Heenan Blaikie LLP

Pensions & Benefits

DECEMBER 22, 2010

Pension *Pulse*

PENSIONS & BENEFITS E-BLAST

Pension Reform in Canada: A National Report Card

2010 has been the busiest year for pension reform and major pension initiatives in over twenty years. This edition of Pension *Pulse* provides comments on the recent proposal by the federal government for Pooled Registered Pension Plans. It also provides a snapshot of pension reforms to date in the federal jurisdiction and the provinces and relevant reforms to the *Income Tax Act*.

Pooled Registered Pension Plans

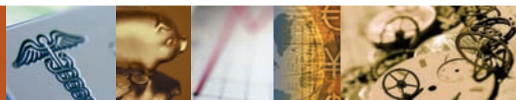
At their meeting on December 19 and 20, 2010, the federal and provincial finance ministers agreed to a framework for the introduction of a new vehicle called a Pooled Registered Pension Plan. The PRPP will be very similar to a defined contribution pension plan, but administered by financial institutions on a large-scale pooled basis. This will enable smaller employers and the self-employed to participate in a pension plan without having to deal with the administrative and regulatory complexities of registering a stand-alone pension plan.

The role of the employer will be limited. This factor alone should effectively promote the growth of PRPPs. The employer's responsibilities will be limited to selecting the appropriate plan and service provider and determining the level of contributions by employees. Employer contributions will not be required. Employers will remit contributions to the financial institution through their payroll provider. Lastly, employers will be responsible for tax reporting, which is expected to be similar to current reporting for defined contribution pension plans.

Under the proposed regime, insurance companies, trust companies and banks that have trust company subsidiaries will be eligible to be administrators of PRPPs. As part of taking on the administrator role, the financial institution will assume fiduciary responsibilities toward the PRPP plan members. As a fiduciary, the financial institution will be required to act in the best interests of plan members.

Because the proposed PRPP will be a large-scale pooled plan, the expectation is that investment fees, or the management expense ratios will be lower than under ordinary retail products. There will have to be full disclosure of all fees, as is currently required under the Capital Accumulation Plan Guidelines. The financial institution will offer a suitable range of investment options, including a default option for members who fail to make an investment election.

While there are many details to be worked out, the framework for the PRPP is sound. This is a positive step forward to promote broad-based access to and participation in an efficient retirement savings vehicle. The other major reform that the government has been considering, namely, modest enhancements to the Canada Pension Plan, has been shelved for now.



Federal Jurisdiction

The federal government announced four sets of reforms to pension law in 2010. The first were contained in the government's budget bill, Bill C-9 on March 29, 2010. Amendments to the regulations under the federal *Pension Benefits Standards Act ("PBSA")* were later released on June 25, 2010. Then on September 30, 2010, the government tabled Bill C-47 which introduces several amendments to the *PBSA*. Lastly, on December 14, 2010, the government released draft regulations dealing largely with pension plan funding.

March 29, 2010

In its budget bill, Bill C-9, the federal government introduced several amendments to the federal *PBSA*. Many of the amendments require additional regulatory amendments, some of which have already been introduced later this year (see below). The amendments introduced in Bill C-9 include:

- Immediate vesting of pension benefits;
- The use of letters of credit in place of solvency payments;
- A prohibition against pension plan amendments that would have the effect of reducing a pension plan's solvency ratio below a prescribed level;
- Full funding of pension benefits upon pension plan termination, subject to payment of any remaining solvency deficiencies over a prescribed period;
- Elimination of pension plan partial wind-ups;
- Provision for pension plan "workout schemes," as agreed to between a pension plan sponsor, pension plan members and retirees, subject to regulatory approval; and
- Authority of the regulator to require the filing of actuarial reports at different intervals should circumstances so require.

June 25, 2010

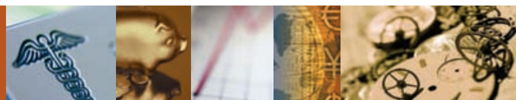
On June 25, 2010, the federal Department of Finance released amendments to the federal *Pension Benefits Standards Act, 1985* regulations. The amendments introduce a form of solvency averaging to reduce some of the volatility that has been attributed to market conditions and changes in interest rates. Solvency funding is to be calculated based upon a three-year average solvency deficiency. In this manner, the impact of a spike in a solvency deficiency in a particular year will be smoothed.

