan receives tax-deferred treatment, which assists Canadians to save for retirement and permits employers to offer cost-effective compensation packages. Employers may also sponsor pension plans that are not registered plans, typically to provide benefits in excess of the maximum limits under the income tax rules (these non-registered plans do not receive tax-deferred treatment).

Registered pension plans must also follow the standards set out in the pension legislation, which typically involves minimum standards for funding, investment, membership eligibility, vesting, locking-in, portability of benefits, death benefits and members' rights to information. For pension standards purposes, plans can be registered under federal or provincial jurisdiction. Plans sponsored by employers in federally regulated industries, which include banking, inter-provincial transportation and telecommunications, are considered part of the federal jurisdiction, and along with plans located in Nunavut, the Yukon and the Northwest Territories, are regulated under the federal *Pension Benefits Standards Act, 1985*. All employees of federally regulated employers are subject to this Act regardless of their place of employment. The plans of other employers are regulated at the provincial level. This paper is designed to specifically address the federal *Pension Benefits Standards Act, 1985* and its associated Regulations.

Canada's Retirement Income System

Promoting the retirement income security of Canadians is an important goal of the Government of Canada. To this end, Canada has a three-pillar retirement income system based on a balanced mix of public-private responsibility and voluntary-compulsory programs.

First Pillar: The Old Age Security and Guaranteed Income Supplement programs provide a basic, minimum income guarantee for seniors who meet residence requirements.

Second Pillar: The Canada and Quebec Pension Plans ensure a basic level of earnings replacement in retirement for all workers in Canada.

Third Pillar: The system of voluntary tax-deferred savings in RPPs and Registered Retirement Savings Plans (RRSPs) encourages and assists

Canadians to save for retirement to help bridge the gap between public pension benefits and their retirement income goals.

Canada's retirement income system is internationally recognized for its adequacy, affordability and sustainability. The two public pillars of the retirement income system are strong. The Old Age Security and Guaranteed Income Supplement programs are funded out of general tax revenues, and are thus supported by the strong fiscal position of the government. Recent estimates by the Chief Actuary show that the Canada Pension Plan is expected to be sustainable at current contribution rates for at least the next 75 years.

The third pillar is a key component of the retirement income system. This pillar provides Canadians with incentives to save for retirement and help bridge the gap between public pension benefits and their retirement income goals. In 2007, assets in RPPs and RRSPs amounted to almost \$2 trillion, or about 130 per cent of GDP. The third pillar provides almost \$40 billion in annual income to those aged 65 and older, representing 44 per cent of retirement income system payments received by seniors.

Over the past several years, a number of improvements have been made to the third pillar to support private retirement savings. Increases to the RPP and RRSP dollar limits were announced in both 2003 and 2005 to support savings, investment and economic growth and allow Canadians to better meet their retirement savings needs. In 2009, the RRSP dollar contribution limit is \$21,000 and the RPP dollar contribution limit is \$22,000. These increases continue to be implemented. More recently, the government has acted to improve the third pillar by increasing the RPP/RRSP maturation age to 71 from 69, permitting more flexible phased retirement arrangements under defined benefit RPPs, allowing pension income splitting, and doubling the pension income tax credit amount. The government has also acted to improve savings opportunities for Canadians by introducing the new Tax-Free Savings Account, starting in 2009.

One of the key challenges facing Canada is an ageing population. In 2005, approximately 13 per cent of the population was older than 65. By 2031, this percentage is expected to exceed 25 per cent. In light of the growing retiree population, ensuring that Canada's retirement income system is effective in enabling Canadians to achieve sufficient means in retirement is an essential goal.

The objective of this paper is to seek views on the most appropriate means of enhancing the legislative and regulatory framework for registered pension plans subject to the *Pension Benefits Standards Act, 1985* (the Act). It covers both defined benefit and defined contribution plans, and includes: i) issues on which there has been widespread consultation and support from most stakeholders; ii) issues where there is less consensus and where there is a need for further consultation; and iii) new topics for discussion. The paper also discusses issues pertaining to multi-employer pension plans and other elements of the pension

framework. In addition, the paper is seeking the views of Canadians on the investment regulations applying to pension plans governed by the Act. Any structural changes arising from this consultation will need to consider the Act and the framework as a whole.

In May 2005, the Department released a consultation paper on federally-regulated defined benefit pension plans. During this consultation, many stakeholders indicated that solvency funding requirements were a pressing concern requiring immediate attention. In response, the government brought into force the temporary *Solvency Funding Relief Regulations* (the Regulations)¹. Solvency funding requirements are again a concern, and the government has responded with the announcement of funding relief in the November 27 Economic and Fiscal Statement. As a result, a key component of this consultation is the examination of elements of the solvency framework to ensure that the rules respecting solvency funding are appropriate.

The government is looking to improve the legislative and regulatory framework to respond to concerns that have been raised by stakeholders. While the list of issues raised herein is not exhaustive, this paper identifies a number of key questions related to these goals and how to balance the interests and incentives of plan sponsors and plan members in advancing them.

