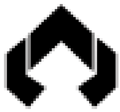

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PBSA Update

Issue No. 10

PBSA Update is issued by the Pension Benefits Division of the Office of the Superintendent of Financial Institutions to improve communication between the Office and pension plan administrators whose plans are supervised pursuant to the *Pension Benefits Standards Act, 1985* (PBSA). Issue No. 9 was dated June 1993.

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1. New Basic Fee Rate

The basic fee rate for calculating PBSA fees for plan years ending between October 1, 1993 and September 30, 1994 is $10.25, as published in the *Canada Gazette* on October 2, 1993. This represents a 22 per cent reduction from the rate that was payable in the previous twelve months.

Last year the basic rate was raised from $10.25 to $13.10 to cover a substantial, but temporary, shortfall in revenue for fiscal year ended March 31, 1992. As explained in *PBSA Update* Issue No. 8, this shortfall was expected because of events at the implementation of full cost recovery in 1991. Now that the shortfall has been recovered through the increased fees, the basic fee rate returns to $10.25.

The $10.25 per member rate applies up to 1,000 members and reduces to $5.13 per member in excess of 1,000. A minimum fee of $205 is payable for plans with fewer than 21 members. The maximum fee is $102,500. Fees are required to be submitted to the Office with the filing of an application for registration under the PBSA and, thereafter, with the annual information return.

2. New Filing Requirements Being Considered

In *PBSA Update* Issue No. 8, we reported that the Office was reconsidering some of its requirements for lists of assets, financial statements and information regarding investment policies. The Office is also considering revising the annual information return. We had hoped to complete these changes in 1993, but we have decided that further consultation is necessary. We hope to complete our review of requirements and change our filing requirements in 1994.

3. New Follow-Up Procedure for Filing Requirements

Effective immediately, the Office will reduce the number of letters it sends to plan sponsors reminding them of filing requirements.

For the past several years, we have reminded plan administrators of filing requirements a few weeks before plan year end (i.e., six months before the documents were due to be filed). With the reminder, we enclosed blank copies of the annual information return. About a month before filings were due, we sent a follow-up letter to any plans that had not yet filed. When necessary, we also sent subsequent follow-up letters.

4. Proposed Amendments to the Pension Benefits Standards Regulations, 1985

OSFI is recommending to the Minister some further changes to the Regulations. First mentioned in *PBSA Update* Issue No. 8, these recommendations are subject to legal review and, in some cases, further government approval. We expect to get approval soon. The amendments include:

- Making British Columbia, New Brunswick and Saskatchewan designated provinces, i.e., provinces in which there is a pension standards legislation substantially similar to the PBSA. Ontario, Quebec, Nova Scotia, Manitoba and Alberta are already so recognized.

- Exempting from the application of the PBSA supplementary pension plans that are designed specifically to provide benefits in excess of the *Income Tax Act* limits.

- Exempting bridging benefits from the joint and survivor form of benefit required under sections 22 and 23 of the PBSA.

- Exempting non-resident plan members and members who cease to be Canadian residents from the application of the locking-in requirements of the PBSA.

- Adopting the Canadian Institute of Actuaries' (the CIA) revised Recommendations for the Computation of Transfer Values from Registered Pension Plans effective September 1, 1993.

Experience has shown that most plan administrators are not able to file these documents much before their due date. We have found that forms sent too much in advance are put aside and forgotten or lost, resulting in unnecessary correspondence and telephone calls.

Under the new procedure, about three months before filings are due administrators will be sent one letter reminding them of filing requirements. Blank annual information return forms will be included in that mailing. Administrators wishing to file at an earlier date may contact the Office in advance for the forms.

We will no longer make specific requests for solvency reports, because a solvency valuation must be included in every valuation report.

The Regulations currently require plans to calculate pension benefit credits for the exercise of portability options in accordance with the Recommendations for the Computation of Minimum Transfer Values of Pensions, issued by the CIA in November 1988. The Institute has adopted new recommendations for the calculation of transfer values, effective September 1993, but the Regulations continue to refer to the recommendations issued in 1988. Until the Regulations are amended, plans must provide transfer values that are at least as generous as those required by the 1988 recommendations.

For the Future

The following issues are currently being considered within the Office and may result in future recommendations for amendments to the Regulations:

- new reporting requirements for the annual information return;

- rules for distributing assets from plans that are wound up;

- strengthening solvency standards for negotiated plans;

- exempting negotiated contribution plans and plans that offer enhancements to benefits conditional on extra contributions from the application of the 50 per cent rule.

Comments on any or all of these issues are welcome.

5. Basis for Solvency Valuation

As explained in *PBSA Update* Issue No. 6, the Office requires that solvency valuations be calculated using interest and inflation assumptions that are consistent with the basis for calculating transfer values. Because the Office intends to adopt the new CIA Recommendations for the Computation of Transfer Values from Registered Pension Plans in the near future, we are prepared to accept solvency valuations being prepared as of June 30, 1993, or later, and based on a set of economic assumptions chosen either from the 1988 recommendations or from the new recommendations. Once the Regulations are changed, all solvency valuations must use assumptions taken from the new recommendations.

