

# PBSA Update

Summer • 1999

*PBSA Update* is issued by the Private Pension Plans Division, Office of the Superintendent of Financial Institutions (OSFI). OSFI administers the *Pension Benefits Standards Act, 1985 (PBSA)*



Issue No. 19

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## Note to our Stakeholders

*PBSA Update 18* (December 1998) contained forms for the Certificate of Year 2000 Readiness and the Declaration of Compliance (for both new plans and plan amendments). More information on both forms is found elsewhere in this newsletter.

Since last October, the *PBSA* has not required OSFI to routinely review and comment on plan provisions and amendments. It is the responsibility of the plan administrator to administer plans in accordance with the letter and spirit of the *PBSA* and the *Regulations*, as well as in the best interest of the plan beneficiaries. To support plan administrators in this endeavour, we will from time to time explain policies on matters of interest. In this issue of *PBSA Update*, for example, we discuss our new policies on flexible benefits, supplemental employee pension plans and portability options at retirement.

The last issue of *PBSA Update* included a preview of guidelines on plan conversions, mergers, spin-offs and full and partial plan termination. Unfortunately, none were ready to include in this issue. Also missing from this issue is the promised satisfaction survey. However, we invite plan sponsors and consultants to continue to make comments and suggestions. We appreciate the co-operation we have received from the pension industry in the past, and look forward to future consultations on our policies and guidelines.

The OSFI Communications Unit has taken over the responsibility of responding to general enquiries and complaints from plan members. Trained staff can provide answers to questions such as locking-in requirements and portability options under the *PBSA*. Plan members with questions regarding legislative requirements should call OSFI's toll free number (800) 385-8647. Plan administrators should continue to call the Private Pension Plans Division.

For additional copies of *PBSA Update*, please contact Kathleen Hunter at (613) 990-8124

## An Update on Recent Changes

### 1. Declarations of Compliance

We are pleased to report that all recent applications for plan registration have included the now-mandatory Declaration of Compliance. Some 90 per cent of submitted plan amendments included a declaration, and the remainder were returned to the plan administrator. As well, the questionnaires that were filed with the plan amendments were completed to our satisfaction.

Please note that plan amendments should not be written so that implementation is contingent on receiving OSFI approval. As discussed in *PBSA Update 15*, only amendments that reduce accrued benefits require the Superintendent's approval before implementation.

### 2. Year 2000 Readiness Certificates

*PBSA Update 18* included a Certificate of Year 2000 Readiness that plan administrators were to have returned to OSFI by January 31. Certain plans are exempted from this filing, specifically those which are single employer, defined contribution plans, where contributions are remitted directly to, and the pension funds are held and managed by, an insurance or trust company regulated by OSFI.

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Of the remaining plans, most filed the certificates on time. Those who did not were reminded by letter that they were expected to submit the certificate or contact OSFI with an explanation by April 30. Although our correspondence has explained that section 34 of the *PBSA* gives the Superintendent the authority to request information related to a pension plan and failure to file a certificate may invoke a Direction of Compliance from the Superintendent, some plan administrators have not yet submitted a Certificate of Year 2000 Readiness.

For those plans for which a certificate has not been received, OSFI is considering various ways of handling the situation. Plan administrators will be informed shortly of the steps OSFI is prepared to take.

Some plan administrators have informed OSFI that they intend to issue two cheques to pensioners in December 1999 to prevent the possibility of late cheques in January 2000. If administrators choose this option, they should ensure that retirees are aware of the tax implications.

## II Filing Requirements

### 3. Joint Annual Information Return -

#### *OSFI and Revenue Canada*

Plan sponsors have by now received their Annual Information Return (AIR) and Financial Statement and General Interrogatories (FS), along with a covering letter explaining the joint filing of the AIR with Revenue Canada. The joint AIR will be filed with OSFI and we will capture and forward the data required by Revenue Canada to that department. This will eliminate duplication for plan administrators who previously had to file two separate returns. The required changes to the AIR delayed their issuance, and we have extended the deadline to June 30, 1999 for plans with a year end before January 1, 1999.

### 4. Financial Statements - Form OSFI 60

Form OSFI 60 has now become mandatory for all pension plans with year ends on or after October 1, 1998. The form was completed on a voluntary basis for plan year ends before that date. (For more information, see *PBSA Update 16*.)

