ADMINISTRATION OF THE *PENSION BENEFITS STANDARDS ACT, 1985*

Annual Report

1997-98

The Honourable Paul Martin, P.C., M.P.
Minister of Finance
Ottawa, Canada
K1A 0A6

Dear Minister:

I am pleased to submit to you the *Administration of the Pension Benefits Standards Act, 1985 Annual Report,* pursuant to section 40 of the Act. The report covers the period from April 1, 1997 to March 31, 1998.

Section 40 specifies that the report shall be laid before Parliament by the Minister within 15 days after he receives it or, if Parliament is not sitting, within 15 days after that Parliament reconvenes.

Yours very truly,

John R.V. Palmer
Superintendent

Ottawa, November 1998

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Report on the Administration of the *Pension Benefits Standards Act, 1985* for the Year Ended March 31, 1998

Introduction

Section 40 of the *Pension Benefits Standards Act, 1985* (*PBSA*) requires that each year the Superintendent submit a report to the Minister on the following:

(a) the operation of the Act during that year;

(b) the extent to which inflation adjustments or other adjustments to pension benefits have been provided during that year, either voluntarily by employers or pursuant to collective agreements, as shown in information filed pursuant to section 12;

(c) the source of the funds used to make any adjustments referred to in paragraph (b); and

(d) the application of gains, if any, from pension funds.

Employer sponsored pension plans, are major components of the Canadian retirement system, along with the Old Age Security, Canada/Quebec Pension Plans and Registered Retirement Savings Plans. Pension plans for all private sector and some public sector employers are subject to standards legislation designed to ensure the security of pension benefits and minimum levels of protection for members and their beneficiaries. The plans are also subject to the *Income Tax Act* which establishes limits within which tax deductions are permitted for contributions from both employees and employers.

The *PBSA* governs private pension plans established in respect of employees working in areas subject to federal jurisdiction, such as banking, interprovincial transportation, telecommunications, and undertakings outside the exclusive legislative authority of provincial legislatures. The latter category includes public and private undertakings in the North and those of Native organizations. All other private pension plans are governed by the laws of the province or provinces in which their members are employed.

The *PBSA* is administered by the Private Pension Plans Division of the Office of the Superintendent of Financial Institutions (OSFI). The Division is responsible for the supervision of pension plans that fall under federal jurisdiction.

The *PBSA* came into force on January 1, 1987, repealing the *Pension Benefits Standards Act* which had been enacted in 1967. The *PBSA* established certain standards which include funding and investments, eligibility for membership, vesting, locking-in and portability of benefits, death benefits, and members' rights to information.

After the period covered in this report, the *PBSA* and the *Office of the Superintendent of Financial Institutions Act* (*OSFI Act*) were amended by Bill S-3 to meet the emerging challenges of private pension plans. The amendments to the *OSFI Act* extend OSFI's mandate and clarify its supervisory role in monitoring the financial condition of pension plans. The *OSFI Act* now recognizes that a reasonable balance must exist between the expectations of plan beneficiaries that obligations be met and the role of the regulator in assessing whether such promises can be relied upon. Further discussion on the changes to the *PBSA* are found on page 8.

Bill S-3 received Royal Assent on June 11 and became effective October 1, 1998, except Section 9.2 which addresses the withdrawal of surplus from pension plans. Section 9.2 will become effective on April 1, 1999.

Operation of the *PBSA* - 1997-1998

Pension Plans Regulated by OSFI

As at March 31, 1998, there were 1,145 active pension plans filed with OSFI, covering 490,375 employees. During the 1997-98 fiscal year, 56 new plans were filed for registration, and 22 previously filed plans were terminated, delegated for provincial supervision, or consolidated with other plans.

Notwithstanding the increase in the number of plans, total membership dropped by more than five per cent. The largest drop in membership was in Crown Corporations (15 per cent) and the communications industry (14 per cent). Plan membership in the banking industry dropped by five per cent while the transportation industry remained stable. There was a 15 per cent increase in membership in all other industries combined. These include harbours, feed and seed mills, Indian Bands, uranium mining, and public or private undertakings in the North.

