ADMINISTRATION OF THE *PENSION BENEFITS STANDARDS ACT, 1985*

Annual Report

1999-2000

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, 1999 to March 31, 2000.

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 Parliament reconvenes.

Yours very truly,

John R.V. Palmer
Superintendent

Ottawa, December 2000

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You are invited to visit the OSFI Internet website for
Private Pension Plans Division at www.osfi-bsif.gc.ca

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 a major component of the Canadian retirement system, along with the Old Age Security, Canada/Quebec Pension Plans and Registered Retirement Savings Plans. Private pension plans established for employees working in areas that fall under federal jurisdiction are subject to the *PBSA*. These include banking, interprovincial transportation, telecommunications, and undertakings outside the legislative authority of the provinces. The latter category includes public and private undertakings in the North and those of native organizations. Also under federal jurisdiction is any work, undertaking or business, declared by the Parliament of Canada to be for the general advantage of Canada or for the advantage of two or more provinces. Uranium mining is an example of an undertaking that falls into this category. All other private pension plans are governed by pension standards legislation of the provinces in which their members are employed.

The Private Pension Plans Division of the Office of the Superintendent of Financial Institutions (OSFI) administers the *PBSA*. In supervising and regulating pension plans, OSFI's actions are directed towards the reduction of the risk that plans will fail to pay expected pension benefits. The *PBSA* sets minimum standards for funding, investments, membership eligibility, vesting, locking-in, portability of benefits, death benefits, and members' rights to information.

Operation of the *PBSA* – 1999-2000

Pension Plans Regulated by OSFI

As at March 31, 2000, there were 1,170 pension plans registered under the *PBSA*, covering 500,000 employees. During the period, 56 new plans were filed for registration, and 47 registered plans informed OSFI they were terminating or consolidating with other plans. The chart on page 3 gives the distribution of plans, members and assets by industry.

The 561 members affected by the 47 plans that wound up in 1999-2000 did not suffer any loss of benefits. However, OSFI is in the process of overseeing the wind-up of several plans that terminated during the period under review and it is expected that one of the plans, covering 190 active members and 200 terminated and retired members, will be forced to reduce benefits by approximately 25 per cent as a result of the plan being underfunded at the time of employer bankruptcy.

A plan is recorded as terminated in the year in which the fund is wound up and assets distributed to members and other beneficiaries. Since 1987, 585 plans have been terminated and all but five were fully funded. The five underfunded plans affected a total of 950 members. The 580 fully funded plans covered 82,000 beneficiaries. The underfunded plan described in the above paragraph will be added to the five underfunded plans when the assets are distributed and the final loss to members is known.

There has been an increase in both the number of pension plans that fall under federal jurisdiction and the number of defined contribution plans relative to the total number of plans over the past five years. The increase is due largely to an increase in the number of pension plans for native organizations that are of the defined contribution type. If native organization pension plans are removed, there has been a decline in the number of defined contribution plans relative to defined benefit plans which is consistent with the trend in the rest of the country. Assets held in all defined contribution plans at year end amounted to 2.25 per cent of total plan assets, up slightly from the previous year.

As of January 1999, there were about 15,000 pension plans in Canada covering approximately 5 million members. Included in this number are pension plans for employees of the federal, provincial and municipal governments and for members of the Canadian Armed Forces and the Royal Canadian Mounted Police. The 1,238 plans in the public sector accounted for a full 46 per cent of total membership in Canadian pension plans. While membership in pension plans across Canada dropped throughout the 1990s, it increased in federally regulated plans.*

Private pension plans under federal jurisdiction, for which the Superintendent has responsibility, comprise approximately eight per cent of all plans and 10 per cent of all plan membership.

Market Value of Assets

The total market value of the assets of pension plans registered under the *PBSA* was approximately $80 billion at the end of the 1999-2000 fiscal year. The increase of $6 billion, or eight per cent over that reported last year was due to both contributions and market conditions during the period.

