ADMINISTRATION OF THE
PENSION BENEFITS STANDARDS ACT, 1985

Annual Report

1998-1999

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, 1998 to March 31, 1999.

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 1999

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You are invited to visit the OSFI Internet Site
Private Pension Plans Division • www.osfi-bsif.gc.ca

Report on the Administration of the *Pension Benefits Standards Act, 1985* For the Year Ended March 31, 1999

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);

(d) the application of gains 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. 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* which was designed to safeguard pension benefits for members and other beneficiaries from undue loss. 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* - 1998-1999

Pension Plans Regulated by OSFI

As at March 31, 1999, there were 1,161 pension plans registered under the *PBSA*, covering 495,186 employees. During the period, 51 new plans were filed for registration, and 35 registered plans were terminated or consolidated with other plans. Plan membership increased in all industries but banking, where it continued to fall.

The 2,024 members affected by plan terminations in 1998-99 did not suffer any loss of benefits. A plan is recorded as terminated in the year in which its assets are wound up and assets distributed to members and other beneficiaries. Since 1987, over 550 plans have been terminated and all but five were fully funded. OSFI had previously reported that nine plans had been less than fully funded at termination over the 12-year period. However, a further review indicated that four of these plans were fully funded by the time they were wound up. Reasons for such an occurrence include larger than expected assets after liquidation and/or lower than expected liabilities due to annuity rate fluctuations. In some cases, assets sufficient to fully fund the benefits have been collected from the employer or a trustee in bankruptcy. The five under-funded plans affected a total of 950 members. During the same period, 548 fully funded plans affecting 80,000 members terminated.

There has been an increase in the number of defined contribution plans relative to the total number of plans over the past five years, and a corresponding increase in membership. The increase is due solely to the increase in the number of pension plans for Native organizations which are of the defined contribution type. If Native organization pension plans are removed, there has been a relative decline in the number of defined contribution 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 approximately two per cent of total plan assets, up slightly from the previous year.

Market Value of Assets

The total market value of the assets of pension plans registered under the *PBSA* was approximately $74 billion at the end of the 1998-99 fiscal year. The increase of $7 billion, or ten per cent, over that reported last year was due to both contributions and market conditions during the period. Historically, the funds held in federally regulated pension plans have represented approximately ten per cent of the funds held in all private pension plans in Canada.

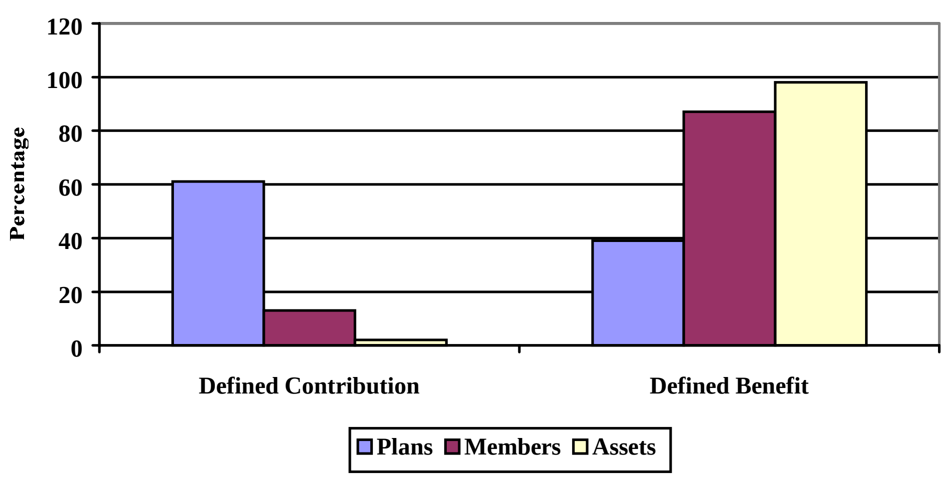
Equity and diversified funds account for over fifty per cent of all investments with debt securities making up the remainder. This is consistent with pension funds in the rest of Canada where more than fifty per cent of their assets have been invested in equities since 1996. Market value of foreign investments is approaching twenty per cent of the total in *PBSA* registered plans which is an increase over that of previous years.

Distribution of Plans, Membership and Assets

The first chart shows the distribution of plan membership and assets by plan type. Although defined contribution plans account for 61 per cent of the total, they account for only 13 per cent of total membership and two per cent of assets. The 450 defined benefit plans include 28 negotiated contribution plans and 55 plans that have both defined benefit and defined contribution components. The latter are referred to as combination plans.

