Office of the Superintendent
of Financial Institutions Canada

Bureau du surintendant
des institutions financières Canada

255 Albert Street
Ottawa, Canada
K1A 0H2

255, rue Albert
Ottawa, Canada
K1A 0H2

June 1996

PBSA Update

Issue No. 13

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

****

Contents

****

1. Amendments to the Pension Benefits Standards Regulations, 1985

The Regulations were amended on November 23, 1995 to permit the use of life income funds (LIFs) as a retirement vehicle option. In a December 1995 memorandum, OSFI informed administrators of this new option available to terminating plan members and surviving spouses. The memorandum also served as a reminder to plan administrators that all plans must be administered with the new LIF provision from November 23, 1995 onward. Further, because the LIF option (section 26 of the PBSA) is a registration standard, administrators of all pension plans registered under the PBSA should review their plan texts and, where necessary, add the LIF option.

It should be noted that there is no minimum age for selecting the LIF option under the PBSA.

Canada

An important feature of the LIF amendment is the description of the maximum annual amount which a holder may withdraw from his fund. This is defined as C/F, where “F” is the value of a $1 annual annuity payable to the end of the year in which the holder reaches 90 years of age.

Unfortunately, after the implementation of this amendment, it was discovered that there is a problem with the description of the interest rate assumption which must be used to calculate “F.” Fortunately, while the definition needs to be amended, its application will have no impact on maximum payments determined during 1996. The Regulations will be changed as soon as possible in order that maximum payments for 1997 and later years are established at the beginning of each calendar year using an interest rate which, *for the 15 years following each annual valuation*, is less than or equal to the CANSIM rate.

In Issue No. 12 of *PBSA Update*, we described a few additional changes to the Regulations that we were considering making. A number of proposals will likely be made as a result of the review of the PBSA announced in the January 23 press release, and there will be an opportunity for public consultation once they are released.

2. Annual Information Return – Clarification Regarding Some Filing Requirements

Section 7 on the Annual Information Return (AIR), under column (4), requests the number of members listed under columns (2) and (3) that are in “included employment.” “Included employment,” as defined in section 4(4) of the PBSA, is employment on or in connection with the operation of any work, undertaking or business that is within the legislative authority of the Parliament of Canada, excluding employment that is excepted by regulation. Employees of enterprises such as banks, airlines, interprovincial and international transportation and telecommunications companies fall within the scope of the PBSA, as does employment of any nature that is located in the Yukon or Northwest Territories.

Some pension plans cover members who are subject to provincial jurisdiction as well as members who are subject to federal jurisdiction. Reciprocal agreements between the federal government and a number of the provinces allow most plans subject to more than one jurisdiction to be registered with and supervised by one pension supervisory authority on behalf of the other authority or authorities.

If some employees listed under columns (2) and (3) of section 7 of the AIR are working in or in connection with an undertaking that does not fall within the scope of “included employment” this should be reflected in the column (4) entries. Please let us know (address and fax number are given at the end of this newsletter) if you have any questions regarding “included employment.”

Section 12 (AIR for money purchase plans) and section 16 (AIR for defined benefit plans). In recent months, the PBSA Section has received several enquiries requesting interpretation and clarification of the first two questions in the Investment Information section of the AIR.

Question (a) asks if all of the benefits are provided by an insured plan or by a pension plan in respect of which an annuity contract has been issued by the Government of Canada. The key words are all and insured. Some pension plans use annuities to cover benefits for retired members or former members with deferred vested pensions. These are not insured plans because annuities or insurance contracts do not cover the accruing active benefits. A fully insured plan consists of guaranteed group and/or individual annuities and/or Canadian government annuities providing for all the promised benefits. There are very few fully insured plans. The appropriate response for most plans to this question is “No.”