Distribution of Plans, Membership and Assets

The chart below shows the distribution of plan membership and assets by plan type. Although defined contribution plans account for 62 per cent of federally regulated plans, they account for only 14 per cent of total membership and slightly more than two per cent of assets. The 436 defined benefit plans include 28 negotiated contribution plans and 59 plans that have both defined benefit and defined contribution components. The latter are referred to as combination plans.

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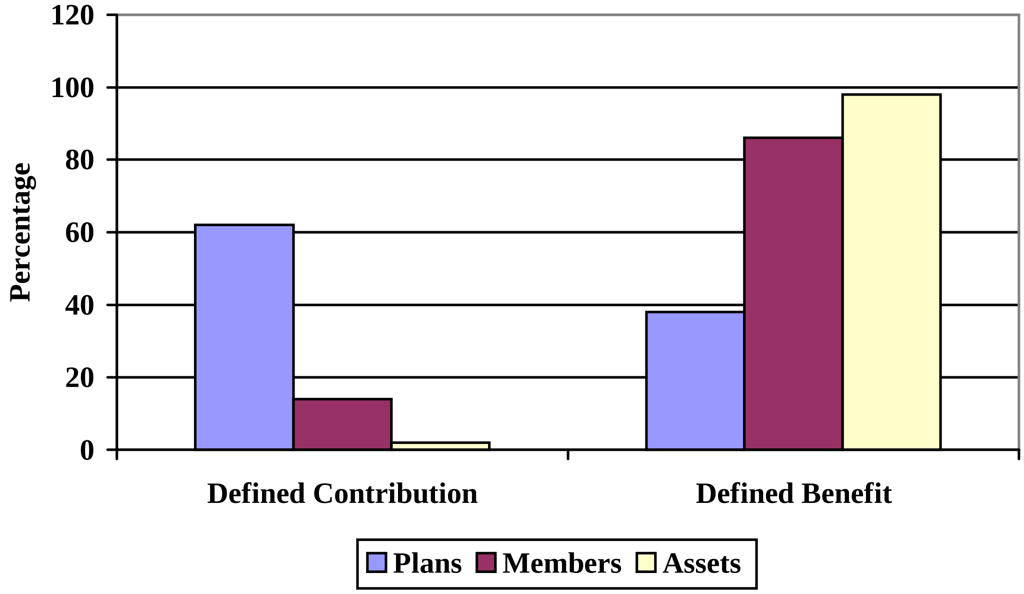
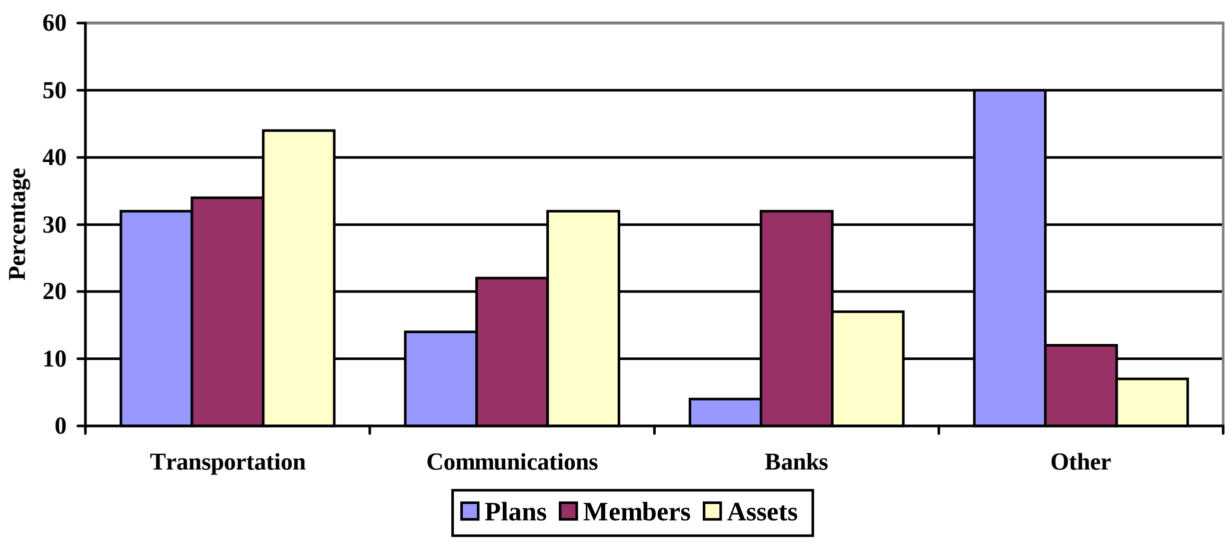
* Statistics Canada's *Pension Plans in Canada, January 1, 1999*