Following the receipt of written comments, the Parliamentary Secretary will initiate a series of public meetings across Canada with key stakeholder groups, including those representing sponsors, labour, retirees, and pension professionals to more directly explore specific proposals, and encourage a discussion on the potential tradeoffs, such as between enhancing safeguards for plan members' benefits and allowing more funding flexibility to plan sponsors. In addition, we are exploring other opportunities to engage stakeholders, such as the Parliamentary Secretary participating in various pension fora, some of which are set to take place as early as January, 2009. In order to address structural issues in legislation and give greater certainty before next year's pension filing deadline, the government intends to issue a final report recommending measures and summarizing comments received during the consultation in early June, 2009 so that legislative and regulatory amendments could be drafted by the Fall of 2009.

¹ As of March 31, 2008, 75 plans availed themselves of the funding relief offered under these regulations. The regulations offered four forms of funding relief for private pension plans. Forty-four took advantage of the option allowing for the consolidation of all outstanding solvency payment schedules into a new five-year schedule. Eleven took advantage of the option that allowed the solvency funding period to be extended to 10 years with agreement from plan members and retirees. Seventeen plans took advantage of the option that allowed the solvency funding period to be extended to 10 years with the difference in payments secured with a letter of credit. Three plans availed themselves of the option for agent Crown corporations.

2. Context

Pension plans registered under the Act include defined contribution and defined benefit pension plans. Under defined contribution plans, contributions are made to an individual account for each member, with benefits on retirement based on the amount contributed to the account plus any investment income, expenses, gains and losses; benefits paid are therefore subject to the return on investment. Defined benefit pension plans provide members with benefits related to their earnings and years of service. As a result, defined benefit plans are designed to provide more predictable retirement income for plan members because the sponsor commits to delivering a certain level of benefits and incurs the risk associated with delivering on that promise. The risk associated with the increased funds required due to reduced investment returns and unanticipated increases in longevity is principally, but not entirely, borne by the sponsor in the case of defined benefit plans, while it largely rests with the plan member in defined contribution arrangements.

While private pension plans are voluntary, they must generally be registered with the Canada Revenue Agency for tax purposes, and either the federal or provincial regulator, depending on the business line of the sponsoring employer. Private pension plans established for employees working in areas that fall under federal jurisdiction are subject to the Act. The Act covers some 1,350 pension plans or close to 10 per cent of the asset value of all registered plans in Canada; 351 of the federal plans are defined benefit pension plans, 904 are defined contribution arrangements, and 95 are combination plans offering both defined benefit and defined contribution components.² One of the main purposes of the Act is to set out minimum standards for federally registered pension plans to ensure that the rights and interests of pension plan members, retirees, and their beneficiaries are protected. Private pension plans, however, represent an agreement between stakeholders and the Government of Canada's role is to ensure that the framework is appropriate and enables all parties to make informed decisions.

While each jurisdiction in Canada has its own legislative and regulatory framework, in many respects the major provisions are similar. Pension plans in all jurisdictions are facing similar issues, and some provinces, including Quebec, Ontario, Nova Scotia, British Columbia and Alberta having conducted public consultations. In certain cases, changes have been made to legislative frameworks.

Improvements in the legislative and regulatory framework should be aimed at improving the security of pension plan benefits and ensure that the federal legislative and regulatory framework is balanced and appropriate in its incentives to establish and/or maintain pension plans. Considering these objectives,

² See Annex for further statistics on federally registered pension plans.

changes to the framework should be approached with the following principles in mind:

- 1) The rules governing private pensions should be reflective of the voluntary and contractual nature of the arrangement;
- 2) Employees and retirees should have the information to make informed decisions; and
- 3) The legislative and regulatory framework should ensure that certain minimum standards are met in order to ensure a level of benefit security for plan members.

Pension Surplus Threshold

One issue that falls outside the purview of the federal pension benefits standards rules is the current 10-per-cent pension surplus threshold over which employer contributions to a defined benefit pension plan must generally be suspended. The pension surplus threshold falls under the income tax rules which apply to all pension plans, whether federally or provincially regulated. These rules allow employers to make whatever contributions are necessary to ensure that pension benefits are fully funded. However, if plans have going-concern surpluses over a specified threshold (generally 10 per cent of liabilities), employer contributions must generally be suspended (employee contributions may continue regardless of the amount of surplus). The purpose of the pension surplus tax rules is to limit the tax deferrals associated with funds over and above those required to finance the benefits promised under the plan.

A number of pension experts and commentators have suggested that the 10-per-cent surplus threshold be increased to permit plans to maintain a larger surplus cushion to protect against market downturns and thereby reduce the risk of funding deficiencies. The Government of Canada will review the level of the pension surplus threshold with a view to ensuring that it provides adequate funding flexibility for defined benefit pension plans while appropriately controlling excess tax deferrals.

Temporary Funding Relief

The global credit crisis has led to a sharp decline in global equity markets that has reduced the funded status of federally regulated private pension plans; the effect of the decline in plan assets is to require sponsors to increase their payments to the plan to ensure it is funded on a solvency basis (see below). The magnitude of these special payments could damage the financial condition of the companies that sponsor these pension plans and divert available funds away from investment in the growth of those companies. These problems would be especially pronounced given current conditions in credit markets.

