Pension Plan Funding Relief

January 29, 2009

Due to the recent economic turmoil and current financial conditions, pension plan funding has become even more volatile. Significantly, increased funding obligations will result in pressure on plan sponsors to increase contributions in a time of global and Canadian economic uncertainty. This article examines the various funding relief measures being proposed or available to sponsors in Canadian jurisdictions.

FEDERAL AND TERRITORIAL

The Pension Benefits Standards Act (the "PBSA") applies to all pension plans coming within federal jurisdiction. With very limited exceptions, the PBSA currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years.

In its November 2008 Economic and Fiscal Statement (the "Economic Statement"), the Department of Finance (the "Department") announced plans to re-examine solvency funding rules applicable to federally-registered plans with the aim of making temporary changes to the PBSA.

Importantly, the Economic Statement proposes solvency relief that would allow federally-regulated plans to extend their solvency amortization period from five to ten years in respect of solvency deficiencies reported from November 1, 2008 to October 31, 2009. Plan

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administrators seeking to take advantage of this relief would have to meet one of the following two conditions by the end of the first year of relief:

1. Both members and retirees agree to the extended schedule; or
2. The difference between the five and ten year payment schedule is secured by a letter of credit.

Regardless of whether either of the above conditions is met, the first year's solvency deficiency payments would be based on the ten-year amortization period. If, however, neither condition has been satisfied by the end of the first year of relief, the plan would be required to fund the remaining deficiency over the following five years.

The specifics surrounding this solvency relief will take the form of new regulations to the PBSA. As of writing, the wording of these provisions has not been made available. The Department has indicated that draft regulations will be published in the Canada Gazette shortly.

To a large extent, the proposed relief mirrors the temporary 2006 Solvency Relief Regulations (the "2006 PBSA Regulations"). Unlike the 2006 PBSA Regulations, however, the proposed measures will not provide the option of consolidating a plan's previously established solvency payment schedules into a new five-year schedule, nor do they anticipate the solvency relief being extended to later plan years.

Additionally, the latest Federal Budget, delivered on January 27, 2009 (the "Budget") has announced unexpected further relief. Currently, the Office of the Superintendent of Financial Institutions allows plan actuaries to smooth asset values over a maximum of five years but precludes using any asset value exceeding 110% of market value. The Budget proposes to permit asset values to exceed 110% with the additional safeguard that any amount in excess of 110% will be subject to a deemed trust in favour of the plan.

In the Economic Statement, the Department also announced that it would initiate a consultation process in 2009 on issues facing defined benefit and defined contribution plans and will coordinate this process with provincial and territorial Finance Ministers. The Budget announced that this consultation process would be expedited in order to be completed within 90 days. The Budget has also reaffirmed the government's commitment to the solvency relief described in the Economic Statement.

**ALBERTA**

Alberta pension legislation currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. Alberta permits sponsors to fund solvency deficiencies with irrevocable letters of credit from qualifying financial institutions, which in turn must meet certain conditions, including having a term of no more than one year.

Moreover, until December 31, 2008, special rules in the legislation allowed a sponsor of a specified multi-employer pension plan ("SMEPP") to receive an exemption from making
solvency payments for three years.\textsuperscript{2} To qualify for this moratorium, going concern unfunded liabilities had to be amortized over ten years instead of fifteen, and no benefit improvements could be granted during the moratorium. After the moratorium, the plan administrator must conduct another actuarial valuation and liquidate any solvency deficiency that the valuation discloses within five years.

On December 18, 2008, the Alberta Ministry of Finance and Enterprise ("MFE") released a discussion paper (the "Alberta Discussion Paper")\textsuperscript{3} that proposes four additional methods of solvency relief for plans that are required to, or choose to, file an actuarial valuation report with a review date on or after September 1, 2008 and before January 1, 2010. They are as follows:

1. The MFE has indicated its intention to allow plans to use the new Canadian Institute of Actuaries Guidelines for Determining Commuted Values for valuations effective prior to their April 1, 2009 effective date. This proposal would have the effect of lowering plan liabilities because a higher discount rate would be used in valuing them;

2. The MFE is considering extending the availability of the three-year moratorium on solvency payments for SMEPPs in respect of solvency deficiencies disclosed in 2008 valuations, until December 31, 2011;

3. The MFE is considering extending the amortization period for solvency deficiencies from five to ten years, but only in respect of a deficiency disclosed by valuations done between September 1, 2008 and December 31, 2009; and

4. The MFE is considering extending the solvency moratorium for SMEPPs to single employer defined benefit plans. As with the SMEPP exemption, this proposal would offer sponsors the opportunity to apply for a three-year moratorium on solvency payments. All going concern unfunded liabilities, including those established at prior valuations, would have to be funded over a maximum of ten years rather than fifteen, and no benefit improvements could be granted during the moratorium. As with the proposed extension to the SMEPP moratorium, this relief would be available to single employer plans until December 31, 2011.