Distribution of Plans, Membership and Assets by Plan Type

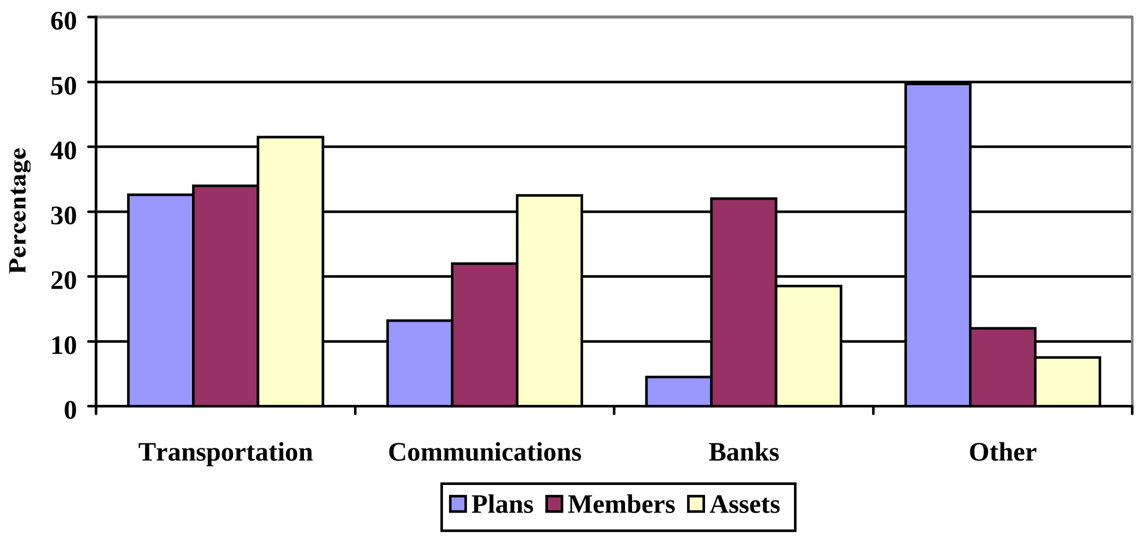
at March 31, 1999



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 Native organization pension plans.

Plans, Membership and Assets by Industry

at March 31, 1999



Legislative Changes

Amendments to the *OSFI Act* were included in Bill S-3 which was assented to on June 11, 1998. The purpose of the amendments was to explain OSFI's role in supervising pension plans, clarify the focus on monitoring the solvency of pension plans, promote policies that are designed to identify and control risk, and take appropriate action to deal promptly with problem plans.

Bill S-3 also amended the *PBSA*. Major changes included enhancing plan governance measures by placing more emphasis on the importance of the responsibilities of plan administrators; requiring the administrator to provide more information to plan members and former members on the financial condition of the plan; a means to facilitate agreements between employers and plan beneficiaries on the distribution of surplus; and additional supervisory powers to the Superintendent.

Approach to Supervision

In May 1998 OSFI published its *Governance Guideline for Federally Regulated Pension Plans*, and in June presented the guideline to the Senate Standing Committee on Banking, Trade and Commerce. The Committee issued a report on governance practices which included a recommendation that pension plans in Canada adopt industry best practices with respect to plan governance. Specifically, the Committee recommended that plan administrators adopt one of several governance guidelines and report annually to pension plan members setting out how they comply with or exceed the adopted set of guidelines, and explain why they do not comply if they choose not to do so.

A joint task force comprised of the Association of Canadian Pension Management, the Pension Investment Association of Canada and OSFI was formed to raise the level of understanding of plan administrators with respect to accountability for decisions and actions which affect their pension plans. The task force has developed a set of governance principles and best practices and a self-assessment and reporting framework which focuses on high level issues such as accountabilities, controls and performance measures. There has been continuous consultation with the pension industry regarding governance issues. In addition, OSFI has agreed to provide technical assistance to some educational institutions with a formal training program for trustees to enhance the safety and soundness of pension plans.

The Senate committee intends to hold hearings in the year 2000 to determine whether regulations are needed to ensure that plans are well governed, or whether voluntary compliance with the task force guidelines has been satisfactory.