Question (b) asks whether the pension plan invests all its assets in unallocated general funds of a life insurance company. The key words are all and unallocated general funds. Investments in unallocated general funds of an insurance company mean that the insurance company guarantees the principal and interest, as for example, with GICs or deposit administration accounts. On the other hand, investments in segregated funds are separate and distinct from the general assets of the insurance company, usually held in Canadian or foreign equities, bonds, mortgages or money markets. These segregated funds are not part of the unallocated general funds of the insurance company and return rates fluctuate with markets. If all of the plan assets are invested through an insurance company, please first verify whether some assets are in segregated funds. Only if all of the assets of the plan are in investments that provide for guaranteed returns (e.g., GICs) should you choose “Yes” as the answer for question (b). For most plans, the appropriate answer for question (b) would be “No.”

The AIR Investment Information questions (c) to (k) must also be completed for all plans that do not have fully insured benefits and do not invest exclusively in unallocated general funds of an insurance company.

3. Basic Fee Rate

Effective October 1, 1995, the basis for calculating the filing fees, for an application for registration under the PBSA and for the annual information return, is \$10.50 per member up to 1,000 members and \$5.25 per member in excess of 1,000. The minimum fee is \$210.00 per plan and the maximum \$105,000.

4. Canadian Institute of Actuaries (CIA) Standard of Practice for Valuation of Pension Plans (January 1994)

This new standard includes many changes (over the old standard) that are to be followed when determining a pension plan's financial condition for valuations having an effective date on or after May 1, 1994.

Many solvency valuations we receive are brief in their description of the provisions valued on plan wind-up. In accordance with Part 3.03 of this CIA standard, we request inclusion and disclosure of the following items in solvency valuations:

1. estimation of wind-up expenses;
2. contributory plans: confirm that the 50 per cent rule has been recognized;
3. handling of transfer deficiencies for plans with a solvency ratio less than 1.0;
4. whether benefits subject to employer consent have been valued;
5. whether any bridge benefit has been valued;
6. reflection of pensionable age and any other early retirement subsidy in the retirement age assumption; and
7. if a full valuation is not performed, a detailed justification for the statement of opinion (that the solvency ratio equals 1.0).

Also, indications from recently reviewed actuarial reports are that some of the disclosure requirements of Part 6 of the standard are not being respected.

5. New Director of the Pension Benefits Division

After nine years with OSFI, Jean-Noël Martineau left to pursue other interests in the pension field. Ron Bergeron moves from our Life Insurance Division on June 10 to assume the duties of Director of the Pension Benefits Division.

6. Pensionable Age Defined

We have encountered several instances during our review of valuation reports and plan documents where administrators of pension plans subject to the PBSA are not aware of the implications of the definition of "pensionable age" as contained in the PBSA, its interplay with sections 16, 17 and 23 of the PBSA and its effect on their plan provisions and solvency funding requirements.

Pensionable age is defined as the *earliest age* at which an *unreduced* pension benefit is payable to a member under the terms of the pension plan *without the consent* of the administrator. This is usually the same as "normal retirement age" under the plan; however, a plan may also have other pensionable ages in addition to a normal retirement age.

Pursuant to section 17 of the PBSA, a vested member terminating before pensionable age is entitled to a deferred pension payable on the same terms and conditions as the immediate pension the member would have received upon attaining pensionable age; i.e., a terminated vested member is entitled to a deferred pension commencing at the pensionable age as defined in the plan. In accordance with subsection 16(2) of the PBSA, an immediate early retirement benefit must be available to members and former members 10 years before pensionable age as it is defined under the terms of the plan. Administrators should also note that the minimum pre-retirement death benefits under section 23 of the PBSA are tied to the pensionable age provisions of their plans.

Pensionable age establishes the following for valuation purposes:

1. members and former members are entitled to an immediate pension benefit upon attaining pensionable age ("R");

2. upon attaining age "R-10", members and former members are eligible to receive an immediate pension benefit;

3. an immediate pension benefit commencing before pensionable age may be reduced provided that its actuarial present value is not less than the aggregate of:

   (a) the actuarial present value of the pension that would have been payable commencing at pensionable age, and

   (b) the actuarial present value of any other benefit to which the member would have been entitled had the member remained a member of the pension plan until pensionable age.