Distribution of Plans, Membership and Assets by Plan Type at March 31, 2000



The following graph shows plans, membership and assets by industry. The assets held in the pension funds of companies involved in transportation, communication and banking comprise more than 90 per cent of all assets held in federally regulated pension plans. The large number of plans in the category "Other" reflects the large number of native organization pension plans.

Plans, Membership and Assets by Industry at March 31, 2000



Legislative Changes

The *Office of the Superintendent of Financial Institutions Act*, which along with the *PBSA* was amended in 1998, clarified OSFI's role in supervising pension plans. The amended legislation emphasized the monitoring of plan solvency and promoted policies to identify and control risk.

One of the major changes in the amended *PBSA* promotes plan governance by placing more emphasis on the importance of the responsibilities of plan administrators. Another is the additional supervisory powers given to the Superintendent.

During the period under review OSFI worked on three packages of changes to the *Pension Benefits Standards Regulations, 1985* (*Regulations),* all of them in support of amendments to the *PBSA*. The first deals with pension plan surplus and is discussed in the section under that heading. The second will, among other things, require plan administrators to provide more information to plan members and former members on the financial condition of the plan. The third package will include increased minimum funding requirements. A discussion paper on minimum funding was sent to the industry and, after consideration of the comments received, OSFI will finalize the amendment and proceed according to protocol.

Although it took effect in July 2000, which does not fall within the period under review, it is worth noting that the *Modernization of Benefits and Obligations Ac*t amended the *PBSA*, along with several other pieces of legislation, to provide recognition of same-sex common law partnerships, including survivor benefits.

Supervision of the *Pension Benefits Standards Act, 1985*

Approach to Supervision

During the period under review, OSFI took a leading role in promoting pension plan governance. A task force, comprising the Association of Canadian Pension Management, the Pension Investment Association of Canada and OSFI, developed a set of governance principles and best practices and a self-assessment and reporting framework that focused on high-level issues such as accountabilities, controls and performance measures. The goal was to raise the level of understanding of plan administrators with respect to accountability for decisions and actions that affect their pension plans.

There has been continuous consultation with the pension industry on governance issues and OSFI has provided technical assistance to institutions with a formal training program for trustees. OSFI issued a special edition of its publication *PBSA Update*, to further explain governance and self-assessment matters. Included was a survey on governance that is intended to determine plan administrators' level of understanding and commitment to self-governance. Through such surveys, OSFI will be able to determine whether regulations are needed to ensure that plans are well governed, or whether voluntary compliance has been satisfactory.

In addition to relying on good governance, OSFI depends on a Risk Assessment System (RAS) and an effective intervention process whereby high-risk plans are identified and closely monitored so that problems can be dealt with in a timely manner.

OSFI's on-site examination program has been fully integrated with the regular review process. This has enhanced both the efficiency and the effectiveness of the regulatory program. The selection of plans for on-site examination is based on the risk to beneficiaries. In addition, some plans are selected for on-site examination at random. During the period, 25 pension plans were examined on site.

