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PBSA Update

Issue No. 9

PBSA Update is issued by the Pension Benefits Division of the Office of the Superintendent of Financial Institutions (OSFI) to improve communication between the OSFI and pension plan administrators whose plans are supervised pursuant to the *Pension Benefits Standards Act, 1985* (PBSA). Issue No. 8 was dated November 1992.

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1. Recent Amendments to the Pension Benefits Standards Regulations, 1985

We are attaching a copy of the amendments that were approved by Order in Council on March 9, 1993 and published in the *Canada Gazette*, Part II, on March 24. Three amendments are significant:

- exempting from the PBSA certain pension plans established or created by a provincial statute;
- exempting pension benefit credits in excess of limits set out in the *Income Tax Act* from the locking-in provisions of the PBSA; and

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- exempting from the PBSA, for the period prior to August 14, 1989, plans that were not previously registered under the PBSA and that were determined to be subject to the PBSA by the Supreme Court of Canada decision on August 14, 1989, dealing with telephone companies' activities.

Other amendments approved by this Order in Council clarify voting entitlements and procedures respecting pension committees, and recognize Quebec as a designated province for purposes of the PBSA. A few housekeeping changes to the English and French versions of the Regulations were also approved.

2. Suspension of Benefits – Conflicts With Tax Rules

In Issue No. 8 of *PBSA Update*, we explained the circumstances under which a pension plan could provide for suspension of a pension benefit in pay, i.e., at the option of the pensioner, and providing certain conditions are met. It should be noted, however, that Revenue Canada imposes constraints on the recalculation of the pension when the member subsequently retires. This may make it impossible for some plans to meet the conditions we have established.

Employers who are contemplating a provision for suspension of pension benefits in course of pay, or who already have such a provision in their plans, should contact Revenue Canada.

3. Borrowing by Pension Funds

Neither the PBSA, the Pension Benefits Standards Regulations, 1985 nor the proposed amendments to the investment regulations mention borrowing by pension funds. We have decided that pension plans may borrow if borrowing is permitted by plan documents and, pursuant to section 8(4) of the PBSA, if the borrowing is prudent.

We feel, depending on the particular circumstances of a pension plan, that it may be prudent to borrow on a short term basis. For example, if money is required to purchase a pension and liquid assets are short until the next deposit of contributions is made, it may be prudent to borrow small amounts of money for a few days rather than cashing in investments. However, all the circumstances of the pension plan should be considered and this should not be regarded as an advance ruling with respect to any proposed action by the plan or the administrator. In addition, the market value of any collateral required should be reasonably related to the amount borrowed.

4. CDIC and Compcorp Insurance Coverage for Pension Plans

Frequently, the Office receives enquiries about Canada Deposit Insurance Corporation (CDIC) and Insurance Compensation Protection Corporation (Compcorp) protection for certain pension plan arrangements and contracts. Since such matters are the concern of CDIC and Compcorp, enquiries should be directed to the applicable organization. Any enquiries received by the Office will also be so directed. Enquiries should be directed to CDIC at 1-800-461-2342 or to Compcorp at 1-800-268-8099 (English) or 1-800-361-8070 (French).

5. Execution, Seizure and Garnishment

There is no specific provision in the PBSA prohibiting execution or seizure of pension benefits. However, common law principles and, in some instances, provincial legislation may prevent execution and seizure against pension funds and funds contained in a locked-in RRSP.

While the PBSA does not specifically exempt pension funds from execution or seizure, it does provide that benefits must not be assigned, charged, anticipated, given as security, commuted or surrendered (paragraph 18(1) of the PBSA). We believe this provision is aimed at preventing those with an interest in the plan (member, former member, etc.) from assigning, charging, anticipating or giving as security, etc., their benefits under the plan. Recently, the courts have decided that third parties generally may not seize locked-in benefits.

The PBSA is silent respecting garnishment of pension benefits. Consequently, the Office maintains that pension benefits in pay would be subject to a garnishee order issued by the courts, unless otherwise prohibited by provincial law.

