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PBSA Update

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1. Amendment Proposals

A discussion paper, Enhancing the Supervision of Pension Plans Under the Pension Benefits Standards Act, 1985, was issued in July 1996 and was distributed to a wide variety of interested parties including those in receipt of the *PBSA Update*. The proposals are designed to keep the supervision of Canada's federally regulated pension plans more effective and responsive to the evolving environment in which they operate.

As set out in the paper, the proposals make recommendations with respect to supervisory and prudential matters and focus on the following key aspects:

- enhanced plan governance by placing more emphasis on the importance of the duties and responsibilities of plan administrators;
- enhanced power for the Superintendent to supervise a pension plan, short of plan termination;
- increased disclosure from the administrator to plan members on matters relating to the financial condition of the plan;
- enhanced funding standards and investment policies;
- clarification that the Office of the Superintendent of Financial Institutions' focus with respect to pension plans is on matters affecting solvency and financial condition;
- introduction of a simplified pension plan;
- a request for comments on the desirability of providing more legislative certainty to facilitate employer/employee arrangements on entitlement to surplus.

Individual pension plan administrators, consulting accountants, actuaries, lawyers, and industry groups responded to the invitation in the discussion paper to comment on the range of proposals, by September 27, 1996. Overall, comments were supportive of the thrust of the proposals and will be considered and, where appropriate, proposals amended. As many of the proposals will be implemented through regulation, there will be opportunity for further consultation.

Life Income Fund (LIF)

In 1995, the PBSA and Regulations were amended to permit members leaving a pension plan (or surviving spouses) to transfer pension benefit credits to a LIF. The Regulations describing the LIF prescribe the maximum withdrawals permitted in any calendar year; however, as we explained in Issue No. 13 of *PBSA Update*, the description of the interest rate assumption to be used in determining the maximum annual withdrawal, is not correct.

The Regulations, as they currently stand, base the maximum annual withdrawal on an interest rate assumption which is in effect from January 1 *of the year in which the contract was entered into*. The Regulations will be amended so that it will be in effect from January 1 *of the year in which the LIF is valued*. This will be consistent with the formula in effect in most other jurisdictions. This new amendment will be retroactive to January 1, 1997.

In summary, "F", the value of the annuity certain appearing in the formula used to determine the maximum annual withdrawal, will be established at the beginning of each calendar year using an interest rate which:

(i) for the first fifteen (15) years after valuation, is lesser than or equal to the CANSIM rate, and
(ii) is no more than 6 per cent for following years.

New LIF contracts as well as those established during 1996 should be administered in accordance with this new amendment.

2. New Approach to Supervision

An initiative included in our strategic plan for the next year is to re-organize the Pension Benefits Standards Division and streamline our business processes to focus on, among other things, matters affecting the solvency or financial condition of plans. We will be drafting "ladders of compliance," describing the supervisory and regulatory activities pursuant to OSFI's mandate and explaining what action can be expected from OSFI when various situations occur, such as when there is a risk to the solvency of a plan.

We will discuss these developments further in upcoming issues of *PBSA Update*.

3. Fee Schedule

Effective October 1, 1996, the basis for calculating the filing fees, for an application for registration under the PBSA and for the annual information return, is $10 per member up to 1,000 members and $5 per member in excess of 1,000. The minimum fee is $200.00 per plan and the maximum is $100,000.

4. Benefit Entitlement on Plan Termination

When a full or partial termination of a defined benefit plan occurs, the settlement of benefit entitlements must be addressed. A vested member is entitled to receive a pension on plan termination. The primary obligation of a defined benefit plan is a deferred or immediate pension unless the participant chooses a transfer value.

As the pension benefit credits for the solvency balance sheet are usually only an estimate of the cost of purchasing annuities, the plan may gain or lose when the annuities are actually purchased on plan wind-up. Normally this is of no great concern, but if there is little or no surplus at plan termination, the payment of accrued benefits in full to all members through annuity purchases may not be realizable.

Converting pension to cash equivalents at the moment of termination, to which money market interest rates are credited, would effectively convert the pension benefit to cash before the beneficiary decides whether to take the defined benefit promise of a pension or a transfer value. The approach to the settlement of benefits on plan termination should recognize the entitlement to a promised benefit.

For ongoing plan solvency valuations as well, consideration should be given to a member's benefit entitlement on plan termination. Because the solvency valuation is a determination of the liabilities on plan termination, the members' entitlement to a pension has implications for and should be reflected in the solvency valuation results. As an advisor on risk measurement, the actuary should report to the administrator and the regulator how benefits should best be preserved on plan wind-up and address the danger of the increasing cost of annuities.

5. Identifying Changes in Revised Plan Texts and Amendments – A Reminder

Recent and future changes to the PBSA, the Regulations and the *Income Tax Act,* as well as changes initiated by the plan administrator may necessitate further amendments to your pension plan(s). For example, in Issue No. 13 of *PBSA Update* we informed plan administrators that as a result of the approval of the LIF as a retirement vehicle option they should review their plan texts and, where necessary, add this option to the portability provisions.

To help OSFI process the changes made to your plan(s) more rapidly, we ask that plan amendments or revised plan texts filed with us clearly identify the changes made and distinguish those made to comply with Revenue Canada Rules from any other amendments being made concurrently. This may be done in a covering letter or by marginal notes in the text.

We remind administrators that plan texts and trust agreements submitted to OSFI must be executed by the administrator.

6. Index of Topics Covered in Issues of *PBSA Update*

We are pleased to attach an index, in both official languages, covering the topics that have been covered in *PBSA Update* since we started producing the newsletter in August 1988.

7. Preparing Computer Systems for the Year 2000

This will serve as a reminder to pension plan administrators of the need to review, test, and correct systems so they are prepared for the transition from December 31, 1999 to January l, 2000. In that regard, we hope the following comments on OSFI's recent experience in this area will prove useful.

In the context of its program of annual on-site examination of federally-regulated financial institutions, OSFI has been reviewing the plans companies have in place to prepare for the transition. The OSFI examiners' findings so far indicate that most institutions are aiming to have the systems changes completed before December 31, 1998 in order to have at least one full year to complete testing and clean up any unforeseen problems. Also, some companies have involved outside consultants where the situation is complex or where available resources might be an issue.

Another finding is that institutions generally have not adequately considered the software readiness of entities on whom they depend. Pension plan administrators who have a systems dependency relationship with their investment managers, plan consultants, actuaries and other service providers might want to consult with them to determine what changes, if any, may be required to their mutual systems to ensure a smooth transition to the year 2000.

8. OSFI Web Site

You may now visit OSFI on its web site, at http://www.osfi-bsif.gc.ca. This issue and future issues of *PBSA Update* and annual reports on the administration of the PBSA may be viewed on the web site. The legislation is also available via the web site. Please inform us if you intend to access *PBSA Update* via the web site and do not wish to receive paper copies of future issues.

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:

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