A plan is recorded as terminated in the year in which its assets are wound up and distributed to the members and other beneficiaries. Since 1987, over 400 plans have been terminated. Of these only nine were terminated in less than a fully funded status. In eight of these cases, the plans had a very small membership and members received at least 95 per cent of their benefit. In the ninth case, members received approximately 80 per cent of what they were due.

The 353 members affected by the 22 plans terminated in 1997-98 did not suffer any loss of benefits. However, OSFI is in the process of overseeing the wind-up of several plans, one of which has been forced to reduce the benefits of 190 active members by 29.5 per cent. Because the plan in question had established priorities on plan termination, the retirees and those eligible to retire have received 100 per cent of their benefit.

Reasons for plan termination included decisions to switch to group registered retirement savings plans (RRSPs), sale of business, or merger with another pension plan.

The following table shows the changes in the number of pension plans in force and the number of members participating in those plans as at March 31, 1998 with the corresponding figures a year earlier.

Plans Filed, Terminated, or Consolidated During the Year Ended March 31, 1998 (prior year's data in parentheses)		
	# Plans	**# Membership**
Filed for registration during the year	56 (59)	3,026 (13,079)
Consolidated with other plans subject to the *PBSA*	8 (15)	n/a
Terminated during the year	22 (32)	353 (430)
Delegated during the year	1 (0)	72 (0)
Loss of membership from previous year	n/a	26,097
In force at end of the year	**1,145** (1,120)	**490,375** (513,871)

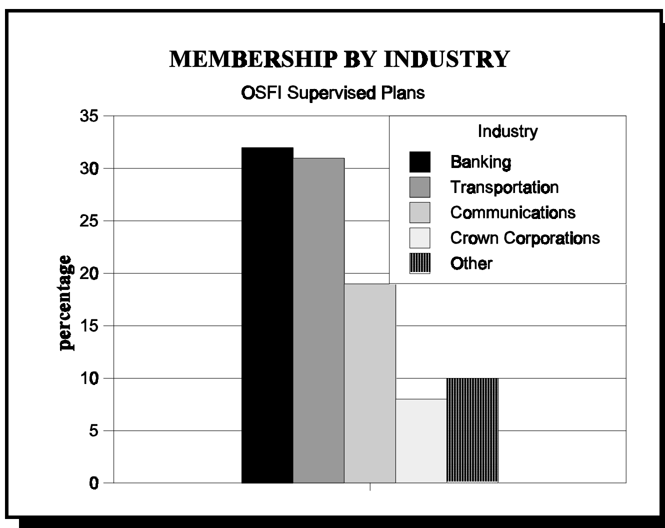
* The table excludes 122 plans covering 169,072 members that were supervised by provinces on behalf of OSFI pursuant to reciprocal agreements. The vast majority of these plans are not subject to the PBSA. (See Agreements with Provincial Authorities, on page 13.)

Distribution of Membership

Membership by Industry

There are 15,308 private and public sector pension plans in Canada.* The 1,145 plans registered under the *PBSA* cover 490,375 members, or approximately ten per cent* of all those covered by pension plans.

Some 90 per cent of the members in *PBSA* plans work for banks, transportation companies (air, rail, road and water) or communication companies (in the telecommunications, radio television, or cable industries).