As a result of the form's wide exposure, OSFI received some suggestions for changes and we will consider these suggestions when the form is next amended. We have added a question on foreign assets to the General Interrogatories section of the form and ask that plan administrators do their best to respond to this new question.

### 5. Filing Requirements for Designated Pension Plans

Pension plans with solvency ratios less than one that meet the definition of "designated pension plan" under Regulation 8515

of the Income Tax Act are exempt from filing annual valuation reports. We are currently examining our policy regarding other filing requirements for these plans.

### 6. Filing Requirements for Hybrid (Combination) Plans

There has been a dramatic increase in the number of combination plans (i.e., plans with both a defined benefit and defined contribution component). As members may have both types of benefit, there is some confusion as to how to report the required information on the Annual Information Return.

Some administrators file two AIRs for a single plan. If plan sponsors wish to consider the defined benefit plan and the defined contribution components separately, they may have two stand-alone plans, with two sets of filings and two fees.

However, if the two components are considered parts of one registered plan, only one set of filings is required. In such cases, plan sponsors can include a separate sheet of paper with all of the relevant data reported separately, such as destination of contributions, amounts paid to each component from surplus and membership of each group. In some plans, members have defined benefit accruals but are currently accruing only in the defined contribution portion and administrators must take care not to count these members twice. Questions on reporting for combination plans should be directed to Leslie Karook at (613) 990-7871.

### 7. Actuarial Information Summary Forms

In March, the Canadian Association of Pension Supervisory Authorities (CAPSA) endorsed an Actuarial Information Summary (AIS) form. The AIS was developed to assist with the regulation of pension plans with defined benefit provisions. It consolidates information in a standard format and simplifies the presentation for both plan sponsors and regulators. The AIS was developed by the Financial Services Commission of Ontario (FSCO) and Revenue Canada, with assistance from OSFI and the Canadian Institute of Actuaries.

OSFI, FSCO, and Revenue Canada have adopted the AIS for use with pension plans registered under federal or Ontario jurisdiction. Other CAPSA members may also adopt it. Regulators will require the AIS to accompany actuarial reports filed after July 1, 2000, regardless of the plan year end. The actuary preparing the valuation report must also certify the AIS. The various regulators will accept a photocopy of the AIS for compliance purposes.

OSFI has sent a copy of the AIS to an OSFI pension advisory committee and will include it with the fall issue of *PBSA Update*. While we are willing to discuss any concerns about the form, because it is a joint venture with CAPSA, we expect to be able to make few, if any, changes to it in the short term.

The content and design of the AIS will be reviewed by CAPSA and the other participants in 2001 to see if additional changes are required. Consequently, plan sponsors are advised not to implement these forms

on their computer systems without allowing for future changes. Questions regarding the AIS may be directed to Denise Codère at (613) 990-8136.

### 8. *Filing of Actuarial Reports*

In PBSA Update 18 we indicated that OSFI reserves the right to refuse actuarial reports when the report is not due and it is filed

more than nine months after its effective date. Some plan administrators have told us that they or their actuary had submitted an actuarial report well before the nine month deadline when, in fact, OSFI is unable to locate it. This is a reminder that acknowledgement letters are sent to plan administrators immediately on receipt of an actuarial report. If administrators do not receive such an acknowledgement, they should contact Dan Gagnon at (613) 990-8081.

## III OSFI Pension Policies

### 9. *Refunds of Surplus*

The regulations supporting the new section 9.2 of the PBSA have been written but not yet promulgated. We hope the Regulations come into force this summer, and a draft guideline on this matter will be posted on our Internet site in the near future. For more information, please refer to the previous issue of PBSA Update.

### 10. *Minimum Funding Requirements*

As announced in the July 1996 White Paper, OSFI is moving forward with new minimum funding standards for pension plans subject to the PBSA. We have identified the basic issues underlying our mandate to enhance the security of promised pension benefits as well as some possible solutions. These will be introduced in a discussion paper on minimum funding. Consultations with interested parties will take place this summer, after which changes to the minimum funding regulations will be drafted.

### 11. *Flexible Pension Benefits*

OSFI's policy on flexible pension plans has been developed with two goals in mind. First, we do not want to discourage the introduction of new defined benefit products. Second, we want to harmonize our policy with the CAPSA Task Force recommendations, developed in co-operation with the Canadian Institute of Actuaries.