To recognise the impact of present extraordinary circumstances on defined benefit pension plans, temporary solvency funding relief was proposed in the 2008 Economic and Fiscal Statement for defined benefit pension plans under federal regulation. The proposed funding relief would allow plans to extend their solvency funding payment schedule to 10 years from 5 in respect of solvency deficiencies that emerged in 2008, subject to certain conditions. In particular, both members and retirees would need to agree to the extended schedule, or the difference between the 5- and 10-year payment schedules would need to be secured by a letter of credit. One of these two conditions would need to be met by December 31, 2009. If agreement by plan members and retirees or a letter of credit were not secured by the end of 2009, the plan would be required to fund the deficiency over the following 5 years. Draft regulations to enact this proposal will be made available in Part I of the Canada Gazette for public comment at an early opportunity.

3. Issues for Discussion Pertaining to Defined Benefit Plans

The following outlines issues on which the Government of Canada is seeking views. Many of these issues were raised during the consultation in 2005; as a result, the items below reflect the broad range of views received at that time.

A. Solvency Measurement and Funding Rules

Defined benefit pension plans are subject to stringent funding rules, both on a going concern basis, which values the plan's liabilities using assumptions consistent with the plan's continued existence, and a solvency basis, which uses assumptions consistent with the plan's immediate termination. Deficiencies on a going concern basis must be funded over a period of no more than 15 years, solvency deficiencies over no more than five years. Plan valuations are determined using standards and practices set by the Canadian Institute of Actuaries, the actuarial industry body, in order to ensure that the standards reflect appropriate industry practice. When a plan is in a surplus position, the administrator is generally required to file a valuation report with the Office of the Superintendent of Financial Institutions (OSFI), the regulator, every three years. If the plan is in deficit, OSFI generally requires a valuation report to be filed annually. The regulator has the power to request valuation reports at a more frequent basis if necessary.

Solvency funding is intended to protect the benefits of members and retirees in the event that a plan terminates. Because they are based on the values needed to fully discharge a pension plan's obligations in a termination scenario, solvency valuations and the associated funding requirements aim to ensure that pension plan assets are adequate to provide members with promised benefits, should the plan sponsor fail or terminate the plan. The government believes that the requirement to fund on a solvency basis is important in enhancing benefit security for plan members. However, the requirement can, under certain economic and financial conditions, put significant strain on plan sponsors'

resources. Solvency funding requirements are also relatively sensitive to changes in interest rates and the market value of pension assets, which can make it difficult for plan sponsors to establish a stable level of funding for their pension plans, in relation to their other cash requirements.

In recent years, volatility in the funded status on a solvency basis has increased significantly. As a result of the market downturn that began in mid-2008, many pension plans now expect that a solvency valuation of their plan will reveal a significant solvency deficiency for the end of their respective plan years. This would result in substantial financial pressure on many sponsors, as pension contributions would increase to comprise a significant portion of operating expenses. In response, the government has recently offered temporary solvency funding relief, for the second time in as many years. This suggests that the current requirements should be reviewed. In particular, the government is interested in examining whether adjustments should be made that would be consistent with the objective of enhancing benefit security, but also provide a more stable funding framework.

A common suggestion in this regard has been to change the funding period (both extensions and contractions in the funding period were suggested in the 2005 consultation, as well as linking the period to the financial strength of the sponsor). Letters of credit have been put forward as a means of satisfying solvency payments, and indeed, were used in the 2006 *Solvency Funding Relief Regulations*, and adopted for this purpose by other jurisdictions, including Quebec, Alberta and British Columbia.

The advantage of properly structured letters of credit is that they permit employers to provide increased security to plan members in the event of, for example, insolvency, while providing greater funding flexibility to plan sponsors. The key issue in permitting letters of credit, as an alternative or complement to solvency funding, is to ensure that a letter of credit would provide a level of security generally comparable to the payment of money into the pension fund. Letters of credit also respond to the 'trapped capital' issue that has been raised by sponsors: in situations of volatility – particularly in discount rate levels – funded positions can change dramatically in a short period of time. In such cases, sponsors have expressed concern that payments to the fund immediately prior to a rapid improvement in funded position would lead to capital being 'trapped' in the pension fund. Letters of credit, on the other hand, can be released if the pension returns to a fully funded position

An important component of the solvency funding framework is the discount rate used in the determination of a plan's liabilities. The Act calls for valuation reports to be prepared in accordance with the standards developed by the Canadian Institute of Actuaries (CIA), except as specified by the Superintendent. The Regulation prescribes that commuted values offered to plan members electing portability options must be determined in accordance with CIA standards. The Superintendent's authority to issue specifications with respect to valuation reports

does not extend to the determination of commuted values, which is a key element of the solvency calculation. The authority of issuing a specification would be used in a case-specific situation where there is a need to supplement standards or narrow the range of accepted practice. While the specific rates used in the preparation of the valuation follow the industry standards, questions have been raised about the appropriateness of the current requirement that bases the discount rate on a long-term Government of Canada bond plus an adjustment factor.

The ongoing uncertainty as to the ownership of surplus in a plan has also been identified as an impediment to the appropriate funding of plans. Many plan sponsors and pension experts have argued in the absence of contractual clarity, the Act has the effect of requiring the plan sponsors to share any surplus while remaining fully responsible for pension plan deficits. There is also the uncertainty of surplus distribution during partial termination, where the surplus is notional until the full termination of the plan. As a result, plan sponsors claim that they are discouraged from contributing more than the required minimum.