* Source: Pension Plans in Canada, Statistics Canada, January 1, 1997

Membership by Plan Type

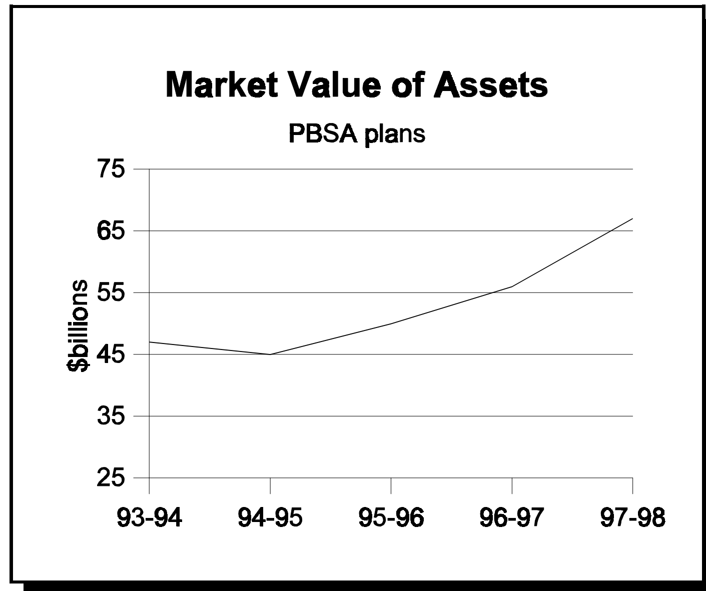
Of the 458 defined benefit plans, 28 are negotiated contribution plans. Of these, 17 are of the flat-benefit type, nine are based on a career-average-earnings formula, and two are money purchase plans with a guaranteed benefit.

There has been an increase in the number of defined contribution plans relative to total number of plans over the past five years, and a corresponding increase in membership from seven per cent to 13 per cent of the total.

Distribution of Plans and Membership by Plan Type as at March 31, 1998
(Previous year's numbers are in parentheses)

Plan Type	Plans	% of Total	Members	% of Total
Defined benefit (includes combination plans)	458 (457)	40% (41%)	428,174 (669,337)	87% (90%)
Defined contribution (money purchase)	687 (663)	60% (59%)	62,201 (51,822)	13% (10%)
Total	**1,145** **(1,120)**	**100%**	**490,375** **513,871**	**100%**

Market Value of Assets



The total market value of the assets of pension plans registered under the *PBSA* was approximately $67 billion at the end of the 1997-98 fiscal year. The increase of $11 billion, or 20 per cent over that reported last year was due to favourable market conditions during the period. A more sophisticated computer system for collecting the data and a change in the reporting date also played a role in the increase. Previously, assets were reported as at the end of the calender year. As of this year, OSFI is reporting assets as at March 31.

In general, OSFI expects that pension plans have been affected by the recent downturn in market conditions but the data on current assets are not available. Based on the data collected to date, however, the assets in federally regulated pension plans have increased steadily over the past seven years, except for a downward move in 1994.

Assets held in defined contribution plans at year end amounted to less than two per cent of total assets, since most defined contribution plans have been in existence for only a short time. As well, when a member retires from such a plan, an annuity must be purchased, since this type of plan cannot itself pay an annuity. Such is not the case for defined benefit plans which can carry billions of dollars to pay the liabilities of retirees alone.

Legislative Changes

As discussed in the Introduction, changes to the *OSFI Act* clarify OSFI's role in supervising pension plans, which includes monitoring the solvency of pension plans, promoting policies that are designed to identify and control risk, and taking steps (or requiring that steps be taken) to deal promptly with problem plans.

Bill S-3 also amended the *PBSA* by:

< providing additional supervisory powers to the Superintendent, including the authority to issue directions of compliance to plans where, in the opinion of the Superintendent, imprudent or unsafe practices exist;

< enhancing plan governance measures by placing more emphasis on the importance of the responsibilities of plan administrators to ensure continuing compliance with the *PBSA*, to oversee the operation of the plan, and to deal with any problems that may emerge;

< requiring the administrator to provide more information to plan members on the financial condition of the plan and giving former members and retirees the same right as active members to view plan documents and financial statements filed with OSFI;

< providing a means to facilitate agreements between the employers and plan beneficiaries on the distribution of surplus, along with a process for binding arbitration where the parties cannot reach an agreement regarding the distribution of surplus on plan termination where the employer is winding up; and

< providing the power to deem an amendment void where it would cause the solvency ratio of the plan to fall below a prescribed level.

Approach to Supervision

In keeping with its role in closely monitoring high risk plans and relying on good governance for less risky plans, OSFI has moved away from the compliance model of regulatory supervision. Whereas the compliance model required the review of over 4,000 documents per year, the risk-based approach allows more time to be spent on serious funding and compliance issues.