Federally regulated pension plans may provide for flexible benefits, as defined in Revenue Canada Newsletter No. 96-3. Plan administrators who wish to provide for flexible contributions and benefits must explain clearly, both in the plan documentation and to members, exactly the type of benefit being offered. Flexible provisions may be designed in a number of ways and must specify how the flexible accounts are to be invested. The actuarial valuation must be done on a reasonable basis that is acceptable to Revenue Canada and to OSFI, and the flexible benefit transfer value from the plan must be an amount equal to the lesser of the value of the flexible contribution account and the maximum permitted by Revenue Canada.

Plan sponsors may define their flexible provisions as:

- additional voluntary type contributions
- not subject to the 50% rule
- requiring the return of member contributions as necessary under common law, and
- not necessarily locked-in.

Since flexible pension provisions are new in the market and driven by Income Tax Act considerations, OSFI does not have a clear picture as to what these products may entail. We reserve the right to review and revise our policy in the best interests of plan members. OSFI has not seen many plan amendments for flexible provisions and does not contemplate a change to the PBSA or the Regulations to accommodate flexible provisions. Our full policy contains all of the requirements for flexible benefits and can be found on our Internet site.

### 12. *Portability at Retirement*

Because of the flexibility that the portability options give to retiring plan members, and because section 26 of the PBSA can be read to allow for portability before benefits commence, plans may offer portability options at retirement. Portability of pension benefit credits during the 10 years prior to retirement is at the option of the plan sponsor. If a plan does provide portability during the 10-year period, portability may be extended to cover members who have attained pensionable age.

Administrators and actuaries are advised to consider any material costs arising from portability at retirement. For example, if retirees are paid their full pension benefit credit in an environment of low interest rates, larger than assumed amounts may leave the pension fund which could result in lower than expected earnings on a smaller fund. Plan actuaries should also consider the need to revise interest rate, mortality and yield assumptions and potential cash flow problems.

For self-protection, the administrator is advised to obtain proof of spousal consent for any transfer, and to inform members and spouses of the risks associated with exercising portability at retirement. Administrators should ensure that members and spouses understand that portability vehicles do not guarantee the pension benefit promised in a defined benefit plan and that opting for portability may result in a loss of value of their entitlement and a smaller monthly benefit.

### 13. Conversion from Defined Benefit to Defined Contribution Plans

**OSFI** has not yet completed its revised conversion guideline, but plan sponsors should know certain expectations OSFI has for conversions where the plan is not fully funded. Our current guideline does anticipate the conversion of an unfunded plan, but offers no advice on handling transfers or the purchase of annuities for members who have converted their benefit.

OSFI has the following requirements for underfunded converted plans:

- transfers into the defined contribution accounts must be limited to the solvency of the plan (i.e., the full conversion value multiplied by the solvency ratio)
- each defined contribution account must receive a portion of the special payments made to the plan with respect to the 5-year amortization schedule of the insolvent portion
- special payments credited to the defined contribution account must include interest equal to or greater than the interest rate assumption used for the solvency valuation at the date of conversion when a converted member terminates within five years after the date of conversion, a transfer to an RRRSP may be made on the basis of the solvency ratio with the remainder due at the earliest of five years or full solvency of the plan
- alternatively, the full amount may be transferred from a defined contribution account if the deficiency is paid from corporate sources
- when the member retires or dies within five years after the date of the conversion, and an annuity is purchased, any remaining special payments, adjusted for interest, must be made from corporate sources to the member's account on the date the event occurs
- in the event of plan termination within five years after the conversion, the member's benefits in the defined benefit component of the plan will be multiplied by the solvency ratio (which may vary from time to time due to actuarial experience) while the defined contribution benefits will be equal to the funds held in the individual member's account (which will reflect the amounts transferred at the conversion date plus interest plus the special payments with interest)
- after the conversion, actuarial experience of the defined benefit component of the plan must not effect the defined contribution portion of the plan
- after five years, the defined contribution portion of the plan will not be in a deficit whereas the defined benefit component may still be have a deficit due to actuarial experience.

### 14. Governance Self-Assessment

**OSFI** has been working with the Association of Canadian Pension Management (ACPM) and the Pension Investment Association of Canada (PIAC) on the question of governance self-assessment. The Joint Task Force plans to introduce its draft recommendations and a governance self-assessment tool for industry comments soon, and we hope many of our *PBSA* Update readers will obtain it from our website and send us their comments.

Next year we expect to ask plan administrators if they have assessed their own governance practices, and whether they have shared the results with the plan members.

