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PBSA Update

Issue No. 6

PBSA Update is issued by the Pension Benefits Division of the Office of the Superintendent of Financial Institutions. Issue No. 5 was dated November 1990. The purpose of *PBSA Update* is to improve communication between the Office and pension plan administrators whose plans are supervised by the Office pursuant to the *Pension Benefits Standards Act, 1985* (PBSA).

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1. Plan Amendments as a Result of New Income Tax Legislation

The new Revenue Canada, Taxation (RCT) requirements may necessitate further amendments to your pension plan(s). These amendments must be filed with the Office if the pension plan is subject to the PBSA.

To facilitate the Office's review of the necessary changes made to your plan(s), and to ensure compliance with the PBSA, we ask that the amendments or the amended plan text(s) filed with us clearly distinguish the changes made to comply with new RCT rules from any other being made concurrently. This may be done in a covering

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letter accompanying the amendments or by marginal notes in the text. Your co-operation will be greatly appreciated.

2. PBSA Fee Increase

In Issue No. 5 of *PBSA Update,* the Office informed the pension industry of its intention to adopt a dynamic fee structure that would permit the full recovery of the cost associated with the administration of the PBSA.

The Pension Benefits Standards Regulations, 1985 (Regulations) were amended to that effect on March 21, 1991. On March 22, 1991, a special memorandum from the Office advised all PBSA plan administrators of the changes.

The new fee structure, which affects all pension plans, was established so that it would permit full recovery of the Office's costs of registering and supervising pension plans during the 1991-92 and subsequent office fiscal years.

Annual Information Returns filed on or after April 1, 1991 for a plan whose year end falls between October 1, 1990 and September 30, 1991 inclusively, must be accompanied by a fee determined in accordance with the new fee structure. The new fee structure is $10 per member up to 1,000 members plus $5 per member in excess of 1,000 subject to a minimum fee of $200 and a maximum fee of $100,000. Fees to accompany an Annual Information Return for a plan year that ended before October 1, 1990 should be calculated under the fee schedule that was in effect from June 1, 1990 to March 31, 1991.

In the future, fees will be adjusted annually to ensure full cost recovery. The adjustment will recognize year-to-year anticipated expenses respecting the registration and supervision of pension plans. Each fall, beginning in 1991, the Office will publish the new schedule of fees for the following year in the *Canada Gazette*. The September 28, 1991 publication of the *Canada Gazette*, announced that the basic fee rate for calculating PBSA fees due in 1992-93 will be $10.25. This is an increase of 2.5 per cent over the current level of $10. Because the minimum and the maximum plan fee are effectively expressed in terms of the number of plan members in the plan fee base definition (subsection 25(2) of the Regulations), they are effectively increased by the same percentage to $205 and $102,500 respectively.

However, because many plans, particularly some large ones, filed their 1990 Annual Information Return before April 1, 1991, which was earlier than they traditionally file them, a significant shortfall of revenue in 1991-1992 is emerging. This shortfall is expected to result in a significant but temporary increase in the basic fee rate for the 1993-94 fiscal year.

The Office is very conscious of the extra cost to pension plans of the increased fees and recognizes its responsibility to control carefully the costs associated with the administration of the PBSA to minimize future fee increases.

3. Future Amendments to the Regulations

The Office has proposed some other amendments to the Regulations with the intention of having them in force, if approved, prior to March 31, 1992. In addition to some “housekeeping” changes, these amendments would:

- designate Quebec as a province in which there is in force a law substantially similar to the PBSA;
- exempt from section 18 of the PBSA amounts of pension benefit credits that exceed the maximum transfer amount allowed under income tax rules;
- exempt from all provisions of the PBSA pension plans that have been created by provincial statute for employees that are under provincial jurisdiction and which may become subject to PBSA because some members of these plans are in included employment; and
- exempt certain provincial telephone companies’ plans from the application of the PBSA for the period prior to August 14, 1989, when the Supreme Court of Canada ruled that these companies were under the exclusive jurisdiction of the Parliament of Canada.

4. Annual Information Return (AIR)

Some changes are being made in order to improve the AIR and Instructions and we would like to take this opportunity to bring them to your attention. We will be mailing the new forms to plan sponsors shortly.

Page 1: To ensure that the appropriate fees are filed with the AIR for a particular plan year, the applicable fee structure is incorporated in the new AIR form and the filing year, for which the AIR form applies, will appear at the top right hand corner of all AIR forms. For example, AIRs coded 1990-91 will indicate that they are for the reporting of data for the end of a plan year between October 1, 1990 and September 30, 1991. The revised AIR forms that will be mailed to plan administrators shortly will be for the reporting of data for plan years ending between October 1, 1991 and September 30, 1992. The AIR will be coded 1991-92.