In addition, the amendments introduce a 5% solvency margin before a plan sponsor is entitled to take a contribution holiday. This means that a plan's solvency ratio, or the ratio of a plan's market value of assets to its solvency deficiency, should be at least 1.05 in order for a plan sponsor to discontinue its current service contributions.

Prior to the amendments, the investment regulations contained a number of limits on the investment of a pension fund's assets, viewed by most in the pension investment community as outmoded and unnecessary:

(i) the number of shares of an entity to which are attached more than 30% of the votes that may be cast to elect the entity's directors
(ii) 10% of the book value of the pension fund's assets in any one entity
(iii) 5% of the book value of the pension fund's assets in a single parcel of real estate or Canadian resource property
(iv) 15% of the aggregate book value of the pension fund's assets in Canadian resource properties
(v) 25% of the aggregate book value of the pension fund's assets in real estate and Canadian resource properties

The government has eliminated (iii), (iv) and (v) above, such that only the 30% and 10% limits remain.



September 30, 2010

In the most recent budget, Bill C-47 of September 30, 2010, the federal government proposed another round of pension reform amendments. The proposed amendments, among other things, formalize "negotiated contribution defined benefit" plans ("NCDB"). NCDBs are typically multi-employer plans for which the defined contribution is negotiated between an employer and a union or other employee group. The Office of the Superintendent of Financial Institutions ("OSFI") has recognized NCDBs since the late 1990s. However, because NCDBs combine aspects of both defined benefit and defined contribution plans they have proven to be a challenge to administer.[1]

The proposed amendments would also expressly permit defined contribution plan members to make investment decisions with respect to their individual accounts. Where a plan administrator offers investment choices to the member, the administrator must offer choices with "varying degrees of risk" and investment returns that would allow "a reasonable and prudent person to create a portfolio of investments that is well adapted to their retirement needs." Where these conditions are met, administrators would be sheltered by a limited form of liability or safe harbour.

In addition, the proposed amendments provide the following:

- The consent of a member's spouse or common-law partner would be required to authorize the transfer of the member's pension benefit credit to a retirement savings plan upon retirement;
- The Minister of Finance would have the authority to enter into multilateral agreements with the provinces regarding any matter concerning pension plans. This would enable the Minister to enter into agreements to limit or exempt the application of federal pension law where a pension plan is also regulated by provincial pension laws;
- The Minister of Finance would be able to designate an entity to receive, hold or disburse the pension benefits of a beneficiary who cannot be located; and
- Any information required by the Act to be provided may be sent electronically, provided consent is given and certain other conditions.

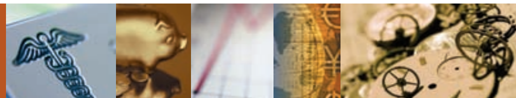
Bill C-47 received Royal Assent on December 15, 2010.

December 14, 2010

The federal government introduced draft regulations to the *PBSA* for public comment. Comments on the regulations will be accepted up to January 17, 2011. This set of draft regulations to the federal *PBSA* is focused on funding obligations and addresses some of the changes proposed by the federal government on October 27, 2009 (see our Pension *Pulse* dated October 28, 2009).

The draft regulations would introduce the following four changes:

- Plan sponsors will be permitted to use letters of credit to fund solvency payments, up to a maximum of 15% of a pension plan's assets;
- Plan sponsors will be required to fully fund pension plans upon a pension plan termination. Remaining solvency deficiencies will be able to be paid off over no more than five years following the pension plan termination;
- Pension plan amendments will be void if the effect of the amendment is to reduce a pension plan's solvency ratio to below 0.85; and
- Workout schemes will be negotiable as between plan sponsors, plan members and retirees, in order to facilitate restructuring or situations of financial distress. These agreements would, of course, be subject to approval by the federal pension regulator, OSFI.



Income Tax Act

The federal government introduced changes to the *Income Tax Act* that would affect all registered pension plans, in its budget bill, Bill C-9, on March 29, 2010. On July 12, 2010, those changes received Royal Assent. These changes increased the permitted surplus threshold for all registered pension plans in Canada to 25% of a pension plan's liabilities, from the current 10%, for periods of pensionable service after 2009.