6. Plan Amendments and the New Income Tax Legislation

We understand that amendments to defined benefit pension plans required to satisfy current tax requirements are due to be filed with Revenue Canada, Taxation shortly. These amendments must also be filed with the Office if the pension plans are subject to the PBSA.

We remind plan administrators of a request we made in Issue No. 6 of *PBSA Update* and through a memorandum to plan sponsors, that the amendments or the amended plan texts filed with us clearly distinguish the changes made to comply with new RCT rules from amendments made for other reasons. This may be done in a covering letter accompanying the amendments or with marginal notes in the text. This will help the Office process the amendments more rapidly.

7. Assets That Are Difficult to Value

Section 9 of the Regulations calls for the valuation of solvency assets at market or at a value based on market values over a term of not more than five years. The market values of many assets such as real estate and resource properties are difficult to estimate before they are sold. Between purchase and sale, market value can only be estimated, and then only roughly.

Many actuarial reports we receive do not include enough information about how market values have been established. If the report does not disclose how the value of an important group of assets was determined, our actuarial staff cannot be sure that the plan is funded according to the Regulations. We feel that the failure to disclose this information violates section 7.01 of the CIA Recommendations for the Valuation of Pension Plans, which requires actuaries to include in their reports enough information to permit another actuary to make an objective appraisal of the valuation.

Section 9 of the PBSA requires the Office to direct changes to reports that have not been prepared in accordance with generally accepted actuarial principles. We feel that if an actuary uses values that have been calculated by another party, generally accepted actuarial principles require the actuary to obtain all the information needed to assess whether these values are appropriate. The actuary must also explain how he has decided whether the

figures may be used without modification, or that adjustments or even qualifications to the report are required. In other words, the Office expects to see in the report enough information to understand what is behind the values that the actuary is using. For instance, the actuary may use asset figures from a financial statement produced by an insurance company. However, the actuary should describe how the company has calculated these figures and discuss whether they represent a fair estimate of what the plan would receive if it needed to liquidate its assets. Finally, any adjustments to the figures provided by the insurance company should be described.

More specifically, if real estate values are based on appraisals, the report should state when these appraisals were done, and should comment on whether some adjustment to the appraised values is necessary. Assumptions underlying the appraisal can be useful: for example, what conditions were assumed for the sale of the assets. What can be realized from the liquidation of a portfolio within half a year is often much less than what can be realized when more time is available. If the terms of a contract or participation require that any liquidation be accomplished over a prolonged term, then this should be stated in the valuation report. The description of the valuation of loans should address credit risk, and the plan's ability to liquidate the loans over a short term.

The valuation of assets is critical to ensure meaningful solvency valuations. Our recent experience has confirmed this more than once. Of course, the Office realizes that the effort expended in valuing a class of assets should be related to its importance to the plan.

8. Funding of Plant Closure Benefits

Section 9 of the Regulations requires the plan actuary to include all benefits that would be payable at termination in the solvency liability. Because any excess of the solvency liability over solvency assets will require the establishment of a series of special payments to amortize the deficit over five years, this section implies the funding of all termination liabilities. Previous issues of *PBSA Update* have underlined the fact that these liabilities include the expenses of winding up the plan and the cost of indexation as provided by the plan text. Issue No. 7 of *PBSA Update* discusses the vesting of benefits when a plan terminates.

The CIA Recommendations for the Valuation of Pension Plans do not specify how these termination liabilities should be calculated. Two approaches that have been put forward do not satisfy us. The first is to value the benefits payable under the circumstances that the actuary thinks most probable, ignoring more expensive benefits that would be payable under less likely circumstances. The second is to value the benefits payable under various scenarios, weight the results by probabilities and arrive at an expected value.

These approaches are unsatisfactory because they will assure funding of the termination liability only under certain circumstances. While some actuaries argue that funding is not required for benefits that are unlikely to be paid, we do not feel that this is consistent with the rationale of the solvency regulations. Indeed, most plans are unlikely to terminate under any circumstance in the near future, but the Regulations require the plan actuary to value

termination liabilities. If a provision for plant closure benefits is of any use at all, there must be some provision to fund them. Without guidance from the Regulations, we can only assume that these benefits should be funded as other termination liabilities.

Some employers may object that they never intended, when they included provisions for special benefits on plant closure, to make additional payments to fund them. Their intention was merely to provide that, once other benefits had been provided, any residual assets should be used to provide these special benefits, rather than returned to the employer. In other words, the plant closure benefits are a method of reserving residual assets to employees. If the employer intends to allocate residual assets, rather than provide specific benefits, then the plan text should state this. If the plan text promises plant closure benefits, rather than an allocation of residual assets, then these benefits must be funded.

Depending on the circumstances of the plan, some employers may wish to amend their plan texts. Like other amendments, modifications to provisions for plan termination benefits must be submitted to the Office for approval.

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 our Office and the pension industry or on other matters about the legislation, please write to:

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