In addition to relying on good governance, OSFI has developed 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 focus has also shifted to areas that have an impact on the security of the pension promise. The RAS has enhanced the reliability of selecting higher risk plans for examination. During the period, 39 pension plans were examined on site. The selection of plans for on-site examination was based 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. 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 which depend on the funded status of the plan and various economic and demographic assumptions.

An actuarial valuation report is required only for defined benefit plans. In the valuation report, the actuary describes the plan's financial condition and determines the current service costs for future service. If the plan has a solvency deficiency or an unfunded liability, the actuary establishes the schedules of special payments required to amortize the deficits. Amortization schedules are defined in the *Regulations* to the *PBSA*.

All of the plans currently reporting a solvency of less than one are meeting the minimum funding standards of the *PBSA*. While 37 plans had a solvency of less than 1.0, 28 reported a solvency level of at least 0.85. The continuation of all of these plans depends on the employer's commitment and ability to remit amounts sufficient to fund future benefits and any unfunded liabilities and/or solvency deficiencies.

Pension Plan Surplus

Pension plan surplus has become a topical issue with both plan sponsors and plan beneficiaries. Amendments to the *PBSA* which address the surplus issue became effective on April 1, 1999. Regulations in support of the *PBSA* amendments have been approved for pre-publication in the Canada Gazette and are expected to be passed before the end of this fiscal year.

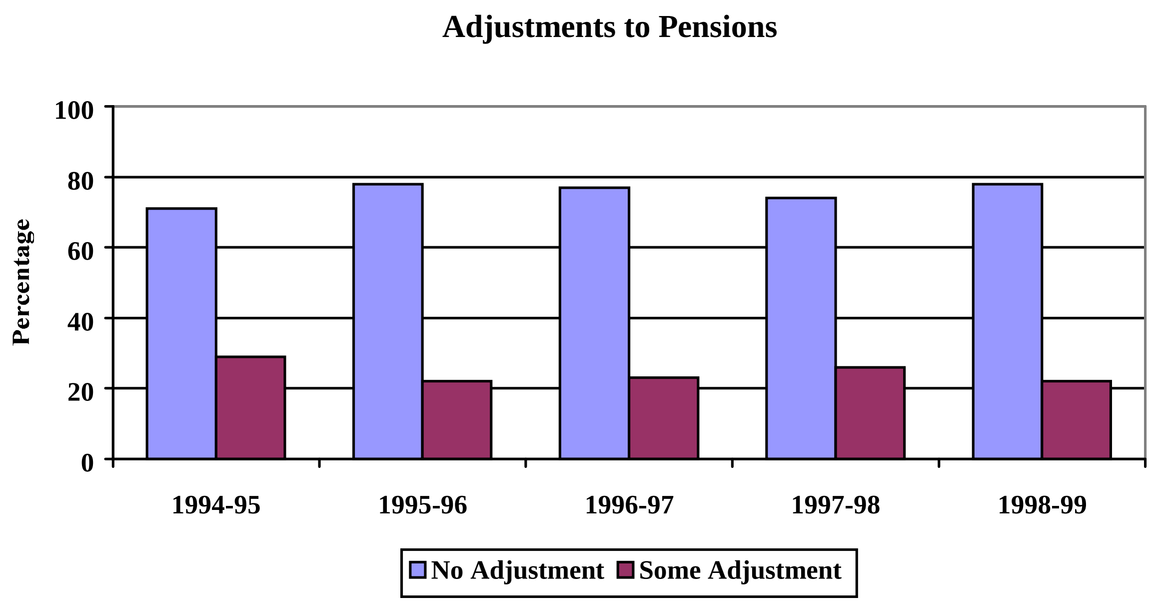
Where a plan does not establish the ownership of the surplus, the amendments to the *PBSA* and the *Regulations* will facilitate agreements between plan sponsors and beneficiaries on the distribution of the surplus. A guideline for requesting refunds of surplus is being drafted.

During the period covered by this report, the Superintendent approved two requests for refunds of surplus on plan termination. The refunds amounted to $1,730,000, of which $710,000 was distributed to plan beneficiaries. In the previous year the Superintendent approved one request amounting to $1,276,720**.**