### 15. Asset Transfers

Section 10.2 of the amended *PBSA* requires that the Superintendent give permission before assets can be transferred from one pension fund to another. We are currently reviewing the basic principles surrounding asset transfers in the case of plan terminations, mergers, spin-offs, and sale of business. We are also reviewing the transfer of accrued defined benefits to money purchase accounts as a result of a plan conversion. Discussions are expected to take place during the fall after which we will formalize the asset transfer guidelines.

### 16. Supplemental Employee Retirement Plans

Just as we finalized our policy on flexible benefits, several consulting firms wrote to inquire if certain pension products were acceptable to OSFI. Unfortunately, new policies take many months to develop and implement, due in part to the time required to co-ordinate our work with other CAPSA members. Because each jurisdiction has different requirements in their legislation, it can be difficult to achieve unanimous results. However, just as we accepted amendments for flexible benefits on their merits, we will likewise consider supplemental employee retirement plans (SERPs). A SERP applies only to a defined benefit plan and is an arrangement for paying the entire

accrued pension benefit that would otherwise be paid from a registered pension plan, if not for the funding maximum imposed by the Income Tax Act (ITA). Because the ITA limits tax exempt contributions and thus indirectly limits the benefits that can be paid from a pension plan, some final average earnings plans cannot deliver the total pension that results from the plan's promised benefit formula. A SERP can remedy this loss for medium and high income earners and deliver the full accrued benefit that otherwise could not be paid. Most of the models presented to OSFI provide that a member's total benefit, including benefits in excess of the ITA funding limits, will be paid from the plan at retirement, termination and death where the assets in the plan exceed the amounts required to pay the benefits below the ITA limit. Two arguments for this arrangement have been put

forward. First, it will remove the inequity of paying some members of the plan the promised pension benefit while others receive only a portion of their benefit due the ITA limits. Second, the use of excess assets to pay these excess benefits is not a surplus withdrawal but a distribution to plan members who would otherwise be paid only part of their promised benefit.

We have been asked whether or not such an arrangement is acceptable under the PBSA. While OSFI has not developed a full policy on SERPs, we are working with other jurisdictions on the issue. We believe that a new plan could provide an arrangement whereby benefits in excess of the ITA limits could be paid from a pension plan surplus. As for existing plans, we are prepared to look at proposed amendments on a case-by-case basis, but there are some issues that must be confirmed by the plan administrator:

- SERP benefits are clearly a part

of the obligations of the pension plan;

- the trust agreement is not restrictive in its purpose;
- SERP entitlements must apply to all plan members;
- as part of the administrators fiduciary responsibility, the best interests of all plan beneficiaries have been considered;
- a full legal review of all pension plan contracts and trust provisions has been undertaken and has found that unilateral amendments to the pension plan are permitted, or alternatively, the plan beneficiaries have consented to a plan amendment allowing for the payment of SERP benefits;
- the actuary has valued the cost of SERP benefits until the next valuation and has assured the plan administrator that there is sufficient surplus in the plan to undertake these payments;

- if the plan has a bad experience while paying SERP benefits, the plan administrator undertakes to immediately remit sufficient funds to cover the cost of regular benefits;
- there has been full disclosure to plan beneficiaries regarding the nature of the SERP;
- the wording of plan amendments providing for SERP benefits has been reconciled, in the plan documents, with references to any restrictions imposed by Revenue Canada;
- SERP benefits paid from the plan are not subject to the locking-in provisions of the PBSA, and thus taxes will be assessed under the ITA.

with insufficient funds to pay the regular accrued benefits. We are therefore considering a rule that part of the surplus must be retained as a cushion and not used for SERP payments. Another possibility is to require plans with SERP provisions to file a valuation report annually.

We have examined one model that assumes full funding for the regular and SERP benefits, with both being subject to OSFI's minimum funding standards. Under this scheme, contributions would be made to a SERP account within the pension plan fund with the required taxes remitted to Revenue Canada, and any refundable tax credit would be classified as a receivable of the plan.

There are many issues that must be addressed and there may be other SERP models that industry participants may propose to us. As we develop our policy, we will do our best to anticipate problems and impose clear and fair guidelines.