On the other hand, some members of plans registered under the Act have argued that pension benefits are deferred compensation, paid as a consequence of contract negotiations that would otherwise have been paid in another form. Plan members bear some risk of not obtaining fully promised benefits and may be exposed to increased contributions, reduced benefits, or wage concessions as a result of the sponsor being forced to fund its pension deficits. In this context, it is argued that plan members ought to have a claim to the surplus.

The government is seeking views from stakeholders on the ongoing appropriateness of solvency valuations and solvency funding requirements in their current form. In assessing any suggestions put forward, the government will consider the goal of reducing volatility in funding requirements, while ensuring the protection of pension benefits.

The Government of Canada is interested in stakeholders' views regarding the rules for funding solvency deficiencies and the solvency calculation itself.

B. Requiring Full Funding on Voluntary Plan Termination

Pension regulations permit defined benefit pension plans to be less than fully funded provided that they are making payments required to amortize funding deficits over specified periods. This provides reasonable benefit security for plan members while providing plan sponsors with flexibility to address any funding shortfall over a manageable period. There is, however, the possibility under existing rules that a pension plan will be voluntarily terminated by the sponsor at a time when plan assets are not sufficient to pay the full amount of promised benefits.

Amending the regulations to require full funding of pension benefits on plan termination would enhance benefits security for plan members. It would also improve incentives for plan sponsors to fund their pension plans because it would remove the possibility of terminating a defined benefit pension plan as a way of not addressing a funding deficit.

Specific rules would need to be put in place in order to provide an appropriate time period over which to fund the outstanding deficit at the time of voluntary termination. One means of providing plan sponsors with an appropriate period to fund solvency deficits on plan termination is to specify that the deficit must be paid according to the payment schedule in place at the time of the termination, and any new solvency deficit identified at the time of termination must be amortized over no more than five years. The obligations of the employer determined following the termination would be considered unsecured debt of the company. The payments when due would still be governed by the Act; consequently, when due, they would fall under the deemed trust provisions of the Act.³

However, in certain situations, it may be appropriate to have the final settlement of the plan subject to some negotiated agreement between the sponsor and plan members. This agreement may provide that the plan would not be fully funded at termination, so long as appropriate consideration was given in place of full funding, subject to certain minimum standards.

The Government of Canada is seeking views on whether to require that plan sponsors fully fund pension benefits when a plan is fully terminated, but provide that payments can be made over a period of five years, and treat the outstanding obligation as an unsecured debt of the company. In addition, the Government is seeking views on conditions, if any, where a plan could be terminated in an underfunded position by virtue of an agreement between the sponsor and plan members.

C. Partial Termination and Immediate Vesting

A partial termination of a pension plan may be declared by the employer or by the Superintendent of Financial Institutions and is usually a result of downsizing or reorganization causing layoffs. Upon a partial plan termination, affected employees cease to be members of the plan, with their accrued benefits fully vested – meaning that they have full rights to their accrued benefits – as of the effective date of partial termination.

Recently, the Court of Appeal found in the case *Cousins et al. v. Attorney General of Canada and Marine Atlantic Inc.* (Marine Atlantic) that the Act does

³ Under Sections 8(1) and 8(2) of the Act, contributions owing, but not yet remitted to the pension fund are deemed to be held separate from the employer's assets. Under bankruptcy, these monies do not form part of the employer's estate regardless of whether or not they were actually held separate.

not require distribution of surplus on a partial termination.⁴ To confirm the decision of the Court of Appeal in the legislation, the legislation could be modified to either explicitly clarify that surplus distribution is not required on partial plan terminations, or to eliminate the concept of partial terminations altogether. There is precedent for the latter option as recent changes to Quebec's legislative framework eliminated the concept of partial terminations.

As illustrated in the 2005 consultation paper, there are a number of downsides to distributing surplus from an ongoing plan when there is a partial termination. It has been argued that surplus is a notional amount and that surplus is subject to actuarial assumptions, which will lead to actuarial surpluses at different times. In addition, a distribution of a surplus could have potential impacts on the ability of a plan sponsor to meet future pension obligations. Furthermore, it can be argued that from a fairness standpoint, members leaving the plan in one way should not receive greater benefits than those leaving in another. On the other hand, some argue that members have contributed to the surplus and are therefore entitled to share in it rather than having the surplus used for other reasons (e.g. benefit improvements), over which the former members would have no say, and from which they may not benefit.

One major purpose of partial terminations is to ensure that plan members affected by an event that could result in a decision to partially terminate a plan, such as a discontinuance of business operations, who did not meet the maximum two-year vesting period, would not see a loss in their accrued benefits. Under the current framework, employees who leave the plan prior to completion of a vesting period are entitled to a return of their contributions plus interest. If the employee's service is longer than the vesting period, he or she is entitled to receive the pension benefits accumulated when he or she ceases to be a member of the plan. Accordingly, providing for immediate vesting would remove the need for partial terminations in respect of this purpose.

The maximum period for vesting is currently two years. If a plan terminates, immediate vesting would protect the rights of plan members who have less than two years of service. Immediate vesting would apply to members of both defined benefit and defined contribution plans.

The Government of Canada is seeking views on whether to eliminate the concept of partial termination from the Act but require immediate vesting of pension benefits for all members.

