



AUGUST 26, 2010

Pension *Pulse*

Ontario Government Announces Phase 2 of Pension Reform

The Ontario government released a backgrounder yesterday afternoon, outlining proposed measures for Phase 2 of its pension reform agenda. These reforms follow Bill 236 that received Royal Assent in May of this year (see our *Pension Pulse* dated June 24, 2010).

The backgrounder is entitled: "McGuinty Government Taking Additional Steps to Strengthen Ontario's Pension System." The steps seem to be going in the wrong direction. For the most part, the proposals impose additional fees in order to provide much-needed cash for the Pension Benefits Guarantee Fund and add another layer of restrictive rules on private sector defined benefit pension plans.

At the same time, the proposals introduce favourable rules for pension plans in the broader public sector. As such, the proposals may well serve to increase the disparity between pension plans in the private and public sectors and to further the decline of defined benefit plans in Ontario. This is certainly not the direction recommended by the Expert Commission on Pensions.

The proposals will take the form of regulations. These will be released first in draft form, allowing time for comment. In addition, the reforms, when finalized will be phased in to permit pension plan sponsors sufficient time to plan and make necessary adjustments. Part of the problem with the recent reforms in Bill 236 has been the absence of effective dates. Introducing pension reforms in a piecemeal manner and without definite effective dates makes it very difficult for employers to plan.

Pension Benefits Guarantee Fund ("PBGF")

The PBGF is unique to Ontario, among all provincial jurisdictions and the federal jurisdiction. It was created in 1980 and essentially provides a top-up in the event of insolvency of an employer with an underfunded pension plan. The PBGF ensures that members of such a pension plan receive a minimum monthly benefit equal to the lesser of the benefit properly payable from the pension plan and \$1,000.

For example, if the benefit payable from a pension plan to a particular pension plan member is \$1,600 per month and, because of the underfunding of the pension plan, only \$800 per month is payable, the PBGF will top-up the pension to \$1,000 per month. The \$1,000 threshold amount has never been changed, so the benefit of the PBGF in real terms has eroded substantially. Even so, the PBGF has been significantly underfunded pretty well since inception.



One solution would be to do away with the PBGF, because the experience in Ontario and in the U.S. with its Pension Benefits Guaranty Corporation, is that guarantee funds do not work. In addition, the PBGF is a significant departure from pension legislation in the rest of Canada. Maintaining the PBGF continues the lack of harmony in pension legislation across Canada, at a time when governments should be doing whatever they can to harmonize legislation and increase efficiencies.

The government proposes to significantly increase the premiums to the PBGF. This is essentially a convenient way to raise taxes. Instead of funding the PBGF deficits through government revenues, as has been the case, now a greater burden will be placed on pension plan sponsors. There will be a minimum assessment of \$250 per pension plan, the base per member fee will increase from \$1 to \$5, the maximum per member fee will increase from \$100 to \$300 and the \$4 million cap on assessments will be removed.

These measures do not increase benefit security for pension plan members. For those members who are caught up in a corporate bankruptcy with an underfunded pension plan, the entitlement to the \$1,000 top-up will be unchanged.

Employer Contributions

Employers will be permitted to use irrevocable letters of credit as a way of funding up to 15% of a pension plan's solvency liabilities. This is a positive development, however, employers in financial risk will have difficulty securing letters of credit or they will be prohibitively expensive.

Employer contribution holidays will be permitted, unless expressly prohibited under an employer's pension plan documents. Holidays cannot be taken if by doing so, a pension plan's solvency (transfer ratio) would be less than 105%. Employers will be required to disclose their intentions to take contribution holidays to all plan members, and will be required to make regulatory filings. The notification requirement sounds good, but it can be very onerous and expensive in practice.

Plan Funding

To reduce the degree of volatility in funding of pension plans and to average out the ups and downs of interest rates and investment returns, plan sponsors have used asset and liability smoothing methods. The use of these strategies has been done on the advice of actuaries and has been in compliance with the standards of the Canadian Institute of Actuaries. It has better enabled plan sponsors to plan their finances.