OSFI is considering various approaches to ensure that the benefits below the ITA maximum are fully funded. We will not permit the use of surplus for SERP benefits where the possibility exists that the plan might terminate

## V Other Items of Interest

### 17. Negotiated Contribution Plans

The nature of negotiated contribution defined benefit (NCDB) plans forces administrators, trustees, and regulators to contemplate the possibility of benefit reductions in the absence of an increase in contributions. Over 30 plans of this type are subject to the *PBSA*, and OSFI has frequently encountered problems with them that require difficult decisions. We have written a memorandum entitled *Negotiated Contribution/Defined Benefit Pension Plans* which covers:

- the funded status of NCDB plans registered under the *PBSA*
- the reasons why they are more exposed to problems
- governance issues, including, in some cases an administrator's lack of authority and expertise
- problems related to valuation and funding of the plan
- plan termination.

The memorandum is available on our web site. For further information please contact Glenn McAllister at (613) 990-7865.

### 18. Fee Assessment Methods

As indicated in previous issues of *PBSA Update*, OSFI will implement a modified user pay system to collect fees from pension plans for certain plan-specific activities. This new program is expected to become effective April 1, 2000, and will include applications for refunds of surplus and plan terminations. User pay also will apply to transfers of assets from one plan to another as a result of a plan split, merger, conversion, spin-off, or sale of business. The fees collected for user pay activities are expected to result in basic annual assessments levied on all pension plans regulated by OSFI. The fee levels have not yet been set, and implementation of user pay will be accompanied by a review of annual assessment rates.

In the last two issues of *PBSA Update*, we explained how these rates are calculated. The full cost recovery program under the *PBSA* requires that any shortfall or excess in one year be considered in setting the basic rate for the two years in the future. This has resulted in substantial increases and decreases in assessment rates from year to year. New regulations will be set to average shortfalls and excesses over a period of five years, and thus smooth the rate changes. These regulations should be ready by October 1, 1999. Consideration is also being given to

implementing penalty fees for late and erroneous filings. Comments from stakeholders may be directed to Philippe Morisset at (613) 990-8055.

Until the amendments to the *Regulations* become effective, the annual fees must be calculated using the old formula. For plans with a year-end between October 1, 1998 and September 30, 1999, the basic rate has

increased by 50 per cent over the 1997-98 rate to \$12 per member for the first 1,000 members, and \$6 per member for members in excess of 1,000. The minimum fee has increased from \$160 to \$240, and the maximum from \$80,000 to \$120,000 per plan. These rates reflect increased costs of delivering the program.

## List of Pension-Related Items on the OSFI Internet site

### Legislation

*Pension Benefits Standards Act, 1985* and *Pension Benefits Standard Regulations*  
Directives of the Superintendent pursuant to the *Pension Benefits Standards Act, 1985*  
Bill S-3 - Amendments to the *Pension Benefits Standards Act, 1985* effective April 1, 1998  
Draft Regulations regarding surplus

### Annual Information Return and Financial Statements

Annual Information Return (AIR) 1998-99  
Memorandum  
AIR Guide  
Certified Financial Statements (CFS) 1998-99  
Financial Statements  
General Interrogatories  
Guide  
Current Fee Schedule

### Other Pension Forms

- Declaration of Compliance and Addendum for new plans and amendments to existing plans
- Year 2000 Readiness Certificate
- **Pension Guidelines**
- Securities Lending - Pension Plans
- Converting Plans from Defined Benefit to Defined Contribution
- Derivatives Best Practices
- Disclosure of Information to Pension Plan Members and Former Members  
Memorandum on Disclosure of Information
- Governance of Federally Regulated Pension Plans
- Draft *PBSA* Investment Guidelines  
Memorandum to Draft *PBSA* Investment Guidelines
- Memorandum to Employers Seeking Consent of OSFI to A Refund of Surplus Under the *Pension Benefits Standards Act, 1985*
- Plan Terminations: Defined Benefit Plans
- Plan Terminations: Defined Contribution Plans
- Supervisory Guide to Federally Regulated Pension Plans  
Memorandum to Supervisory Guide to Federally Regulated Pension Plans
- Instructions for the Preparation of Actuarial Reports
- Risk-based Supervision of Pension Plans  
Appendix II to Risk-based Supervision of Pension Plans

### Pension Publications

*PBSA Update 19*  
*PBSA Update 18*  
*PBSA Update 17*  
*PBSA Update 16*  
*PBSA Update 15*  
*PBSA Update 14*

*PBSA Annual Report 1998*  
*PBSA Annual Report 1997*  
*PBSA Annual Report 1996*

### Other Items

Check our Internet site for speeches delivered by OSFI personnel to various pension organizations.  
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