Question 2: Each plan is now required to provide the name and address of the auditor of the financial statements of the plan, if applicable.

Question 8: This question has been expanded to request the contribution base if it is other than payroll. Although most of the plans subject to the PBSA use payroll as the base for calculating contributions, many do not. Rather than indicating that the payroll is not applicable, the administrator should indicate what the base is. An example of a base other than payroll is hours worked.

Question 15: Because interest credited applies to both employer and employee contributions in a money purchase plan but applies only to employee contributions in a defined benefit plan, we have changed this question to reflect the difference.

Question 16: The wording of this question has created some misunderstandings and problems for administrators of defined benefit plans and for the Office. We hope that the change to this question will clarify the type of information required and make both reporting and reviewing easier.

Question 17: This question asks whether or not adjustments have been made to pensions in pay or deferred pensions. We have replaced the Yes or No response by asking the administrator to specify whether an adjustment has been made to (a) a pension in pay (b) a deferred pension, or (c) both.

Page 6: The fees pertaining to the plan year under review appear on this page.

AIR Instructions: The amended Instructions are generic and apply each year. We continue to include a set of Instructions with each AIR. In addition, the signatory requirements of the AIR have been clarified.

5. Solvency Valuations

We would like to remind plan administrators and actuaries of the requirement for solvency valuations to be provided with every pension valuation report, and outline our current standards for these valuations.

The solvency valuation and certifications must be clearly distinguishable from other certifications in the actuarial report. To ensure this, they should be presented in a separate section and clearly identified as a solvency valuation.

The Regulations define both a solvency deficiency and a solvency ratio. These two items serve two different purposes. The calculation of the solvency deficiency serves to ensure compliance with a minimum funding standard. The calculation of the plan's solvency ratio reveals what portion of the plan's benefits would be funded if the plan were terminated on the valuation date. According to Directives issued by the Superintendent, the plan administrator must take the plan's solvency ratio into account when transferring pension benefit credits from the plan. Actuaries must therefore certify the solvency ratio of the plan as well as the existence or absence of solvency deficiencies. Copies of the Directives are available on request.

It is important to remember that a certification that a plan has no solvency deficiency does not necessarily imply that the solvency ratio is one. Although determination of both the solvency deficiency and the solvency ratio involve a comparison of assets to termination liabilities, different assets are involved. To determine the solvency deficiency, the actuary compares termination liabilities to assets that can include special payments (subsection 9(1) of the Regulations). To determine the solvency ratio the same liabilities must be used but no special payments are included in assets (section 2 of the Regulations).

For calculating solvency deficiencies and ratios, the Office requires the use of assumptions that are consistent with the assumptions prescribed in the Recommendations for the Calculation of Minimum Transfer Values issued by the Canadian Institute of Actuaries, November 1988. Since it is difficult to assess whether annuity quotations for a continuing plan are *bone fide* quotations, the solvency valuation may not be based on annuity rates. In respect to termination liabilities, where a plan provides for benefit increases on a non-discretionary basis (e.g., post-retirement or pre-retirement cost of living increases), such benefits must be assumed to continue indefinitely, i.e., form part of the termination liabilities calculation. In addition, estimated expenses of winding up the plan should be included in the termination liabilities.

A solvency balance sheet need not be provided if the actuary can certify, based on the results of the going concern valuation, that the solvency ratio is one. However, the actuary's report must explain in detail how this conclusion was reached. Otherwise, the report must include a solvency report and balance sheet that will disclose the amount of the solvency deficiency if it exists. In circumstances where a solvency balance sheet is necessary, the actuary must provide details regarding the method and the assumptions used in the calculations. For greater certainty, the actuary's solvency report must clearly identify all benefits that have been included in the ongoing valuation of the plan that are excluded in the solvency valuation and vice versa. The actuary must determine a schedule of payments to amortize any emerging solvency deficiency within five years.

6. Gain and Loss Analysis

An analysis of how the surplus (or deficit) of a defined benefit plan changed between valuations can be an invaluable tool for actuaries, plan administrators and anyone who wants to understand how benefits are being funded. It provides a check on the accuracy of the calculation of liabilities, it may alert users of the actuary's report to problems with the valuation assumptions and it highlights the cost of amendments to the plan. The Recommendations of the Canadian Institute of Actuaries for the Valuation of Pension Plans require the preparation of a gain and loss analysis to the extent reasonable in the context of the purpose of the valuation and the number of participants in the plan.