The proposals will significantly limit the availability of such smoothing methodology. Notably, the averaging of solvency interest rates to value a plan's liabilities will not be permitted, the smoothing of going concern assets will be limited to five years, the value of assets either on a going concern or solvency basis will not be able to vary more than 20% from market value, the value of any indexation benefits will have to be included in going concern valuations but not solvency valuations and an 85% funding threshold will be used to identify plans with solvency concerns requiring annual valuations.



Currently, if a pension plan is amended to improve the level of benefits, the cost must be funded over no more than 15 years. The proposals reduce the funding period to no more than eight years. In addition, if the pension plan's solvency (funded ratio) is less than 85% either before or after the improvement, a lump sum payment will be required and remaining costs will have to be funded over no more than five years.

Surplus Entitlement

In the era when pension plans had surplus assets, there were many legal battles over entitlement issues. This continues to be an area of uncertainty. The proposals will introduce a binding arbitration process, and permit payments to a plan sponsor where entitlement is clear or with a surplus sharing agreement. Payments of surplus assets to plan sponsors will be permitted on an on-going basis where there is clear entitlement or with consent of two thirds of plan members. In such case, a surplus cushion would have to remain in the plan. The proposals will also protect surplus rights in the event of pension plan mergers, spin-offs and asset transfers.

Investment Limits

The proposals will make the necessary changes to the regulations in order to adopt the modifications to the quantitative investment limits under the federal *Pension Benefits Standards Act*. Please refer to our *Pension Pulse* dated May 4, 2010 and July 2, 2010 for more details on the federal changes.

Plan Expenses

One of the proposals is to permit the payment of reasonable expenses from a pension fund, unless the pension plan documents prohibit such payments. This follows the 2009 decision of the Supreme Court of Canada in *Nolan v. Kerry*. Please refer to our *Pension Pulse* dated August 12, 2009 for details on the Kerry decision.

Funding of MEPPs and JSPPs

Multi-employer pension plans ("MPPPs") and jointly sponsored pension plans ("JSPPs") are different from the typical single-employer defined benefit pension plans in some respects and have different rules applicable to them under the Ontario *Pension Benefits Act*. The proposals will exempt target benefit MEPPs from solvency funding requirements. These are typically the industry-wide collectively bargained pension plans that set a benefit rate based on bargained contribution rates. These plans are notoriously underfunded.

Part of the rationale for the special treatment is that these MEPPs may reduce accrued benefits. There is also a proposal to exempt JSPPs from solvency funding requirements. These plans are some of the very large multi-employer plans. These proposals might not be a bad idea for all defined benefit plans, namely, to permit them to reduce benefits and exempt them from solvency funding. This would level the playing field somewhat.



Broader Public Sector

The government proposes to allow more time for employers in the broader public sector, such as universities, to pay down solvency deficiencies. Pension plans that are less than 90% funded would submit a plan to the government to enhance plan sustainability. In such case there would be a three-year period permitting these employers to fund their plans to a lower solvency threshold. Provided this produces positive results, there would be a further ten-year period to liquidate solvency deficits instead of the normal five-year amortization period.

The rationale for this proposal is:

"Certain employers in the broader public sector have found themselves facing the prospect of having to make significant solvency special payments that could negatively affect front-line public services. To protect these vital services and place pension plans on a more sustainable track for the future, the government is proposing to offer more time to pay down solvency deficits provided that the broader public sector employers make their plans more sustainable."

These pressures are not unique to the broader public sector. The financial pressures and economic conditions are common to all employers, both in the broader public sector and the private sector.

The next step in this pension reform process is for the government to release the draft regulations for comment. We will keep you informed and in the interim, please contact any member of our Pensions and Benefits Group for guidance with pension issues. ■



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