The single most important issue during the fiscal year was the termination of an underfunded pension plan due to the plan sponsor being forced into receivership. At this writing, the final termination report has not been filed but it is expected that accrued benefits, including those of retirees, will be reduced by approximately 25 per cent. Economic conditions, particularly the impact of falling interest rates on the plan's liabilities during the two years prior to the plan's termination, were the primary reason for the deterioration of the solvency position.

The changing economic environment has an impact on the considerable amount of time OSFI must spend on what are referred to as special situations, of which there were approximately 200 during the period under review. The number of special situations, which vary from year to year, was up slightly from previous years and included plan mergers and spin-offs as a result of sales of business (these are particularly high in the telecommunications industry), plan conversions and follow-up on non-remittance of contributions. Refunds of surplus, which are also considered special situations, were not counted among the total as the Superintendent will not have the authority to approve such applications until the *Regulations* have been passed.

OSFI must also keep abreast of the innovative pension benefit proposals submitted by administrators in response to the demands of an increasingly well-paid and knowledgeable membership. In addition, high profile issues, such as surplus ownership, sometimes result in write-in campaigns by retiree associations and individual requests for the Superintendent's intervention regarding matters that are beyond the mandate of the *PBSA*.

Solvency of Plans

Early detection of solvency and funding problems are key elements in safeguarding members' benefits. Defined contribution plans are fully funded as long as the required contributions are remitted on a timely basis. Defined benefit plans, on the other hand, have fluctuating contribution rates that depend on the funded status of the plan and various economic and demographic assumptions.

An actuarial valuation report must be filed for defined benefit plans. In the valuation report, the actuary describes the plan's financial condition and determines the required costs for future service. If the plan has an unfunded liability or a solvency deficiency, the actuary establishes the schedules of special payments to amortize the deficits. Amortization schedules are defined in the *Regulations* to the *PBSA*. Under the *PBSA*, if the minimum funding standards of the *PBSA* are being met, the plan is defined as solvent.

While all active plans are currently meeting the minimum funding standards of the *PBSA,* 32 have a solvency ratio of less than one. Twenty-eight of these have a solvency ratio above 0.85. The solvency ratio of a pension fund is the ratio of market value of assets to the liabilities assuming plan termination on a specific date. A plan with a solvency ratio of less than one is not necessarily a cause for concern, as long as the employer is financially sound, operates in a solid industry and contributes in accordance with legislative requirements. The continuation of any defined benefit plan depends on the employer's commitment and ability to remit amounts sufficient to fund future benefits and any unfunded liabilities and/or solvency deficiencies that occur.

Pension Plan Surplus

Amendments to the *PBSA* that addressed the refunds of surplus became effective on April 1, 1999. *Regulations* have been drafted to set out the procedures associated with a refund of surplus request by an employer. OSFI published the amendments in the Canada Gazette in the fall of 1999 and, as a result of the many comments received, reviewed the amendments and considered the recommended changes. OSFI foresees that these *Regulations* will be submitted to the Privy Council Office before the end of the current fiscal year.

The major change in the *PBSA* in this area concerns situations where the employer has not or cannot establish entitlement to surplus assets. The procedures to be followed before the Superintendent can consent to a refund of surplus are included in the amendments to the *Regulations*. A guideline for refunds of surplus will be released when the amendments to the *Regulations* have been passed.