Most administrators and actuaries have recognized that an analysis of gains and losses is well worth the cost, and have included one in the reports they have submitted to the Office. Experience of the Office has shown that some plans that have not had a gain and loss analysis prepared have subsequently been faced with the need to make significant unexpected adjustments. Had an analysis of gain and loss been prepared, the administrators, the actuaries and the Office would likely have been aware of problems more quickly, and had more time to address them.

With this in mind and to protect pension plans and their members, the Office will now require an analysis of gains and losses for all defined benefit plans with more than 50 active members to be included with the valuation report. This is not to discourage other plans from providing an analysis of gains and losses. We believe that such an analysis is also often appropriate for smaller plans. In fact, if the circumstances of a smaller plan warrant it, the Office will notify the plan and insist that a gain and loss analysis be performed. However, the requirement for a gain and loss analysis for smaller plans will not be made universal because the Office recognizes that a gain and loss analysis involves a cost that small plans may not want to bear on a regular basis and that such analysis often lacks reliability when there are few members.

The gain and loss analysis should be appropriate to the benefits provided by the plan and the assumptions used by the plan's actuary. For example, the gain and loss analysis for a final average earnings plan should disclose the effects of salary increases, and an indexed plan should show the effects of increases in the Consumer Price Index since the last valuation. One would always expect to see the effect of plan amendments and investment gains or losses.

7. Pension Plan Termination Guidelines

In *PBSA Update* No. 5, we explained that we are working on plan termination guidelines. These guidelines will be completed within the next few months and will be sent to interested parties upon request. There will be specific guidelines for defined benefit plans and money purchase plans.

8. Pension Plan Conversion Guidelines

In July 1988, the Office issued a memorandum concerning conversions of defined benefit plans to money purchase plans. The memorandum established guidelines concerning the conditions under which we would approve these conversions. We are in the process of amending these guidelines and a final revised version should be available shortly. Copies will be sent to interested parties upon request.

9. Prudent Person Approach

As you are aware, pension plan investment requirements under the PBSA consist of qualitative rules that establish whether a particular investment is permitted at all, and quantitative rules, that establish limits on the holding of a particular investment, or class of investments.

In a press release dated June 14, 1991, Finance Minister Don Mazankowski indicated that the prudent portfolio approach to investments would be implemented for federally regulated pension plans. This approach places less emphasis on specific rules for quality and gives pension plan administrators the responsibility of establishing prudent investment policies and goals. In January 1988, the province of Ontario adopted a prudent portfolio approach for pension plans under its jurisdiction; Quebec pension reform legislation implemented prudent portfolio rules in 1990.

The federal trust and loan company legislation that was introduced in the House of Commons last September proposes replacing the investment approach to regulating investments of trust and loan companies with the prudent person approach. This approach will be applied to all financial institutions under the supervision of the federal government, including pension plans subject to the PBSA. In December 1990, the Office of the Superintendent of Financial Institutions published a discussion paper outlining a broad framework for directors and managers of financial institutions to use in developing policies and procedures for their companies or their Canadian branch offices, and describing in general terms how the Office will monitor investment and loan portfolios under the proposed prudent portfolio regime.

It is expected that a similar framework will be adopted in a future revision of the Regulations applicable to pension plans subject to the PBSA. Under the new regime, the Office will expect pension plans to follow sound business practices, specifically:

- the pension plan should have written investment policies;
- the policies should be reviewed regularly and approved by the plan administrator;
- the policies should address the specific risks related to asset quality, matching to liabilities and portfolio diversification; and
- the plan administrator should review regularly the results of these policies.

We invite pension plan administrators' comments on any of these points. We are working on the amendments to the Regulations and hope to have a discussion document available for circulation to interested parties sometime early in 1992.

10. Signatory of Certified Financial Statements

The Office has clarified its signatory requirements with respect to certified financial statements. We now require that the signatory be authorized to act on behalf of the financial institution for that purpose. The Office felt that this was necessary because of the importance of these documents.

We are attaching a memorandum to clarify the Office's policy regarding the certification required with the filing of certified financial statements.

Comments?

The Office welcomes readers' comments on any matter covered in *PBSA Update* or related to the Office's supervision of pension plans. If you have any suggestions that you think would improve communications between our Office and the pension industry or on other matters pertaining to the legislation, please let us know. Write to us at:

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