This will permit plan sponsors to hold more surplus assets in pension plans, before being required to take contribution holidays. Some have commented that the regulatory requirement to take contribution holidays has contributed to the current funding crisis. The Canada Revenue Agency has stated that an actuarial valuation report with an effective date of December 31, 2009, or later may be used to reflect the increased threshold, even though the amendments were not in effect at that time.

British Columbia and Alberta

British Columbia and Alberta are expected to harmonize their pension reform. Together, these provinces released an outstanding joint report at the end of 2008, entitled "*Getting Our Acts Together: Pension Reform in Alberta and British Columbia*," highlighting some innovative ideas. Since the report however, both provinces seem to have lost the momentum for reform.

At the beginning of this year, the British Columbia government posted an 8-page on-line pension consultation paper, seeking input by April 1, 2010. The paper focused on four broad categories of pension reform:

- Expansion of the Canada Pension Plan (CPP) by either increasing the targeted income replacement rate (currently 25%) or by increasing the Year's Maximum Pensionable Earnings (YMPE) (currently $47,200);
- Creation of a voluntary defined contribution supplement to the CPP;
- Modernization of pension standards to improve flexibility in pension plan design; and
- Reform of the *Income Tax Act* to promote tax-effective retirement savings.

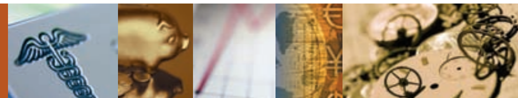
The Alberta government released an almost identical paper, seeking input by April 16, 2010. Then, on June 11, 2010, the Alberta Minister of Finance and Enterprise issued the following statement:

> "Alberta does not support an expansion of the Canada Pension Plan because it is not a targeted response to the issue at hand. Rather, it is an overreaction."

It is not clear whether the above statement was in response to specific feedback from the consultation paper. While both governments have been reviewing the submissions to the papers, no concrete action has yet been taken.

Saskatchewan

The Saskatchewan government amended the regulations under its *Pension Benefits Act* as of September 11, 2009, to provide for temporary relief from solvency deficiency funding. This is in line with the response taken by many other jurisdictions. There have been no other recent reforms.



Manitoba

The Manitoba government substantially amended its *Pension Benefits Act*, with most changes effective May 31, 2010. Pension plans with members in Manitoba, not just pension plans that are registered in Manitoba, must be amended and the amendments must be filed by the end of 2011.

The most significant changes are:

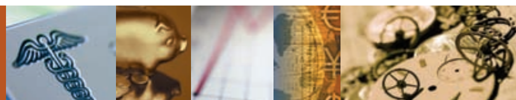
- There is to be immediate, full vesting and locking-in for all benefits earned on or after July 1, 1976;
- Phased retirement benefits are permitted;
- A member who has reached the early retirement age will no longer be entitled to a transfer of the commuted value unless the pension plan so permits;
- The provisions for joint and 60% survivor pensions are harmonized with other jurisdictions;
- The criteria for participation of part-time members are harmonized with most other provinces, with the exception that plan participation remains mandatory where the criteria are met;
- The ability of employers to take contribution holidays will be subject to maintaining a surplus cushion equal to 5% of the pension plan's solvency liabilities;
- The legislation defines what constitutes a full and a partial pension plan wind-up;
- An employer's responsibilities are set out for pension plans with member choice of investments;
- Most pension plans will be required to be administered by a pension committee that includes at least two representatives selected by plan members. This change will be effective as of May 31, 2011;
- A small pension is commutable if the lump sum value of the pension is less than 20% of the YMPE;
- Employer contributions are required to be made monthly instead of quarterly; and
- Audited financial statements are required, subject to a $5,000,000 threshold or if the plan funds are held by one trust company, insurance company or in an annuity contract.

There are many other administrative changes to the legislation. The regulator prepared a summary of the changes, Update 10-01: http://www.gov.mb.ca/labour/pension/industry/updates.html

Ontario

The Ontario government has been very busy with pension reform in 2010. Bill 236, entitled: "*An Act to Amend the Pension Benefits Act,"* which was originally introduced on December 9, 2009, received Royal Assent on May 18, 2010. This sweeping pension reform bill followed many of the recommendations of the Expert Commission on Pensions released late last year. Please refer to our Pension *Pulses* dated December 11, 2009, and June 24, 2010, for details of Bill 236. The provisions of Bill 236 have still not been proclaimed in force.