On-Site Examinations

During the fiscal year 42 pension plans were examined on-site. OSFI examiners use a similar risk assessment model which focuses on plan governance, investment policies, records, accounts, controls and administration procedures.

The selection of plans for on-site examination was based primarily on the risk to beneficiaries, as indicated by a low solvency ratio, late filing of reports, frequent complaints from members, and major amendments to plan documents. In addition, some plans were selected for examination at random.

Solvency of Plans

Early detection of solvency and funding problems are key elements in safeguarding members benefits. Money purchase plans are fully funded as long as the contributions, as defined by the plan, are remitted. Defined benefit plans, on the other hand, have fluctuating contributions which depend on the funded status of the plan and various economic and demographic assumptions.

In the valuation report, the actuary describes the plan's financial condition and establishes the amount of any solvency deficiency and/or unfunded liability along with schedules of special payments for the amortization of any deficits. These schedules are defined in the Regulations to the *PBSA*. Current service costs for future benefits are also determined.

All defined benefit plans must submit a valuation report every three years. Where the solvency ratio of a plan is less than one, however, the plan administrator must file a valuation report annually. The solvency ratio (assets divided by liabilities on a termination basis) indicates whether or not there are sufficient assets in the plan to pay all of the liabilities if the plan had been terminated on the date of the valuation.

All of the plans currently reporting a solvency of less than one are meeting the funding standards of the *PBSA*. While 32 plans had a solvency of less than one, 25 reported a solvency level of at least 0.85. The continuation of these plans depends on the employer's commitment and ability to remit enough contributions to fund not only future benefits but also to make good the current solvency deficiencies.

An actuarial valuation report must also be filed when a plan amendment affects the cost of benefits. Under the amended *PBSA*, a plan amendment which causes the solvency ratio of the plan to fall below a prescribed level will be void unless the amendment has been approved by the Superintendent. Regulations are being prepared to specify the conditions under which an amendment to a pension plan would be considered void. The purpose of this change is to prevent the granting of benefits that could render a plan insolvent or jeopardize its long-term viability.

In the past, a plan could increase benefits regardless of the resulting deficiencies. The benefit increase would then result in a reduction in benefits if the plan terminated before the deficiencies were paid. While most defined benefit plans are fully funded on a termination basis, economic conditions can quickly alter that status. During the fiscal year OSFI has increased the monitoring of pension plan solvency which is critical to adequate funding and benefit security.

Surplus

The issue of entitlement to a plan's surplus arises only in defined benefit pension plans. This type of plan defines the benefit which is promised to plan members at retirement. The benefits are fixed by a formula typically based on a percentage of salary and years of service. When the plan's assets are greater than the pension liabilities, there is a surplus in the pension fund.

The refunding of surpluses to employers has traditionally been subject to any terms and conditions dealing with this issue in the plans, whether or not members were required to contribute to the plans. While some plans do address entitlement to surplus, most plans, particularly the older ones, are either silent or ambiguous on this matter. In addition, most do not contain provisions which would allow the plan to be amended to grant a right to surplus.

Where a surplus is refunded from a going-concern plan, the maximum surplus withdrawal cannot be greater than the amount by which the surplus exceeds the greater of:

(a) two times the contribution of the employer to the normal cost of the plan, and

(b) 25 per cent of the liabilities of the plan, determined in accordance with the definition of solvency deficiency.

Where an employer shows clear entitlement to surplus on plan termination, provision must be made for accrued or payable benefits before an application for surplus distribution is approved. The employer must also give notice in writing of the intention to withdraw all or part of the surplus. All plan members, former members, and other beneficiaries entitled to a benefit must be notified and they may comment in writing to the Superintendent concerning the surplus withdrawal.