D. Disclosure of Information

Given that pension plans are established to provide benefits for employees and their beneficiaries, it is important that they receive information regarding the

⁴ The plan members involved in this case have sought leave from the Supreme Court of Canada to appeal this ruling. The Supreme Court has not yet indicated whether it will hear the appeal.

plans and their benefits. As a result, the Act currently requires that, on an annual basis, plan members receive a statement outlining certain personal and plan information, which includes the member's individual contributions and benefits and the solvency ratio of the plan, where applicable. Moreover, members, former members, retirees, beneficiaries, spouses and common-law partners have the right to examine at the administrator's offices most plan information filed with the Office of the Superintendent of Financial Institutions.

The Statement of Funding Policy is a document that outlines a plan's activities in regard to funding. This includes funding objectives, contribution strategy and policies for the management of funding risks. It also includes information on contribution holidays. It has received wide support from sponsors, plan members, and industry experts.

Better disclosure of plan information provides plan members and beneficiaries with a sense of the plan's health and improves their ability to raise concerns in an informed and timely manner. Moreover, should the plan be in either a strong surplus or deficit situation, it may explain to members and beneficiaries why certain actions are being taken, such as contribution holidays or denying benefit improvements.

Under the Act, an annual statement of information regarding both member-specific and plan-specific information is to be sent to members and their spouses. This information includes details such as the member's contributions and benefits, and details on the plan's solvency ratio. This information is not provided, however, to former members of the plan (i.e. deferred vested members) or retirees. As both of these groups are beneficiaries of the plan, principles of fairness would suggest that they should receive similar information as active members and spouses. For retirees that have been annuitised with a third party, no such disclosure requirements would be necessary or required.

Enhancing disclosure adds another layer of compliance requirements. Therefore, to facilitate the provision of additional information, one consideration would be to provide members with greater access, possibly through electronic means, to information that may be important to members. This provision, routine in many areas, has not yet been provided for under the Act. Electronic provision of plan information would be permitted on a consent basis.

An additional piece of information that could be disclosed to members and beneficiaries is whether the sponsor has missed a payment. Imposing this requirement ensures that the parties affected by the sponsor's missed payment are duly informed so that they are able to raise concerns in a timely manner.

The Government of Canada is seeking views on whether to:

- require administrators to establish a Statement of Funding Policy (SFP) in a similar fashion as the Statement of Investment Policies & Procedures (SIP&P). The SFP would be examinable upon request, like the SIP&P.*
- allow required disclosure items to be disseminated by electronic means, at the option of the receiving member or beneficiary.*
- expand the categories of members required to receive plan information to include former members and retirees, where it is appropriate.*

E. Contribution Holidays

Generally, an employer is required to remit to a pension fund an annual amount in order to fund the amount of pension benefits accrued in a plan year. Where the fund has sufficient surplus, the employer is not required under the Act to remit all or part of this amount. In addition, the *Income Tax Act* requires that sponsors take a contribution holiday when the plan surplus reaches a certain level, generally 10 per cent on a going concern basis.

Some observers argue that contribution holidays leave pension plans exposed to unexpected deficiencies if they subsequently experience declining revenues or asset values. However, similar criticisms could also be applied to situations where surplus is utilised for the purposes of benefit improvements or reductions in employee contribution rates.

The ability of plan sponsors to be able to take contribution holidays based on valuation reports that are not current (i.e., value the plan based on a date greater than a year earlier) has also been raised. Accordingly, it may be prudent to require that a plan sponsor can only take a contribution holiday in the year in which a valuation report is filed with the Superintendent. This requirement would not otherwise affect plans that are required to suspend employer contributions under the tax rules. OSFI has a number of effective tools and has enhanced its early warning capacity to discourage a plan from imprudently taking contribution holidays.

Some stakeholders have also suggested that plan sponsors should be required to develop a formal policy with respect to their approach to contribution holidays and that it should be disclosed to plan members. This would increase transparency and also encourage sponsors to develop a formal approach for contribution holidays. This could be incorporated as part of the Statement of Funding Policy proposed above.

The Government of Canada is seeking views on whether:

- *plan sponsors be required to develop a formal policy on contribution holidays for inclusion in a Statement of Funding Policy; and*
- *to the extent that employer contributions are permitted under the tax rules, plan sponsors only be permitted to take a contribution holiday in the year in which a valuation report, filed with OSFI, shows a surplus in the plan on a solvency basis.*

F. Void Amendments

Section 10.1(2) of the Act voids any plan amendment that would have the effect of reducing pension benefits accrued before the date of the amendment, or if the solvency ratio of the pension plan would fall below a prescribed solvency ratio level set out in the regulations. The latter provision, which was added to the Act in 1998, aims at preventing significantly underfunded plans from implementing amendments if they would further reduce the plan's funded position. However, regulations have not been made to set out a prescribed solvency ratio level.

After reviewing submissions from the 2005 consultation, it is proposed that a solvency ratio threshold of 0.85 be used for the purpose of implementing the void amendment provision. A solvency ratio of 0.85 is proposed on the basis that, while a single measure does not fully describe the financial position of a plan, plans with solvency ratios below this level could generally be considered significantly underfunded to a degree that justifies placing restrictions on benefit improvements by such plans.