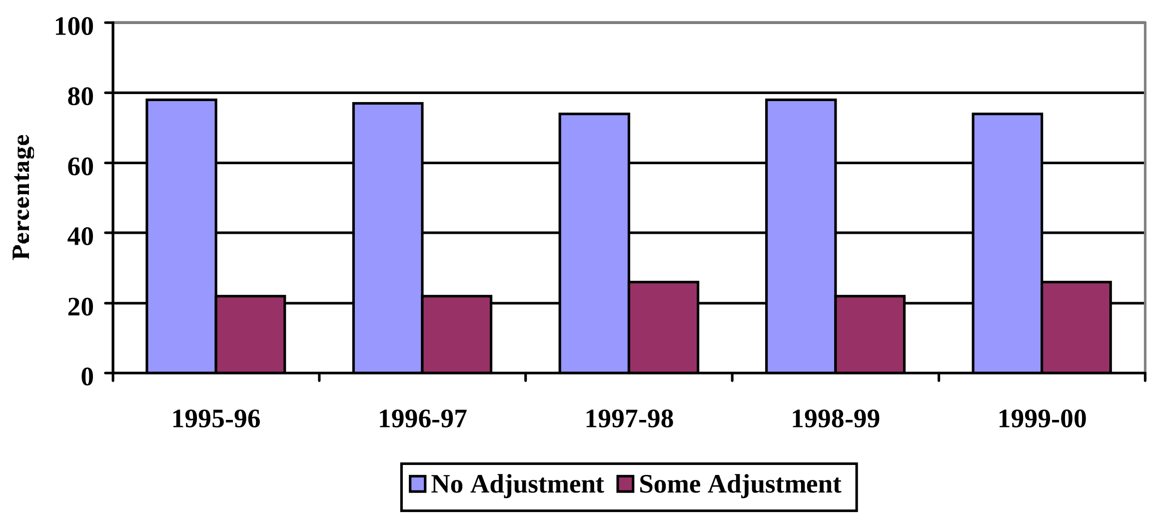
During the period covered by this report, the Superintendent did not consent to any refunds of surplus.

Report on Inflation Adjustments to Pensions

As required by the *PBSA*, plan sponsors report the extent to which they have provided inflation protection and the source of funds for the adjustments.

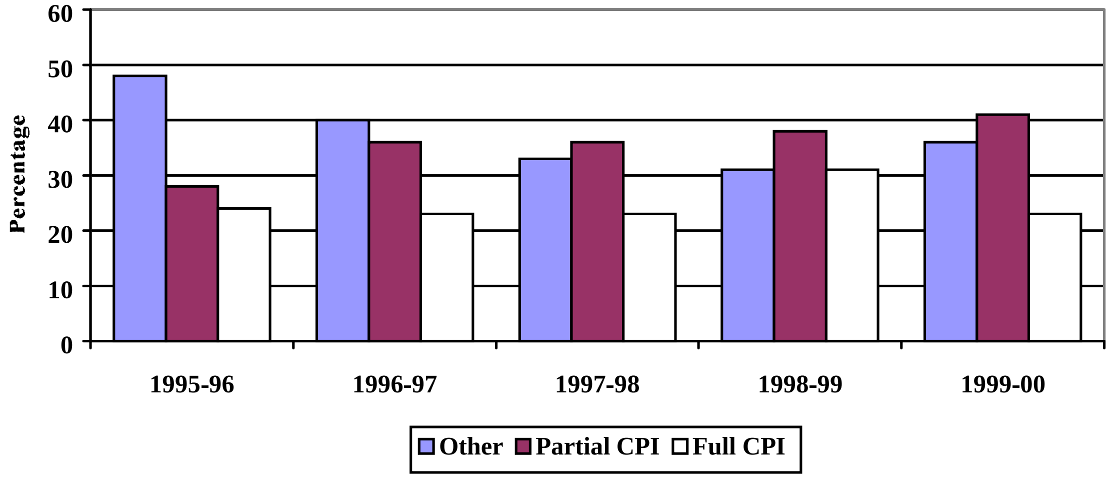
The following graphs summarize inflation adjustments for 1995-96 through 1999-2000.