Report on Inflation Adjustments to Pensions

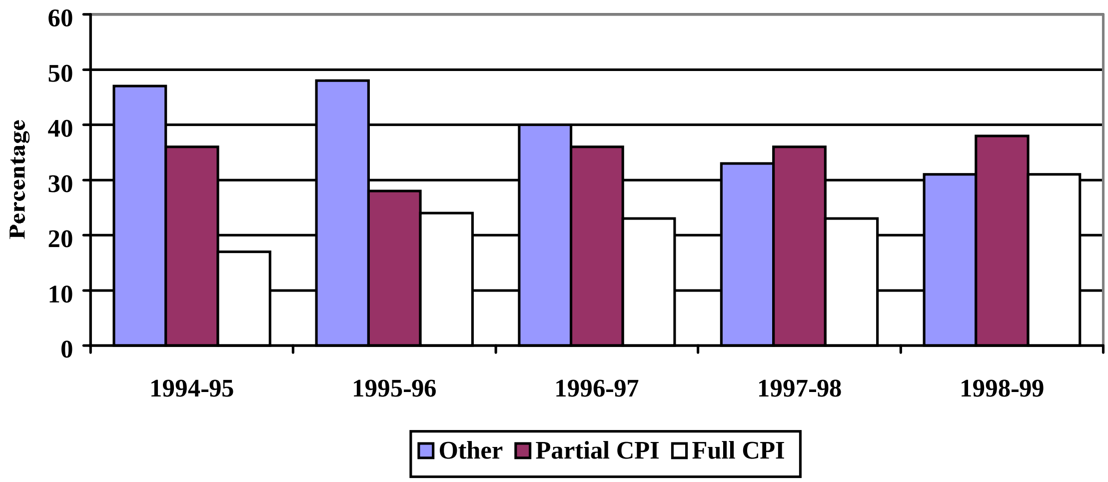
As required by the *PBSA*, plan sponsors report the extent to which they have provided inflation protection and the source of funds for these adjustments.

The following graphs summarize inflation adjustments for 1994-95 through 1998-99.



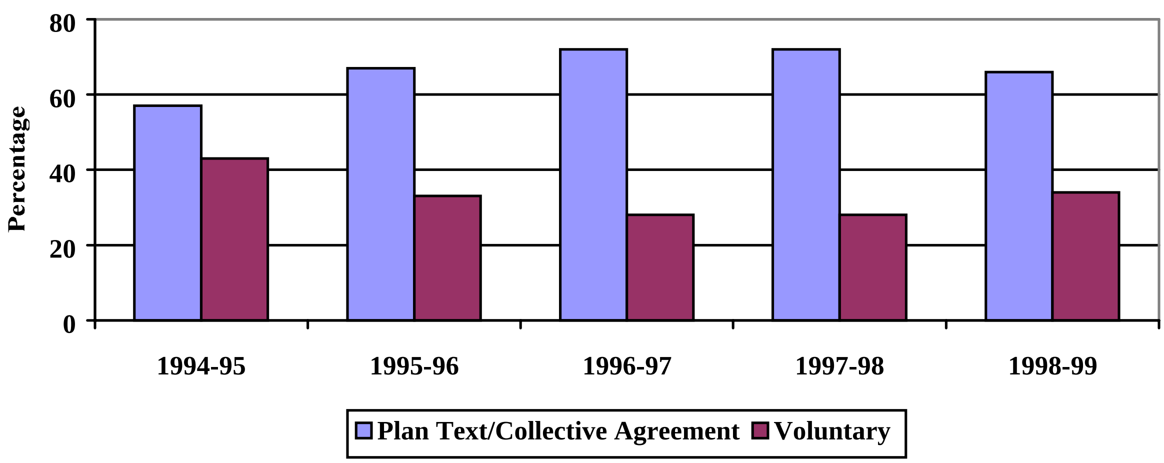
This graph shows that 22 per cent of defined benefit pension plans reported that they had increased pensions in pay. Of those plans that did provide such adjustment in 1998-99, 14 per cent also increased deferred pensions.