On August 25, 2010, the Ontario government released a backgrounder outlining proposed measures for phase 2 of its pension reform agenda. The backgrounder was entitled: "*McGuinty Government Taking Additional Steps to Strengthen Ontario's Pension System.*" The proposals are intended to take the form of regulations. Please refer to our Pension *Pulse* dated August 26, 2010 for the details of the backgrounder.



Lastly, Bill 120, entitled: "*Securing Pension Benefits Now and for the Future Act, 2010,*" received first reading on October 19, 2010. Please refer to our Pension *Pulse* dated October 22, 2010 for details of Bill 120. The Bill received Royal Assent on December 8, 2010. The Bill includes many of the proposals contained in the earlier backgrounder referred to above. Much of the detail in the Bill will have to be implemented in the form of regulations.

The original version of the Bill was amended by the Standing Committee on Finance and Economic Affairs. Technical changes were made to provisions relating to target benefit plans, pension plan expenses, surplus withdrawal rules and surplus arbitration provisions.

Quebec

Pension reforms under Bill 30, the Quebec government's most aggressive and far-reaching pension reform package since 1990, generally came into effect on January 1, 2010, and are as follows:

- Plan sponsors are entitled to use letters of credit to fund up to 15% of a plan's solvency liabilities in accordance with prescribed conditions;
- Each pension plan must establish a contingency reserve provision for "adverse deviations";
- Annual partial or full actuarial valuations are required. Full valuations are required to be filed at least every three years;
- If an amendment reduces the plan's solvency ratio below 90%, the plan sponsor must fund the lesser of the cost of the amendment and the amount required to restore a 90% solvency ratio; and
- Surplus assets may be "appropriated" to fund plan amendments, as long as the plan has surplus assets on a "going concern" funding basis and the surplus on a solvency basis is sufficient to include the amount of the provision for adverse deviations (PfAD) determined by regulation. More importantly, surplus assets may only be used to pay for plan amendments in a manner that is equitable as between active plan members and inactive plan members and beneficiaries.

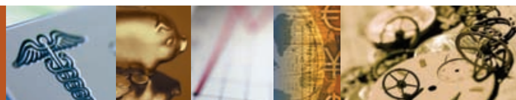
In April 2009, Quebec published a draft regulation under Bill 30, *the Act to amend the Supplemental Pension Plans Act, particularly with respect to the funding and administration of pensions plans.* The regulation took effect on January 1, 2010, and provides for the establishment of a provision for adverse deviation, clarifies the letter of credit rules, revises actual valuation requirements and harmonizes the provisions related to the partition of benefits between spouses and civil unions.

Nova Scotia

In January, 2009, the Pension Review Panel, an expert advisory panel tasked with reviewing the Nova Scotia's existing pension legislative framework, released its final report entitled "*Promises to Keep*" in which it made a number of recommendations for reform. On March 5, 2010, the government of Nova Scotia released a Discussion Paper on Pensions commenting on the recommendations made by the Pension Review Panel and inviting feedback from the public on key recommendations, particularly around the funding formula and the impact of changes on the near-public sector. The deadline for submissions was April 15, 2010.

In the Discussion Paper, the government indicated that it accepted "about 90 percent" of the Pension Review Panel's recommendations. The most significant recommendations that the government accepted include:

- Jointly Sponsored Pension Plans, whether single or multi-employer, should be eligible for registration and regulation as a distinct type of plan;
- All plans should have an amortization period for deficits over a maximum of ten years, which would apply to sponsors from the next valuation date onwards;
- A "collar" of 5% should be provided. If a plan is in deficit of 5% or less, the plan may make payments towards the deficit, but is not required to do so. Any deficits over the 5% collar must be amortized;



- Ancillary benefits should be treated like all other benefits and if they are promised, should be paid for. Sponsors should not be able to have them removed retroactively;
- The current requirements for partial wind-ups and surplus distribution on termination of individuals or groups should be eliminated;
- If an original plan is closed to new members and there are no new accruals, any surplus in an original plan should be transferable to a new plan;
- The governance process for investments should be strengthened and the quantitative investment limits should be removed from the regulations; and
- The current *Pension Benefits Act* provisions for "grow-in" benefits should be such that the plan terms alone will determine whether terminating employees receive eligibility for early retirement subsidies earlier than qualification rules would stipulate.