Adjustments to Pensions



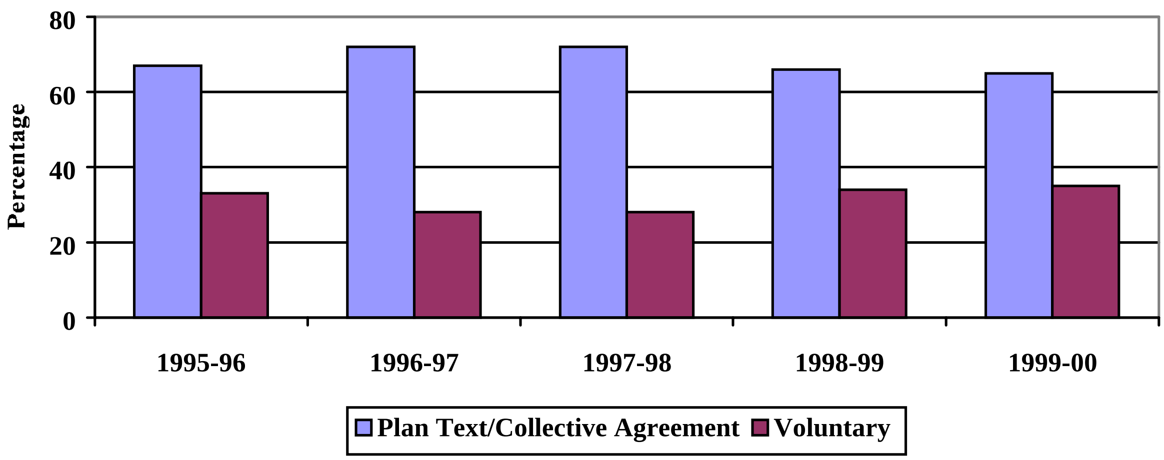
This graph shows that 26 per cent of defined benefit pension plans reported that they had increased pensions in pay in 1999-2000. Of those plans that provided such an adjustment, 31 per cent also increased deferred pensions.

Basis for Adjustment



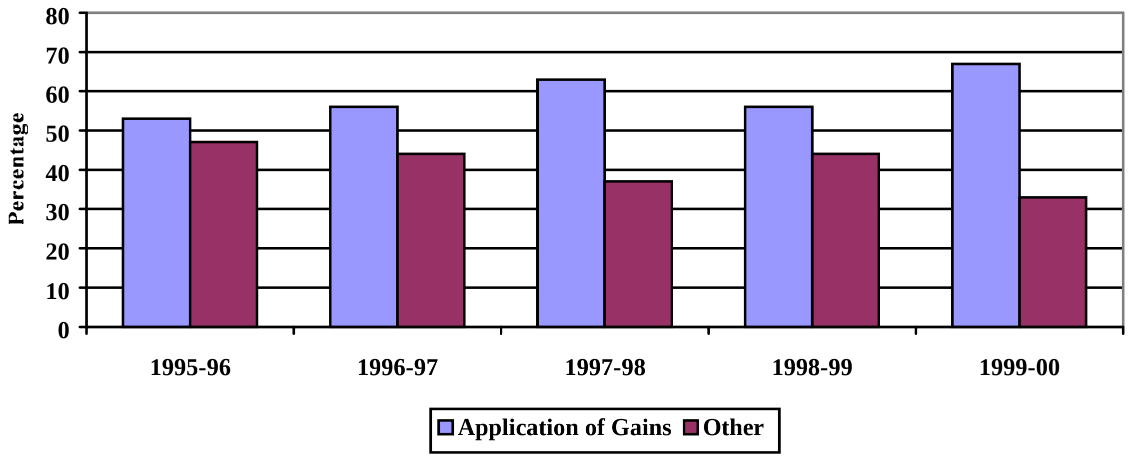
This graph shows that 41 per cent of the plans that made adjustments to pensions in 1999-2000 based increases on a partial increase in the Consumer Price Index (CPI), and 23 per cent based increases on the full CPI increase. The remaining 36 per cent used some other formula such as excess interest, a flat dollar amount, or a percentage of pension payment to calculate the increases.