Basis for Adjustment



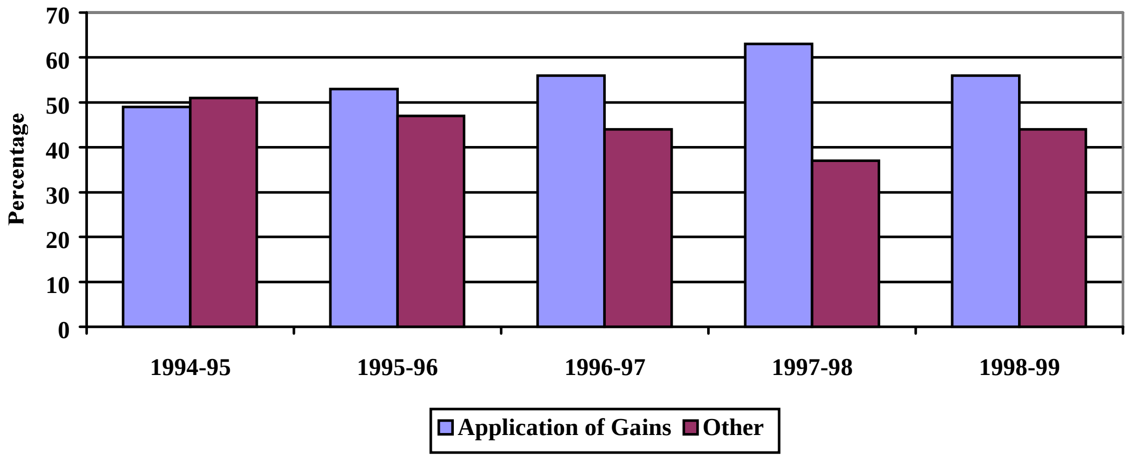
This graph shows that 38 per cent of the plans that made adjustments to pensions in 1998-99 based increases on a partial increase in the Consumer Price Index (CPI), and 31 per cent based increases on the full CPI increase. The remaining 31 per cent used some other formula such as excess interest, a flat dollar amount, or a percentage of pension payment to calculate the increases.

Reason for Adjustment



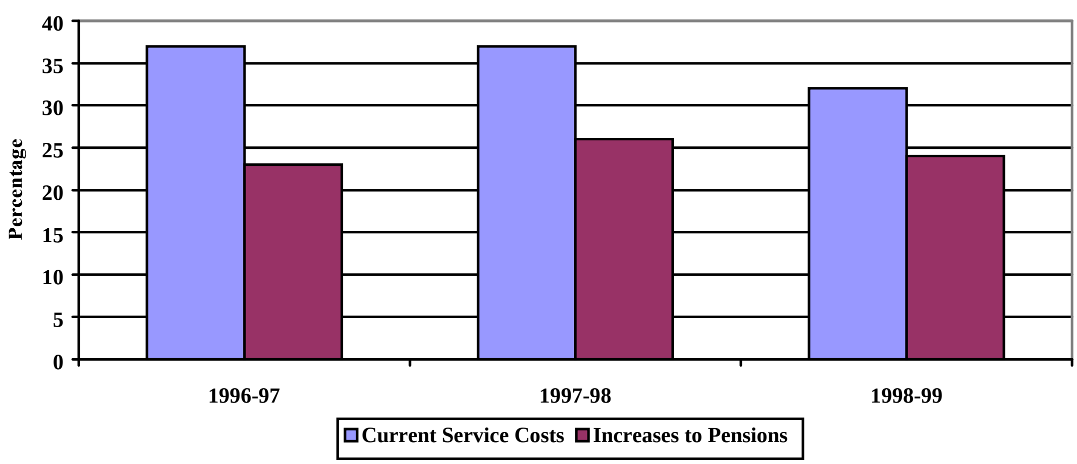
This graph shows that for the past five years the majority of adjustments to pensions have been contractual as opposed to voluntary. During the period 1998-99, 66 per cent of adjustments were due to collective agreements or requirements of the plan text, while 34 per cent were voluntary. This was the first time in several years that voluntary adjustments increased.

Source of Funds For Pension Adjustment



During the period under review, 56 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. While the number of plans using an existing surplus or gains had increased over the past several years, the past fiscal year saw a reversal of this trend.

Application of Surplus/Gains



Data provided in the annual information returns indicated that 110 plans used surplus/gains to improve pensions while 146 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, 1998 to March 31, 1999

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. Total fees received during the fiscal year ending March 31, 1999 were $2,347,000, down from $2,736,000 a year earlier. The cost of administering the *PBSA* for fiscal 1998-99 was $3,190,000, an increase over the $3,016,000 the previous year.

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

Revenue and Expenditures in 000s							
Year	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**
Revenue	$2,899	$3,686	$2,911	$2,774	$3,178	$2,736	$2,347
Expenditure	$2,704	$2,594	$2,632	$2,772	$2,604	$3,016	$3,190
Basic Fee Rate	$13.10	$10.25	$9.60	$10.50	$10.00	$8.00	$12.00

Basic Fee Rate

OSFI has been able to maintain the same fee assessment rate as that established last year. For plans with a year end between October 1, 1999 and September 30, 2000, 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 on October 2, 1999.