Furthermore, the government of Nova Scotia has already implemented the Pension Review Panel's recommendation to accommodate phased retirement. This amendment to the *Pension Benefits Act* received Royal Assent on November 5, 2009.

New Brunswick

On October 28, 2010, the New Brunswick government announced it would be establishing an expert panel "to consult New Brunswickers on how to ensure private pensions are protected and sustainable in the long-term." The panel members have since been appointed.

The mandate of the panel is to: (i) examine pension rules in the event of insolvency, (ii) review the long-term sustainability of pensions, and (iii) review the structure and effectiveness of pension legislation. A separate review of public service pension plans will also be conducted.

Prince Edward Island

The PEI government introduced comprehensive pension legislation in the form of Bill 30, the *Pension Benefits Act*. The Bill received first reading on December 1, 2010. The Bill is essentially a copy of Nova Scotia's pension legislation, the most notable feature of which is grow-in rights. According to a statement of the Justice and Public Safety Minister, there will be an extensive consultation with stakeholders, following which the Bill will be brought forth for second reading. As of December 2, 2010, the date of the government's announcement, thirty-five parties had identified themselves as interested in participating in the consultations.

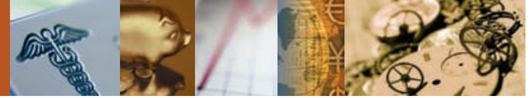
Osgoode Certificate in Pension Law

Osgoode Professional Development, part of Osgoode Hall Law School, will be offering its first Certificate in Pension Law, commencing in February 2011. This will be an intensive six-day program, held on successive Tuesdays. It will cover all aspects of pension law, including: (i) an overview of the retirement system, (ii) pensions, the employment relationship and collective bargaining, (iii) the funding and investment of pension plans, (iv) pensions in corporate transactions and restructuring, (v) pension governance and risk management, and (vi) pension litigation.

The Certificate qualifies for professional development credits under various provincial bar requirements, including 36 hours under the Law Society of Upper Canada's rules. Please follow this link to the program:
http://www.osgoodepd.ca/cle/2010-2011%20Fiscal/2011_pensions_cert/index.html ■

---

[1] OSFI Memorandum "Negotiated Contribution Defined Benefit Plans", October 19, 1999. Available online :
http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/pension/guidance/99-10-19_e.html.



Mark Newton is a partner in Heenan Blaikie's Toronto office and chairs its national Pensions & Benefits practice. He has over 25 years of experience in pensions and benefits.

As a member of our firm's Labour and Employment group, Mark handles all aspects of pensions and benefits law, including governance, regulatory compliance, collective bargaining, litigation, due diligence, mergers and acquisitions, financing agreements, bankruptcy and insolvency, and the tax aspects of compensation, pensions and benefits.

The National Pensions & Benefits Group Includes:

Toronto

Mark Newton	416 643.6855	mnewton@heenan.ca
John Craig	416 360.3527	jcraig@heenan.ca
Jodi Gallagher	416 360.3555	jgallagher@heenan.ca
Peter Clark	416 360.3543	pclark@heenan.ca

Montreal

Robert Bonhomme	514 846.2260	rbonhomme@heenan.ca
Robert Dupont	514 846.2314	rdupont@heenan.ca
Troy McEachren	514 846.2319	tmceachren@heenan.ca
Frédéric Massé	514 846.2386	fmasse@heenan.ca

Vancouver

Andrea Zwack	604 891.1161	azwack@heenan.ca
Peter Gall	604 891.1152	pgall@heenan.ca
Jillian Frank	604 891.1160	jfrank@heenan.ca

Calgary

Robb Beeman	403 261.3452	rbeeman@heenan.ca

Ottawa

Sébastien Lorquet	613 236.1327	slorquet@heenan.ca
Judith Parisien	613 236.4673	jparisien@heenan.ca