The Government of Canada is seeking views on whether to amend the regulations to prescribe a solvency ratio level of 0.85 for the purpose of implementing the void amendment provision in the Act.

4. Issues for Discussion Pertaining to Defined Contribution Plans

In recent years, defined contribution pension plans have garnered increased attention as an alternative to defined benefit pension plans. These arrangements are growing in popularity, given changing workplace dynamics. Evolving employment habits, along with the challenges facing defined benefit plans, have, in part, led to a gradual shift to defined contribution plans. There are several examples where sponsors have closed their defined benefit plans to new members, instead offering defined contribution plans to those individuals. Indeed, the shift from defined benefit to defined contribution pension plans was noted by many stakeholders in the course of the 2005 consultation. Accordingly, it is important to ensure that the framework governing these arrangements be current. As such, stakeholders are invited to provide comments on the practicality and the desirability of the following policy options pertaining to defined contribution plans.

A. Safe Harbour Protection for Qualified Default Investment Options

In most defined contribution plans, plan members are required to make an affirmative choice of the investment fund or product that they wish their contributions be directed. As the level of retirement benefit from a defined contribution plan depends on the value of the investment account at retirement, choices made by the members over their working life will significantly affect their standard of living in retirement. Proper investment choices are critical for members to meet their retirement goals.

There is legal uncertainty concerning the ability of the sponsor to provide investment advice to the plan members. Plan sponsors typically rely on outside providers, in accordance with the Capital Accumulation Plan (CAP) Guidelines, to provide plan members with investment advice. This is done as employers typically have a fiduciary responsibility to plan members, and therefore, risk legal liability should a particular piece of advice yield an unfavourable outcome. Citing legal liability concerns, many plans have chosen a money market mutual fund, or comparable investment vehicle, as the default option. While that investment choice may be appropriate for some members, some have argued that the risk-return profile of such funds does not adequately reflect the plan member's age and return needs.

To address this possible outcome, it has been suggested by many stakeholders that legislation provide safe harbour protection for plan administrators in setting a default investment option that meets certain criteria set forth in regulation. Such a change would protect plan administrators from legal liability when they provide a default investment option, such as a balance or target date mutual fund, that is in accordance with the regulations. A similar approach has also been followed in the United States, under the 2006 *Pension Protection Act*. Introducing a qualified default investment option would not impair the ability of the plan member to have adequate choice to make alternative decisions.

In determining the criteria for the qualified default option, the government is not looking to describe specific funds or investment options. Rather, broad criteria are instead sought, so as to not artificially exclude any appropriate fund.

The Government of Canada is seeking views on the practicality and desirability of safe harbour protection, and what considerations should be made in the determination of the qualified default investment options.

B. Retirement Benefits Paid from the Pension Fund

Under the Act, members in defined contribution plans must opt for either a life annuity purchased for them by the pension plan or transfer their assets to an RRSP or Registered Retirement Income Fund (RRIF) upon retirement. Retiring members generally choose the transfer option because of the greater flexibility

provided under an RRSP or RRIF in deciding how much is withdrawn as retirement income each year.

Certain plan members may prefer to leave their account as part of the plan and do not wish to have a new relationship with a financial institution. The Act does not permit this option. The payment of variable retirement benefits (in a similar fashion to the payouts from an RRSP or RRIF) from the fund is permitted by the *Income Tax Regulations* and allowed in the pension legislation of British Columbia, Saskatchewan and Manitoba.

To allow flexibility for both members and administrators, it has been proposed to allow variable payments to be made directly from the defined contribution plan fund, as permitted under the *Income Tax Regulations*. Such a change could entail additional administrative costs for the plan administrator; accordingly, both the plan and the members would be required to consent to such an arrangement before it could proceed.

The Government of Canada is seeking views on whether to allow the payment of variable retirement benefits directly from the defined contribution account.

C. Standard of Care Changes

Under the provisions of the Act, the administrator is subject to a fiduciary standard of care in respect of its actions regarding the pension plan. Through this fiduciary responsibility, plan members and other beneficiaries have redress through the courts to take action against the administrator if it breaches its responsibility. This standard of care is appropriate in the case of a defined benefit plan, where the administrator is given the responsibility in managing the plan's affairs to provide the member with a specific benefit.

Defined contribution plans impose a different set of responsibilities on plan administrators. Instead of having the responsibility to guarantee a plan member a specific retirement benefit, their obligations are limited to ensuring that contributions are made, and that the plan complies with the legislative and regulatory framework.

Employers may be hesitant to offer defined contribution plans – instead relying on Group RRSPs – given the potential for lawsuits arising out of perceived breaches of fiduciary responsibility. Given that defined contribution plans are subject to greater protection than Group RRSPs – for example, the Superintendent has the ability to require that the employer makes the necessary contributions – ensuring the legislative and regulatory framework does not impose unnecessary burdens on sponsors is important.

Recognising this difference in responsibilities, it may be more appropriate to have a 'good faith' standard of care apply in respect of the employer's role instead of a fiduciary standard. Such a change would not be expected to negatively impact

plan members, as the employer would still be responsible for carrying out actions in accordance with the terms of the plan and the Act.

The Government of Canada is seeking views on whether it is appropriate to revise the standard of care for employers sponsoring defined contribution plans to 'good faith' rather than 'fiduciary'.