BRITISH COLUMBIA

British Columbia pension legislation currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. On June 26, 2008, new regulations came into force providing the following two measures of solvency relief in respect of solvency deficiencies:

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\textsuperscript{2} The Superintendent has the discretion to designate a multi-employer pension plan as a SMEPP. According to the Superintendent’s policy, a MEPP may be eligible to be designated a SMEPP when it is union sponsored, collectively bargained and subject to a negotiated contribution amount.

1. Sponsors may now use irrevocable letters of credit from qualifying financial institutions to secure solvency deficiency payments. Each letter of credit may only be used for up to one year. Upon expiration, the sponsor may renew or replace the letter of credit provided that the sponsor gives notice to the B.C. Superintendent of Pensions; and

2. Sponsors of a defined benefit multi-employer negotiated cost pension plan ("MENC") may apply for a moratorium on solvency payments for up to three years, provided that certain conditions are met. Generally, the conditions require the MENC to continue meeting prescribed funding and current service cost tests, to amortize any unfunded liability over a period of up to ten years and to restrict benefit improvements during the moratorium. After the expiry of the moratorium, the administrator must prepare a valuation report and liquidate any solvency deficiency over five years. The administrator currently may not apply for a second moratorium.

**MANITOBA**

Manitoba pension legislation generally requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. In December 2008, Manitoba introduced a new relief regulation (the "Manitoba Relief Regulation") available only to sponsors whose funding payments are up-to-date and only in respect of the first valuation report filed before January 2, 2011. The relief is available, with substantially similar requirements, to single-employer defined benefit plans and multi-unit pension plans. The Manitoba Relief Regulation allows sponsors to elect to consolidate existing solvency deficiencies with a new ten-year amortization period, provided that written notice is given to members and retirees, and, after a specified objection period, no more than one third of members and no more than one third of retirees, taken as separate classes, object to the election. During the relief period, the plan cannot be amended to increase benefits if it would create an unfunded liability nor can it decrease employee contributions. Any solvency deficiency calculated after the date of the initial deficiency must be determined according to the criteria in the Manitoba Relief Regulation. Finally, the election may be revoked, subject to certain requirements. Special rules also apply to sponsors who are universities.

**NEW BRUNSWICK**

New Brunswick pension legislation currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. The Superintendent has the discretion to extend the amortization period in respect of solvency deficiencies to a date on or before December 31, 2018, provided that certain conditions are met. These conditions include the maintenance of sufficient assets to ensure the plan's cash flow requirements over the extended amortization period and the provision of written notice to plan members and beneficiaries. Furthermore, any relief granted at the Superintendent's discretion imposes a continuing obligation on sponsors to notify the Superintendent if it is at risk of not making a required special payment. There are also special relief provisions for sponsors who are New Brunswick municipalities and universities.
NEWFOUNDLAND AND LABRADOR

Newfoundland and Labrador pension legislation currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. On May 26, 2008, Newfoundland and Labrador amended its pension legislation to provide temporary solvency funding relief for single-employer and multi-employer defined benefit pension plans. Separate provisions govern single and multi-employer plans, but in substance the relief permits the following two options for both plan types:

1. Consolidating previous solvency funding payment schedules with the entire deficit to be amortized over a new five-year period; and

2. Extending the solvency funding period from five to ten years, provided that one of the following two options is met:

   (a) No more than one third of a plan's active and no more than one third of its non-active and retired members, taken as separate classes, object to the extension; or

   (b) The difference between the five and ten year payment schedule is secured by a letter of credit. Notice of this option must be given to members.

These measures are available in respect of solvency valuations made between January 1, 2007 and January 1, 2009.

NOVA SCOTIA

Nova Scotia pension legislation currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. There are three exceptions to the rule in respect of solvency deficiencies: universities may temporarily extend their amortization period to fifteen years for pre-2006 deficits; SMEPPs have a three-year exemption from solvency funding; and, until August 2016, municipalities can elect to fund only 85% of the solvency deficit over a five-year period.

On January 27, 2009, the Nova Scotia Pension Review Panel (the "Panel") released its final report. The Panel proposes legislative changes whereby plans have an amortization period for solvency deficits over a maximum of ten years from their next valuation date. The Panel does not address whether member approval or notice would be required in respect of this extension. It is also unclear whether these measures would be temporary or permanent.

The Panel also makes the following recommendations for solvency relief:

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1. Solvency valuations should be made on an accrued benefits basis including consideration of all promises, which would be closer to actuarial assumptions used for going concern valuations;

2. No benefits improvements should be allowed if the plan is in deficit;

3. A 5% "collar" should be provided. If a defined benefit plan is at least 95% funded at the time of valuation, the sponsor would not be required to make special payments. Actuarial valuations would be on a fixed three-year schedule, but these plans would have to perform an annual test as of the anniversary of the most recent full valuation. If this test shows that plan funding levels are falling below 95%, a full valuation must be performed and filed with the Superintendent within six months subject to fines if deadlines are missed;

4. If a plan begins to amortize a deficit over ten years and the next year's deficit is lower than expected, then the reduced deficit would be amortized over the remaining nine years. Conversely, if a subsequent valuation shows an increase in deficit, the existing deficit would continue with its previous amortization schedule and the increase in deficit would be subject to a new amortization schedule;

5. Target Benefit Plans, including specified multi-employer pension plans, should also be allowed the 5% collar, subject to the three-year valuation schedule and required annual tests. Benefit improvements could only be made when the benefits could be supported by 90% of current assets and future contributions;

6. Smoothing of assets should not be permitted; and

7. Any surplus exceeding 105% funding should be amortized over a minimum of ten years, with interest. Surplus in excess of 105% may be used to improve benefits, but improvements could not bring the plan below 100% funding.