Where a plan does not unequivocally establish the ownership of the surplus, the amendments to the *PBSA* and the Regulations (in force after the period covered in this report) are intended to facilitate agreements between plan sponsors and beneficiaries on the distribution of the surplus. First, it must be established that a surplus exists, on either a going-concern or a termination basis. For a going-concern plan, the employer may enter into an agreement with various parties with respect to surplus distribution. An agreement is recognized under the *PBSA* if more than two-thirds of members, former members, and other persons within a prescribed class consent. If more than one half but less than two thirds of active members and other beneficiaries consent, the employer may, for a going-concern plan, submit the proposal to arbitration. For a terminated plan, where the employer is winding up the business, the plan assets, including any surplus must be distributed. If agreement cannot be reached, arbitration is obligatory.

The Regulations, which are currently being drafted, will describe the process for a refund of surplus application, listing those who must receive notice and the prescribed time periods for notification. The amendments will also define the arbitration process, specifying the parties to be involved, the information that must be given to interested parties and time limits. As well, the period after which the Superintendent can name an arbitrator will be specified.

Section 9.2 of the *PBSA,* which addresses the surplus issue, and the Regulations in support of the *PBSA* will become effective on April 1, 1999.

During the period covered by this report, the Superintendent approved one request for a refund of surplus in the amount of $1,276,720. In the previous year, one request was approved for a total of $963,789.

Communications

OSFI publishes the *PBSA Update* to discuss topical pension matters with pension plan administrators and other professionals in the pension industry. The newsletter also serves to remind plan administrators and their representatives of particular *PBSA* standards and to inform them of changes in legislation and OSFI's administrative policies and procedures. The most recent issues of *PBSA Update* were sent to stakeholders in February and August 1998. The latter was a special edition to explain the amendments to the *PBSA*. A regular fall edition of Update, Issue 18, will be sent to stakeholders in November. Readers are encouraged to respond to the articles in the newsletter, or comment on any matters related to OSFI's supervision of pension plans.

CAPSA Activities

The Canadian Association of Pension Supervisory Authorities (CAPSA) was established in 1974 as a federal-provincial forum to:

< ensure that pension plans with members in more than one jurisdiction are regulated in a coordinated manner;

< discuss and resolve supervisory problems and issues of an interjurisdictional nature;

< consider and recommend measures for the benefit of plan members and sponsors; and

< communicate with industry groups and professional associations on pension plan issues.

The following officials are represented in CAPSA:

Alberta: Superintendent of Pensions
British Columbia: Superintendent of Pensions
Government of Canada: Superintendent of Financial Institutions
Manitoba: Chairperson, Pension Commission of Manitoba
New Brunswick: Superintendent of Pensions
Newfoundland: Superintendent of Pensions
Nova Scotia: Superintendent of Pensions
Ontario: Superintendent of Pensions and CEO Financial Services Commission
Quebec: Président, Régie des rentes du Québec
Saskatchewan: Superintendent of Pensions

Prince Edward Island, where pension standards legislation has been passed but not proclaimed, will automatically be represented on CAPSA when its legislation comes into force. In the meantime, representatives of PEI, in addition to representatives of Revenue Canada, Finance Canada and Statistics Canada, have a standing invitation to attend CAPSA meetings.

CAPSA meetings are held twice a year. The CAPSA Strategic Plan and regulatory harmonization have been the main topics of discussion at recent CAPSA meetings. Jurisdictional reports and papers are tabled and discussed at CAPSA meetings.

With respect to harmonization, OSFI has designed a universal Annual Information Return and Financial Statement Form for use by all of the regulatory bodies and Revenue Canada. To date, Revenue Canada has agreed to a joint filing with OSFI of the Annual Information Return.

Agreements with Provincial Authorities

Prior to the period of extensive pension reform that began in the mid-1980s, the relatively few differences among the various legislation had enabled regulatory bodies to reach reciprocal agreements under which jurisdiction of registration was based on province of work and nature of employment. The regulator in the jurisdiction applied the rules of other jurisdiction(s) where applicable. Although this approach remains the practice, the increased complexity of pension standards legislation has made its continued operation very difficult.