6. Marriage Breakdown – Credit Splitting

Many plan administrators call the Office with questions about marriage breakdown and credit splitting. We appreciate the difficulties that these issues impose on administrators, and hope this article will help by explaining some of the requirements imposed by the PBSA. Unfortunately, we cannot help plan administrators deal with unclear or impractical court orders or separation agreements.

Section 25 of the PBSA was implemented to allow administrators of pension plans to comply with provincial law respecting the division of property on marriage breakdown. For example, with the exception of subsection 25(4), this section of the PBSA adopts the definition of spouse under provincial law. It also extends portability options to the spouse and permits the division of a joint and survivor pension into two separate pensions.

Section 25 relaxes some constraints in order to let plan administrators cooperate with the courts and with parties to separation agreements. However, some constraints are retained, either to protect the entire plan or to protect members, former members or their spouses. An example of a standard that protects the plan is subsection 25(8), which prevents the plan administrator from paying parties to a divorce or separation benefits that are more valuable than what would have been payable had the parties remained married. Occasionally, plan administrators confront us with court orders or separation agreements that would take too much from the plan. We advise them to seek guidance from the courts or to consult legal counsel.

Section 18 of the PBSA locks in plan benefits. However, subsection 25(5) imposes on the administrator the duty to administer pension benefits or credits in accordance with court orders or separation agreements between spouses. The Superintendent will not object to a plan administrator complying with a court order or the terms of a separation agreement made in accordance with the laws of the relevant province respecting distribution of pension benefits and pension benefit credits. If a court order or separation agreement is silent with respect to locking-in, section 18 will prevail.

Assignments are prohibited under section 18, except as assignments to spouses at divorce, annulment or separation. Subsection 25(4) requires plans to treat spouses that have been assigned benefits or benefit credits as former members who have just ceased membership in the plan. This gives many spouses portability rights. While the PBSA seems to distinguish between assignments and court orders and separation agreements, court orders and separation agreements will often result in assignments. This section has therefore fairly wide application.

The Office has changed its interpretation of some practical aspects of assignment to spouses. We had thought that if a member's spouse were assigned benefits or benefit credits, the right of the member's spouse to begin receiving pension benefits depended on the age of the member. We now feel that, because the spouse is deemed to be a former member, the assigned portion of the benefit becomes payable at the retirement age of the spouse, not the former member – notwithstanding an illustration in the PBSA Reference Manual. Similarly, it is the spouse's retirement age that determines when the portability options apply to the assigned portion of the benefit. Suppose, for example, that the pensionable age for a plan is 65, a member is 53 and the member's spouse is 56. Any pension assigned to the spouse is payable in 9 years, when the spouse attains age 65. Actuarial reductions to benefits may be required to respect subsection 25(8). Finally, since the spouse is 56 years old, the plan need not offer portability if the plan text does not offer portability to members leaving within 10 years of pensionable age. Since the Office itself has had difficulty interpreting these points, it does not expect plan sponsors to reverse any past arrangements guided by the Reference Manual.

Sometimes, court orders and agreements may appear inconsistent with the terms of a pension plan, or they may fail to direct the administrator how to act under various contingencies. For example, the court order may state that the benefit is to be split when the member retires but does not give any direction as to what happens in terms of the distribution if the member dies before the retirement date. Unfortunately, the Office cannot help the plan administrator in these cases. We can only suggest to the administrator to refer to their own legal counsel.

7. Interest on Benefits

Based on findings of OSFI examiners during on-site examinations, and on subsequent discussions with plan administrators and consultants, some clarification of the PBSA requirements with respect to applying interest on retirement benefits when payments are delayed appears to be in order. The Office takes the position that administrators should pay interest on delayed payments as a matter of fiduciary responsibility. Section 7 of the Directives, which refers to section 19 of the PBSA, does not apply, notwithstanding Directive 7(4).

8. Life Income Funds (LIFs)

Introducing an amendment to the Regulations to allow LIFs as an optional retirement vehicle may take longer than originally expected. The Office has learned that it will first require an amendment to the PBSA, which is a lengthier process. The Office will keep administrators informed of developments on this matter.