ONTARIO

Ontario pension legislation currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. The Ontario government announced measures for solvency relief in December 2008 and intends to introduce corresponding legislation this spring. This legislation would lengthen the period of time for solvency payments retroactive to September 30, 2008. As of writing, the Ontario government is still seeking comments on its relief measures. Eight key measures are proposed:

1. Extending solvency amortization periods from five to ten years with the requirement for some form of member consent, either through a collective bargaining agent or through approval of its active and retired members. Requirements for consent have not yet been

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formulated and there is currently no alternative relief option not requiring member consent;

2. Consolidating previous funding schedules;

3. Deferring catch-up payments to provide one year of cash-flow relief;

4. Using actuarial gains to reduce annual payments required by plan sponsors;

5. Providing enhanced notice to current and retired plan members;

6. Accelerating funding of benefits improvements;

7. Temporarily limiting certain contribution holidays; and

8. Adopting the revised Canadian Institute of Actuaries Guidelines for Determining Commuted Values. This proposal would have the effect of lowering plan liabilities because a higher discount rate would be used in valuing them.

These measures are meant to strike a balance between providing temporary relief to pension sponsors and providing adequate protections to plans and their members.

QUÉBEC

Currently, Québec temporarily allows sponsors to reduce solvency amortization payments with a letter of credit, provided that the amount of the reduction is no more than 20% of the difference between the plan's assets and liabilities. Also, similar to some Maritime jurisdictions, Québec has already extended its amortization periods in respect of solvency deficiencies from five to ten years for plans sponsored by municipalities and universities. On January 15, 2009, the Québec government unanimously approved Bill 1, An Act to amend the Supplemental Pension Plans Act (the "Amendment Act"). While the bulk of the Amendment Act came into force on the date of assent, certain provisions will come into force in the future, in varying stages. Additional proposals are also expected to come into force by regulation in the near future, but as of writing, these regulations have not been published. Generally, the Amendment Act and expected regulations will allow for consolidation of solvency deficiencies and the extension of amortization periods from five to ten years. It is not yet known what conditions will apply, including whether this extension will require the consent of members and retirees, though the previous changes made in respect of municipal and university plans did require consent of active members and beneficiaries with no relief possible if more than 30% of active or more than 30% of non-active members, taken as separate classes, objected.

The Amendment Act also allows for the adoption of the Canadian Institute of Actuaries Guidelines for Determining Commuted Values for valuations effective April 1, 2009 retroactive to December 31, 2008. Finally, it is expected to allow for the smoothing of assets over five years and for the use of actuarial gains to reduce cash payments. Whether the Amendment Act and upcoming regulations will apply to all defined benefit pension plans or only to those in financial distress remains unclear.
SASKATCHEWAN

Saskatchewan pension legislation currently requires solvency deficiencies to be amortized over five years and going concern unfunded liabilities to be amortized over fifteen years. On December 11, 2008, the Saskatchewan Financial Services Commission ("SFSC") released a discussion paper proposing two relief mechanisms for plan sponsors and inviting feedback as to which proposal would be preferable.6

1. The SFSC is proposing an extension of the amortization period in respect of new solvency deficiencies from five to ten years for actuarial valuations with a review date falling between December 31, 2008 and December 31, 2009. The proposed relief would not apply to solvency deficiencies previously established.

2. In the alternative, the SFSC is proposing a three-year moratorium on solvency payments in respect of new solvency deficiencies disclosed by actuarial valuations with a review date falling between December 31, 2008 and December 31, 2009. As the moratorium would only last three years, this proposal would still require the sponsor to make solvency payments in the fourth and fifth year as normal.

In respect of both proposals above, the SFSC has indicated three principal conditions that would likely have to be satisfied in order to be eligible for relief. First, no benefit improvements would be permissible during the course of the relief period. Second, if the plan should terminate during the relief period, any outstanding solvency deficiencies would have to be fully funded over the remainder of their respective amortization periods (this requirement already exists in many other Canadian jurisdictions). Third, the sponsor would have to provide notice to plan members and beneficiaries respecting any application for solvency relief.

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As many solvency relief measures in various Canadian jurisdictions are still in the development stage, the options available to sponsors will likely evolve. Davies Ward Phillips & Vineberg LLP will continue to monitor these and other developments as they are effected.

If you have any questions regarding the foregoing, please contact Natasha vandenHoven (416.863.5521), in our Toronto office or Janet Ferrier (514.841.6511), in our Montréal office.

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