

The HR Space

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Significant Pension Changes Coming

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After years of consultations, the Canadian government has announced significant changes to the legal framework for federally regulated pension plans. In addition, proposed changes to the *Income Tax Act* would impact all defined benefit plans, whether regulated federally or provincially.

While we cannot cover all of the contemplated changes in this article, we do highlight some of the more significant ones we will likely face in the near future.

Pension Plan Funding Requirement Changes

(A) Average Solvency Ratios

A new minimum funding standard is proposed. The most significant change is that the solvency basis will use average (rather than current) solvency ratios to determine minimum funding requirements. The average solvency position of the plan for funding purposes will be defined as the average of the solvency ratios over 3 years, *i.e.* the current and previous two years. The 3 solvency ratios used in the determination of the average will be based on the market value of plan assets.

(B) Increased Surplus Threshold for Defined Benefit Plans: Changes to the “Rainy-Day Provision”

The current 10% pension surplus threshold that applies to defined benefit plans at both the federal and provincial level in the *Income Tax Act* will be increased to 25%.

The *Income Tax Act* allows employers to make whatever contributions are necessary to ensure that pension benefits promised under a defined benefit registered pension plan are fully funded. However, if plans have surplus funds over a specified threshold (generally 10% of liabilities on a going-concern basis), employer contributions must generally be suspended. The 10% surplus threshold will be increased to 25% in order to provide more funding flexibility to plan sponsors.

It is expected that a 25% threshold will help employers better maintain a surplus cushion, thereby reducing the likelihood and severity of funding deficiencies, while containing related tax assistance amounts.

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(C) Letters of Credit

Sponsors will be permitted to use properly structured letters of credit to satisfy solvency payments up to a limit of 15% of plan assets.

Changes Intended to Benefit Plan Members That Will Impact Employers

(A) Plan Sponsors to Fully Fund Pension Benefits on Plan Termination

Any solvency deficit that exists at the time of termination will be required to be amortized in equal payments over no more than 5 years. The obligations of the employer following the termination will be considered unsecured debt of the company.

(B) Limiting Employer Contribution Holidays

Contribution holidays will only be permitted if the pension plan is more than fully funded by a solvency margin, which will be set at a level of 5% of solvency liabilities. The rationale for this change is that it enhances members' benefit protection by creating a cushion to mitigate the risk of the plan falling into an underfunded position due to fluctuating asset and liability values.

(C) Minimum 0.85 Solvency Ratio

The void amendment provision will restrict benefit improvements by a plan that has or would lead it to have a solvency ratio of 0.85 or less. To put into effect a plan amendment that would otherwise be voided under this provision, the sponsor could fund the benefit up front such that the amendment would not have the effect of lowering the solvency ratio of the plan.

(D) Elimination of Sponsor Declared Partial Terminations

The intent of this change is to have a plan member who leaves voluntarily to be treated in a similar fashion to a member who leaves as part of a large corporate restructuring.

(E) Immediate Vesting of Benefits

Currently, there is a 2-year maximum period before accrued benefits are vested. The changes propose that vesting be made immediate upon membership in a plan. This approach would have the effect of increasing benefits under certain circumstances, such as where a member leaves just prior to the two years of service. In this case, under the current framework, this member would only be entitled to a return of his or her contributions plus interest. With immediate vesting, the same member would be entitled to the entire accrued benefit.

(F) Further Disclosure Requirements

The information required to be provided in annual member statements would expand to include: (i) the date of the solvency ratio reported in the annual statement along with the date of the next required valuation report; (ii) total assets and liabilities of the plan; (iii) summary of the plan's investment allocation and 10 largest investment holdings; (iv) a statement regarding members' right to examine the plan's Statement of Investment Policies & Procedures; and, (v) total employer contributions made for the reporting year.

The requirements for the types of statements would be expanded to include: (i) notification to beneficiaries of a plan's termination, within 30 days of the termination date; and (ii) an annual statement to former members and retirees with relevant plan information.

Conclusion

These are only highlights of some of the contemplated pension plan changes. Other proposed changes not covered in this article include: an entire scheme for “distressed pension plans”; a revised framework for defined contribution and negotiated contribution defined benefit plans; and modernizing the rules for pension fund investments. For more details go to <http://www.fin.gc.ca/n08/09-103-eng.asp>.

As noted, these proposals would not cover all pension plans. And they have not yet been enacted into law by the federal government. However, as employers, workers, and provincial governments

across Canada look to reform their own provincial pension legislation, do not be surprised if many of these amendments are replicated for provincially regulated pension plans in the next few years.

For more information on the subject of this bulletin, please contact the author.

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