9. Assumed Valuation Retirement Age

This article is directed to actuaries who value pension plans. OSFI has a duty to review the reports on these valuations. To perform this review, we must understand the plan provisions and how the liabilities reflect them. Unfortunately, this is not always possible from reading the valuation report.

Disclosure of plan provisions is usually good, at least for going concern liabilities. However, in many reports, the description of how these liabilities are valued is often incomplete or unclear. Most actuaries take it for granted that all benefits (except benefits that arise only on plan termination) must be considered in a going concern valuation. Many are puzzled when we ask whether a bridge benefit or an early retirement subsidy has been reflected in the liabilities; they feel that the answer is obvious from the fact that the actuary has listed these provisions. To them it is clear that both the normal cost and the actuarial liabilities must be based on cost of all benefits for which members will be qualified at termination or retirement. For example, the normal cost and actuarial liabilities will reflect the fact that many members with less than the 20 years of service needed to qualify for a bridge benefit will eventually qualify for it.

We agree that valuations should reflect the likelihood that members will qualify for special benefits. This is consistent with the universal practice of recognizing the cost of normal retirement benefits accruing to members when these benefits are not yet vested. However, we have learned that some actuaries do not consider the fact that some members will qualify for special benefits that depend on completing a term of service. In these valuations, a bridge benefit affects neither the normal cost nor the actuarial liability for members who have not served long enough to qualify for it. We cannot be sure that an actuary has considered the cost of a benefit from the fact that it is included in the list of plan provisions.

The Office believes that it is usually incorrect to ignore members' potential to qualify for special benefits, although sometimes the complexity of projecting service may not be justified. Because practice is not uniform the Office must make sure, when evaluating reports, that it understands how the actuary has handled benefits that depend on completing a term of service. When the report does not make this clear, we contact the actuary and, sometimes, request changes to the report. Actuaries can avoid this with an explicit discussion of these benefits in their reports.

For solvency valuations, there is usually no question of projecting service beyond the date of valuation, because termination liabilities are based on service in the plan. However, the Office has difficulty reviewing many of these reports because the plan provisions listed are for going concern benefits. The valuation does not discuss what benefits are payable when the plan terminates. In fact, under the provisions of many plans, or by the application of section 29 of the PBSA, the benefits payable, if a plan terminates are often different from the benefits that are payable from a going concern. The Office published its position regarding benefits vesting on plan termination in No. 7 of *PBSA Update*. In summary, bridge and subsidized early retirement benefits are vested pursuant to the conditions of the plan, except that conditions regarding mode of exit are deemed to be satisfied when a plan terminates. For example, if the pension plan offered special benefits for early retirement, these benefits would be vested to all members who were eligible to retire with them immediately before the plan terminated.

A typical solvency valuation filed with OSFI does little to acknowledge the difference between going concern and solvency benefits, other than using a different set of retirement assumptions. A more elaborate description of the benefits payable on termination for members with various service records would facilitate our review.

An example will illustrate the Office's concerns:

The XYZ plan provides for a flat benefit amount for each year of credited service. Pensionable age is 65, but members 55 years and older may retire with a pension that is reduced by 3 per cent for each year that early retirement precedes pensionable age. Members with at least 30 years of service can retire after age 60 with a full pension or can retire early, starting at age 50 with a reduction of 3 per cent for each year that retirement precedes age 60. The plan also provides a bridge benefit of $500 per month payable from early retirement to age 65 to members with 20 or more years of service.

For the going concern valuation, the actuary could state that *service has been projected to termination of employment or retirement and members have been assumed to retire with the bridge benefit if they have 20 years of service at the assumed date of termination or retirement. Moreover, it is assumed that members will retire with an unreduced pension once they have accrued 30 years of service. Otherwise, the valuation assumes that members will receive a pension reduced by 3 per cent a year at the assumed date of retirement.*

In the solvency valuation, the actuary could state that *members within 10 years of pensionable age receive an immediate pension reduced by 3 per cent a year for each year that early retirement precedes pensionable age, which is 60 for members with 30 years of service and 65 for everyone else; if they have more* *than 20 years of service they receive, in addition, a bridge benefit of $500 payable to age 65. All other members are assumed to receive a deferred annuity starting at age 65.*

Comments?

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

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