Since existing agreements only allow one regulator to apply numerous rules to a given plan, CAPSA has proposed a new multi-lateral reciprocal agreement. It's objective is to reduce the administrative and compliance burdens facing the administrators of pension plans subject to more than one jurisdiction. While its adoption would leave unchanged the number of plans registered with the various jurisdictions, it would result in plans being governed in all matters by the pension legislation of the jurisdiction in which there is a plurality of members. In other words, the supervising jurisdiction would no longer be required to ensure compliance with the standards of other jurisdictions. Some jurisdictions, including the federal government (by virtue of the recent amendments to the *PBSA*), have the power to enter into such agreements while others must amend their legislation to gain such power.

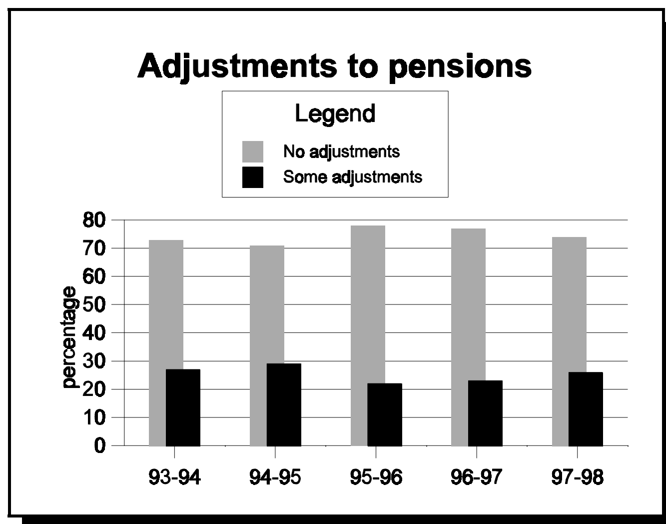
It is not clear that the multi-lateral agreement will proceed under its present form. One major jurisdiction has recently raised concerns about the agreement which could nullify the initiative. The Association of Canadian Pension Managers has sponsored a task force to examine an alternative idea: the introduction of a uniform law.

OSFI and British Columbia currently plan to sign a bi-lateral agreement, which will make B.C. the sixth province to sign such an agreement with OSFI.

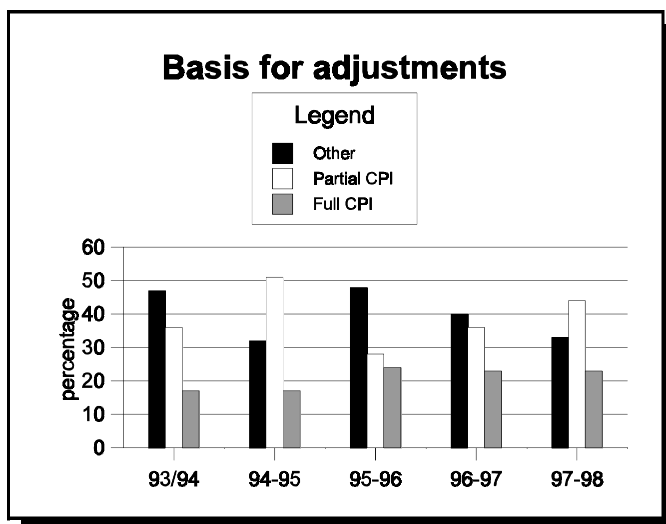
Report on Inflation Adjustments to Pensions

As required by the *PBSA*, plan sponsors annually report the extent to which they have adjusted pensions to provide inflation protection and the source of funds for these adjustments. Only defined benefit plans can make adjustments to deferred pensions and pensions in pay.