D. Use of Surplus in Defined Contribution Plan Components

Certain pension plans incorporate both a defined benefit and a defined contribution component. This type of hybrid plan design can offer additional flexibility for plan members and sponsors, incorporating positive elements from both designs. In any hybrid plan design, a pension 'promise' (i.e. the defined benefit component) must be funded, and accordingly, from time to time, surplus monies may arise in this component.

Generally, sponsors are able to use a surplus to fund their defined benefit plan current service costs. To provide for greater clarity for these hybrid arrangements, the legislative framework could be amended to clarify that a hybrid plan in surplus may take a contribution holiday in respect of its required contributions for the defined contribution component of the plan.

The Government of Canada is seeking views on whether it is appropriate to clarify that defined benefit surplus can be used to offset employer's defined contribution current service costs for hybrid plans.

E. Administrative Procedures

The Act and associated regulations impose a number of administrative responsibilities on plans. While regulations of this nature are required to ensure the proper operation and regulation of pension plans, it is important that the specific administrative responsibilities imposed are appropriate.

One situation that has been raised in this regards relates to the responsibilities of former plan members. When an employee leaves a plan (i.e., terminates membership), the employee generally transfers the accumulated plan assets to a new fund or a locked-in tax deferred vehicle, such as a locked-in registered retirement savings plan. Should a terminating plan member be vested, and not transfer the assets to an alternative vehicle, the employer is still required to perform the requisite administrative tasks for this former member. As the former plan member is no longer employed by the employer, it may not be appropriate for these administrative costs to be borne by the employer. Accordingly, it has been suggested that former members of a defined contribution plan who are vested be required to have their assets transferred to a pre-determined alternative tax-deferred retirement savings account. This would only take place upon sufficient notice being given to the former member.

In Budget 2008, the Government announced regulatory changes to significantly enhance the flexibility to withdraw funds from federally-regulated Life Income Funds (LIFs). These enhancements included provisions for a one-time unlocking of up to 50 per cent of a LIF holdings by those individuals aged 55 and over, and for the closing-out of those LIFs with small balances by those aged 55 and over, as well as for the unlocking of federally regulated locked-in funds, by any individual, regardless of age, for reasons of financial hardship (for example, high medical or disability-related expenses).

The Government of Canada is seeking views on required administrative practices that may impede the proper and efficient administration of defined contribution plans.

5. Other Issues Respecting the Framework for Private Pension Plans

In addition to concerns raised specifically about defined benefit and defined contribution plans, the Government is seeking views on other elements respecting the legislative and regulatory framework for private pension plans. Views are sought to ensure that the private pension system remains relevant and sound.

A. Flexibility of the Pension Benefits Standards Act, 1985

The policy intent of the government is to allow employers and employees to come to their own agreements on pension matters, so long as these agreements conform to minimum standards for funding, investment, membership eligibility, vesting, locking-in, portability of benefits, death benefits and members' rights to information. The government respects the ability of employers and employees to determine the particulars of their plans, such as benefit levels and contribution rates.

While the Act was originally envisaged for single employer defined benefit plans, there is the capacity for alternative arrangements to be made. Included in these are hybrid plan designs, which incorporate elements from both the defined benefit and defined contribution style of plans. The current legislation is flexible enough to accommodate a range of hybrid pension designs. Examples include: giving plan members the choice between a defined benefit and a defined contribution formula; providing a defined benefit formula for some classes of members or some periods of service and a defined contribution formula for other groups or other periods; providing a defined contribution formula with a defined benefit minimum guarantee. Nonetheless, some have argued that there is not sufficient flexibility. To this end, the government is seeking views on whether employers and employees are interested in alternative plan designs that may not currently be accommodated by the legislative framework.

One alternative plan design that has been identified is the member funded pension plan. While there can be several variations in the concept, in general,

such an arrangement would provide a defined benefit to plan members, but any funding deficiencies would have to be made up by the members rather than the employer. Quebec recently implemented such a design in its framework.

The Government of Canada is seeking views on whether there is interest in alternative plan designs that may not currently be accommodated by the legislative framework.

B. Multi-Employer Pension Plans

Multi-employer pension plans, commonly known as MEPPs, are registered pension plans that are sponsored by more than one non-affiliated employers. As such, these types of arrangements are popular in industries where firms tend to be smaller, and the employees tend to move between employers. Many MEPPs are administered by labour unions, rather than employers under traditional single employer plans.

MEPPs must follow similar funding rules as single-employer defined benefit plans. However, many MEPPs are negotiated contribution defined benefit plans, also known as NCDBs. In an NCDB plan, the contributions on the part of both employers and employees tend to be a fixed portion of payroll, typically negotiated in labour contracts.

MEPPs have been identified by many stakeholders as a pension plan design that should be encouraged. MEPPs have a number of advantages: they spread risk across a number of employers; they provide employees with benefit transferability when they switch employers within the plan; and, they allow employers to provide defined benefit coverage without the same administrative burden borne by a single employer defined benefit plan sponsor.

As noted above, much of the legislative framework was originally designed to apply to single employer defined benefit plans. As such, it has been suggested that the extension of this framework to multi-employer plans does not appropriately recognise the unique circumstances that apply to these arrangements.