Based on the above, the minimum retirement age assumptions to be used in the solvency valuation for various pensionable ages are:

1. members having attained age "R-10" at the date of valuation: entitlement to an immediate pension benefit with appropriate reduction for early retirement;

2. other members: pension benefit deferred to pensionable age.

Here are some examples.

	Pensionable Age	**10 Years Before Pensable Age**
Example 1	Age 60	Age 50
Example 2	Age 55 with 20 years of service	Age 45 with 20 years of service
Example 3	85 points	75 points

Examples 2 and 3 are more complicated scenarios because of the service component. In example 2, entitlement for a member who has 20 years of service but is not yet age 45 at the date of valuation is a deferred pension benefit payable at age 55. In example 3, entitlement for a member who has less than 75 points at the date of valuation is a deferred pension benefit payable when 85 points have been accumulated. In a solvency scenario, it is usually assumed that members accrue no future service. This means one point is credited for each additional year of age.

If a plan has more than one pensionable age, the most costly benefit should be valued when determining individual solvency liabilities. Assuming, for example, that the pensionable age is defined as the earliest of age 60 or 85 points, the benefit valued for a member who is 48 and has 26 years of service (74 points) at the date of valuation should be an unreduced pension deferred to age 59, which is the age when the member reaches 85 points. The pensionable age, i.e., the earliest age at which an unreduced benefit is payable to this member without the consent of the administrator, is age 59.

Some plan texts define normal retirement age as age 65, with an early retirement reduction from age 65. Amendments are submitted which change the early retirement reduction factors and grant an unreduced pension at age 62. Although probably not the intent of the administrator, this amendment establishes a new pensionable age for the plan at age 62 and the “R-10” age at age 52. Some plans have run into further complications in trying to rectify unintended pensionable age provisions because changing them to an older age may be a reduction in accrued benefits.

The purpose of pensionable age under the PBSA is to ensure that plan entitlements are provided consistently. Plan administrators and actuaries should verify how pensionable age is defined in plan texts and costed in valuation reports. Misunderstandings typically lead to wrong determination of deferred vested members’ pension entitlements, inappropriate early retirement eligibility provisions and death benefit calculations and their associated costs to the individual members and to the plan as a whole.

7. Retirement Annuity Purchases by Defined Benefit Plans with Solvency Ratios Less than One

This article is targeted at plan administrators who are in the practice of purchasing annuities for retiring members, rather than paying their pensions from the fund.

Even though a retiring member is entitled to the full pension he or she has accrued under the terms of the plan, the administrator, as a fiduciary, must ensure that remaining member benefits are not jeopardized through annuity purchases. When a pension plan has a solvency ratio less than one, the administrator who wishes to purchase annuities for retirees must compare:

> (A), the current solvency ratio times the value of the pension calculated on a solvency basis, and
> (B), the annuity quote to purchase the retiring member’s full pension entitlement.

If (A) < (B), the administrator must contribute to the fund an amount equal to (B) - (A) before the annuity is purchased, unless the transfer deficiency meets the test described under paragraph 9(3)(b) of the Superintendent's Directives.

If (B) < (A), the plan's obligation may be discharged in full through the purchase of the annuity.

Comments?

OSFI welcomes readers' comments on any matter covered in *PBSA Update* or related to OSFI's supervision of pension plans. If you have any suggestions that you think would improve communications between OSFI and the pension industry or on other matters about the legislation, please write to:

PBSA Update
Pension Benefits Division
Office of the Superintendent of Financial Institutions
255 Albert Street
Ottawa, Ontario
K1A OH2

You may fax the Pension Benefits Standards Division at (613) 990-7394 or e-mail us at penben@osfi-bsif.gc.ca.

Note: To help us keep our mailing list up to date, please let us know if you no longer wish to receive a copy of this publication.