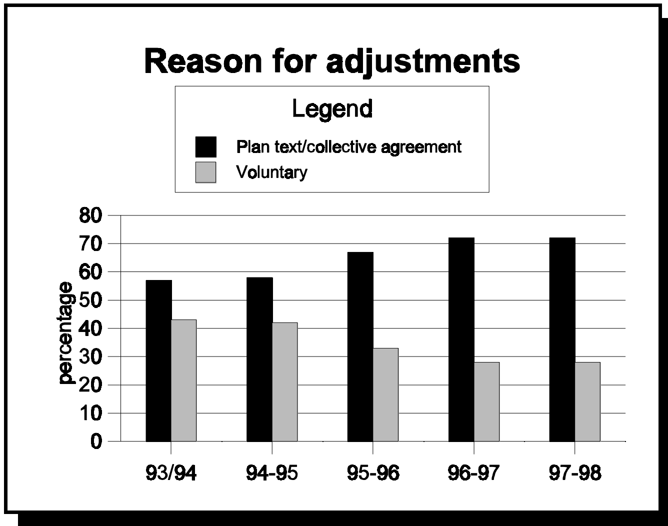
The following charts summarize inflation adjustments as reported by pension plan sponsors for 1993-94 through 1997-98.



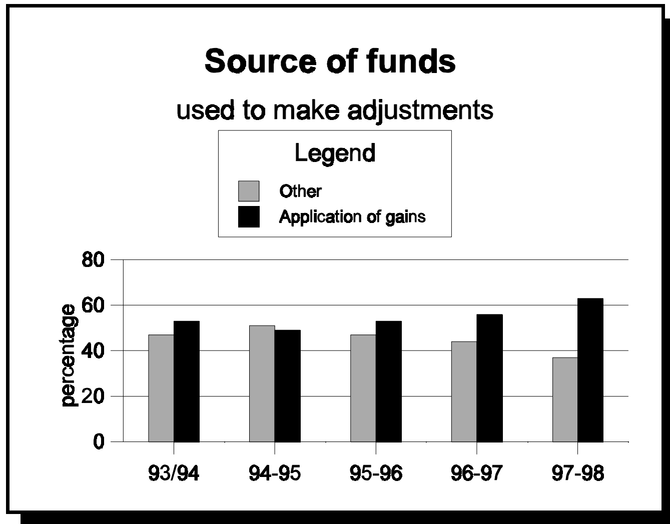
Of the defined benefit pension plans that had filed annual information returns in respect of the 1997-98 plan year end, 26 per cent reported that they had made some adjustments to pensions in pay. This is up from 23 per cent in 1996-97, and 22 per cent in 1995-96. Of the 101 plans that made adjustments to pensions in pay, 27 also made adjustments to deferred pensions.



Of the plans that made adjustments to pensions in 1997-98, 44 per cent did so using a partial increase of the Consumer Price Index (CPI), and 23 per cent based increases on the full CPI. The remaining 33 per cent used some other formula such as excess interest, a flat dollar amount or a percentage of pension payment to calculate the increases.



For the past five years, the majority of adjustments to pensions have been contractual as opposed to voluntary. In 1997, 72 per cent of adjustments were due to collective agreements or requirements of the plan text, while 28 per cent were voluntary. Although there had been a noticeable drop off in voluntary increases over the past few years, the same number of plans gave voluntary increases in both 1996-97 and 1997-98.



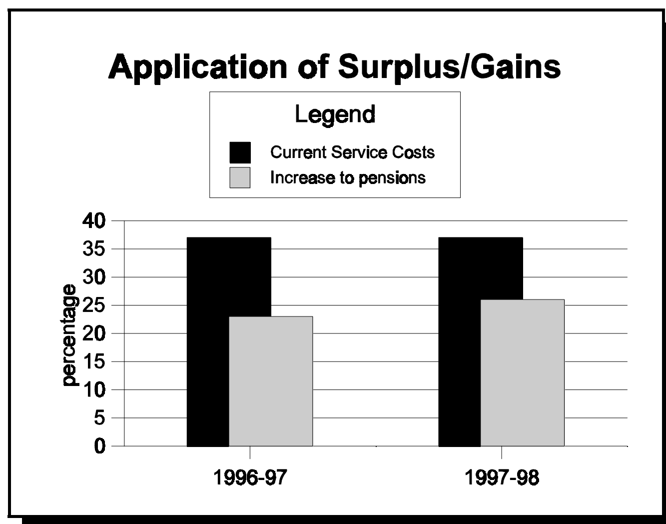
During the past year, 63 per cent of the plans that made adjustments to pensions did so using surplus funds or gains. The remainder used sources outside the pension fund, created unfunded liabilities, or used some combination of the above options to improve pensions. The number of plans using an existing surplus or gains has increased over past years. This is likely due to the increased rate of returns experienced by many plans in recent years.