Another related issue that has been receiving attention in recent months consists of establishing large, pooled defined contribution arrangements for employers and employees who do not already have a private pension plan, potentially with the involvement of the government. Proposals for such arrangements are typically advocated under the premise that investments could be managed professionally and efficiently, leveraging economies of scale due to pooling. Some of these proposals suggest that new annuitisation options could be offered.

The Government of Canada is seeking views on whether there are legislative impediments to the creation or operation of multi-employer pension plans, and if there are improvements that could usefully be made to the legislative framework for these arrangements.

C. Simplified Pension Plans

In 1998, the federal legislation was amended to provide for the adoption of the Simplified Pension Plan. Recognising that smaller employers may find the compliance cost and administrative responsibility burdensome, Simplified Pension Plans were designed to mitigate these concerns for such employers. Simplified Pension Plans are defined contribution plans with a financial institution acting as the administrator. These arrangements are similar to those allowed in Quebec and Manitoba.

To date, the adoption of Simplified Pension Plans has been very limited. The government is interesting in understanding why there has been limited uptake and whether improvements could be made that would make this type of plan more attractive.

The Government of Canada is seeking views on the relevance of Simplified Pension Plans, and whether there are any impediments in the legislation to the adoption of such arrangements.

D. Distinction between Defined Contribution and Defined Benefit Plans under the Act

In large measure, the Act was originally written with the traditional pension model of single employer defined benefit pension plans in mind. Some experts have expressed support for a clearer distinction in the Act between what is applicable to defined benefit plans and defined contribution plans. For example, in a defined benefit plan, employer contributions are not predetermined but are calculated on the basis of actuarial valuations. These valuations are not required for defined contribution plans, as both employers and employees are committed to a specified contribution rate. Indeed, the application of significant portions of the Act have no effect on defined contribution plans. Examples of such sections include 9 and 9.2 (but not 9.1) regarding funding and surplus, as neither exist under a defined contribution plan; or section 10.1(2), which refers to accrued pension benefits and credits and the solvency ratio of the pension plan, all of which are only applicable to defined benefit plans. Greater clarity could be provided to plan members and sponsors under the Act by creating separate sections applicable only to each specific type of registered retirement plan. Alternatively, greater guidance could be given by the Superintendent to provide clarity on what aspects of the Act and the associated regulations are to be followed for defined contribution compared to defined benefit plans.

The Government of Canada is seeking views on the appropriateness of reorganising the Act to provide greater clarity on the differing legislative provisions applicable to defined benefit and defined contribution plans. Specific examples of legislative impediments and uncertainties are particularly desired.

E. Investment Rules

The investment rules under Schedule III of the regulations to the Act, which most provinces have adopted by reference, have not been reviewed for some 15 years. In the early 1990s, the investment rules migrated from a “legal list” concept with many rules on investment to a more principles-based “prudent portfolio” approach. The surviving quantitative rules are as follows:

- A pension plan may not own more than 30 per cent of the voting shares of a single entity;
- A pension plan may hold no more than 10 per cent of its portfolio in a single investment;
- A pension plan may hold no more than 5 per cent of its portfolio in a single parcel of real estate or Canadian resource property;
- A pension plan is limited to having its total of Canadian resource properties be no more than 15 per cent of its portfolio; and,
- A pension plan is limited to having its total of Canadian resource properties and real estate be no more than 25 per cent limit of its portfolio.

The Government of Canada is seeking views on ways to improve the regulatory framework governing pension investment.

6. Next Steps

Written comments regarding any element of this paper are invited and should be forwarded by March 16, 2009, to:

Diane Lafleur
Financial Sector Policy Branch
Department of Finance
L'Esplanade Laurier
20th Floor, East Tower
140 O'Connor Street
Ottawa, Canada K1A 0G5

Comments can also be emailed to pensions@fin.gc.ca.

Subject to the consent of the submitting party, comments will be posted on the Department of Finance Web site to add to the transparency and interactivity of the process. Once received by the Department of Finance, all submissions will be subject to the *Access to Information Act* and may be disclosed in accordance with its provisions. Should you express an intention that your submission be considered confidential, the Department will make all efforts to protect this information within the requirements of the law.

Annex – Federally Registered Pension Plan Statistics

Table 1: Number of Plans by Plan Type

Registered Pension Plans	2002	2003	2004	2005	2006	2007	2008
Total Plans	1195	1205	1256	1284	1304	1332	1350
Defined Benefit	352	346	336	344	345	359	351
Combination	70	70	84	84	87	89	95
Defined Contribution	773	789	836	856	872	884	904

Table 2: Total Membership by Plan Type (000s)

Registered Pension Plans	2002	2003	2004	2005	2006	2007	2008
Total Members	557	579	547	572	576	582	594
Defined Benefit	389	397	367	386	383	386	391
Combination	88	88	96	99	99	98	99
Defined Contribution	80	94	84	87	94	98	104

Table 3: Total Assets by Plan Type (Billions)

Registered Pension Plans	2002	2003	2004	2005	2006	2007	2008
Total Assets	91	85	91	104	116	130	132
Defined Benefit	75	70	78	85	95	108	109
Combination	14	13	11	16	18	19	18
Defined Contribution	2	2	2	3	3	3	4

Source: OSFI

The data are for the fiscal year ended March 31 of the indicated year.