Reason for Adjustment



During the period 1999-2000, 65 per cent of adjustments were due to collective agreements or requirements of the plan text, while 35 per cent were voluntary. This is consistent with the results from the previous year.

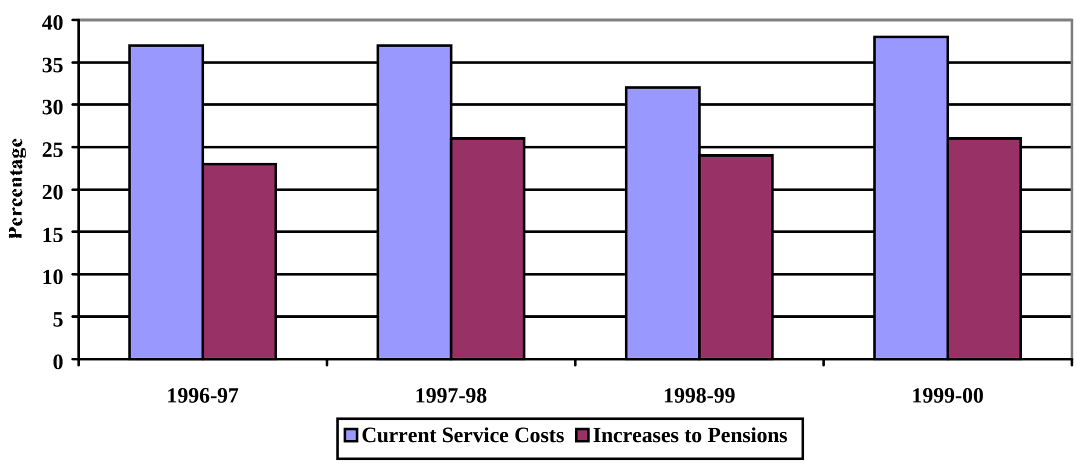
Source of Funds For Pension Adjustment



During the period under review, 67 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 options to improve pensions. Compared to previous years, the use of surplus for pension adjustments was proportionately higher than use of other sources.

Report on Application of Surplus/Gains

Application of Surplus/Gains



Data provided in the Annual Information Returns indicated that 115 plans used surplus/gains to improve pensions while 164 plans used such surplus/gains for required employer contributions. The remaining defined benefit plans either did not have surplus funds, or chose to let their surplus funds accumulate.

Revenue and Expenditure from April 1, 1999 to March 31, 2000

Pension plans are assessed a fee with an application for registration under the *PBSA* and with the filing of the Annual Information Return. Total revenues during the fiscal year ending March 31, 2000 were $3,875,000 up from $2,347,000, a year earlier. The cost of administering the *PBSA* for fiscal 1999-2000 was $3,589,000, up from $3,190,000 the previous year. An assessment base larger than anticipated was the reason for the increase in revenues. The expenditure increase was partly due to the extra resources required to handle a high risk plan.

The following Table shows revenues and expenditures over the past seven years.

Revenue and Expenditures
($000s)

Year	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**	**1999-00**
Revenue	$3,686	$2,911	$2,774	$3,178	$2,736	$2,347	$3,875
Expenditures	$2,594	$2,632	$2,772	$2,604	$3,016	$3,190	$3,589
Annual Assessment	$10.25	$9.60	$10.50	$10.00	$8.00	$12.00	$12.00

Annual Assessment

Due to a larger membership base, OSFI has been able to reduce the annual assessment by $1.00 for fiscal year 2000-2001. For plans with a year end between October 1, 2000 and September 30, 2001, the basic rate has been established at $11 per plan member up to 1,000 members, and $5.50 per member in excess of 1,000. There is a minimum assessment of $220 per plan, and a maximum of $110,000. As required by the *Regulations*, the basic assessment rate was published in the Canada Gazette on September 30, 2000.