Application of Surpluses from Pension Funds

Only defined benefit plans can experience actuarial gains or losses. These gains and losses are the result of many factors. In the simplest case, a plan experiences a gain when, for example, the return on investments is higher than the interest assumption used by the actuary. If the return is lower than the assumed interest rate, the plan experiences a loss.

A plan may experience a gain or a loss with respect to a number of assumptions. The legislation requires that when an actuarial report reveals an actuarial gain, the amount of the gain must first be applied to reduce the outstanding balance of any unfunded liability or solvency deficiency. If there is no such liability, the gain may be used to increase benefits or used to reduce the required contributions to the plan. A gain may also be added to an existing surplus in the fund. (Surplus is simply an accumulation of gains in excess of losses in previous years.)

As a result, not all gains are applied to increase pensions in pay, and, as indicated in a previous chart, not all increases in benefits are paid from gains. In fact, a gain in a given year does not necessarily trigger an increase to pensions or a reduction in contributions, nor does a loss preclude a contribution holiday or benefits increase.



Data provided in the annual information returns indicated that of the 444 defined benefit plans registered under the *PBSA*, 109 used surplus/gains to improve pensions while 166 used surpluses for required contributions. These numbers reflect a fairly stable incidence of use of excess assets over a period of years.

Revenue and Expenditure April 1, 1997 to March 31, 1998

Pension plans are required to submit a fee with an application for registration under the *PBSA* and with the filing of the annual information return. In 1991, regulations were adopted by the federal government to implement full cost recovery of the *PBSA* regulatory program. The legislation required that any shortfall in revenue over expenditures be recovered by an increase in the fees and any excess of revenue over expenditures be taken into consideration in setting the basic fee rate for subsequent years. While full cost recovery ensures that plan sponsors pay the cost of administering the *PBSA*, and no more, it has resulted in substantial annual increases or decreases in fees. As a result, new regulations are being drafted that will permit OSFI to average shortfalls and excesses over a period of five years. This will have the effect of smoothing the changes in fees while protecting the integrity of the program.

Total fees received during the fiscal year ending March 31, 1998 totalled $2,736,000, down from $3,178,000 a year earlier. The total cost of administering the *PBSA* for fiscal 1997-98 was $3,016,000, up from $2,604,000 in 1996-97.

During the year there was both an increase in expenditures and a decrease in revenues. The revenue decrease was due to both a drop in membership and lower fees per member. The basic fee rate of $8.00 was artificially low because a surplus which was carried over from a previous period reduced costs by about $3.00 per member. At the same time, expenditures were up because of higher costs for running the program. The increase is attributable to travel costs associated with the on-site examination program, and an increase in salaries and information technology costs. As explained, the new regulations which OSFI hopes to have in place before next year will permit the smoothing of fees over a five year period. This will preclude the 50 per cent increase in fees that was required for 1998-99.

Income, Expenditure and Fees for *PBSA* Supervision

Year	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**
Revenue	$2,899,000	$3,686,000	$2,911,000	$2,774,000	$3,178,000	$2,736,000
Expenditure	$2,704,000	$2,594,000	$2,792,000	$2,772,000	$2,604,000	$3,016,000
Basic fee rate	**$13.10**	**$10.25**	**$9.60**	**$10.50**	**$10.00**	**$8.00**

For plans with a year end between October 1, 1998 and September 30, 1999, the basic fee rate has been established at $12 per plan member up to 1,000 members, and $6 per member in excess of 1,000. There is a minimum fee of $240 per plan, and a maximum of $120,000. As required by the *Pension Benefits Standards Regulations*, the basic fee rate was published in the Canada Gazette before October 1, 1998.