ADMINISTRATION OF THE *PENSION BENEFITS STANDARDS ACT, 1985*

Annual Report

1997

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

Dear Minister:

Pursuant to section 40 of the *Pension Benefits Standards Act, 1985*, I am pleased to submit to you the PBSA Annual Report which covers the period from April 1, 1996 to March 31, 1997.

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

Yours very truly,

John R.V. Palmer
Superintendent

Ottawa, October 1997

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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;

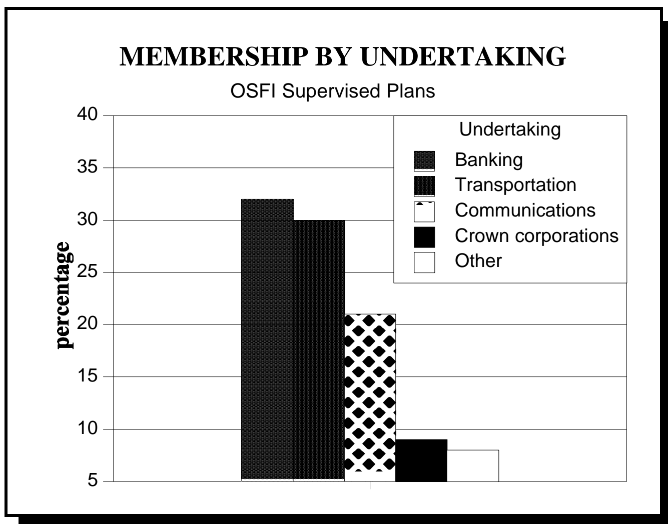
(b) the extent to which inflation adjustments or other adjustments to pension benefits have been provided during that year, either voluntarily by employers or pursuant to collective agreements, as shown in information filed pursuant to section 12;

(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, or private, pension plans, together with the Old Age Security, Canada/Quebec Pension Plans and Registered Retirement Savings Plans are the major components of the Canadian retirement system. Private pension plans are subject to standards legislation designed to ensure the security of pension benefits and minimum levels of protection for members and their spouses. They are also subject to the *Income Tax Act* which establishes limits within which tax deductions are permitted for both employee and employer contributions.

The *PBSA* governs private pension plans established in respect of employees engaged in work that is 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 a large number 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 Office of the Superintendent of Financial Institutions (OSFI) regulates 1,120 of Canada's 14,626* private sector pension plans. OSFI supervises plans which cover 514,000 members, or approximately ten percent* of the members covered by all public and private sector pension plans in Canada.

Over eighty per cent of the members in *PBSA* plans work for banks, transportation companies (air, rail, road and water) and communications companies.

*Source: Pension Plans in Canada, Statistics Canada, January 1, 1996

The *Pension Benefits Standards Act, 1985* (*PBSA*) came into force on January 1, 1987, repealing the *Pension Benefits Standards Act* which had been enacted in 1967. The *PBSA* establishes 16 standards for registration which include funding and investments, eligibility for membership, vesting, locking-in and portability of benefits, death benefits, and members' rights to information.

OSFI's Pension Benefits Standards Division (the Division) has regulatory and supervisory responsibilities for pension plans which fall under federal jurisdiction and are thus regulated by the *PBSA*.

Operation of the *PBSA* - 1996-1997

Pension Plans Regulated by OSFI

As at March 31, 1997, there were 1,120 active pension plans filed with OSFI covering 513,871 employees. During the 1996-97 fiscal year, 59 new plans submitted application for registration and 47 previously registered plans were terminated or consolidated with other plans. Consequently, the number of plans filed with OSFI increased by 12 during the year. The following table reconciles the number of pension plans in force as at March 31, 1996 with the corresponding figures as at March 31, 1997.

Plans Filed, Terminated, or Consolidated During the Year Ended March 31, 1997**
(prior year's data in parenthesis)

	# Plans	# Membership
Filed for registration during the year	59 (67)	13,079 (4,133)
Consolidated with other plans subject to the *PBSA*	15 (22)	No change in total membership
Terminated during the year	32 (49)	430 (1,191)
In force at end of year	**1,120*** **(1,108)**	**513,871** **(501,222)**

* Excludes 117 plans covering 124,679 members (the vast majority of whom are not subject to the *PBSA*) that were supervised by provinces on behalf of OSFI pursuant to reciprocal agreements - see *Agreements with Provincial Authorities* on page 12.

** A plan is recorded as being terminated in the year in which its assets are wound up and distributed to the members and other plan beneficiaries. The 430 members affected by the 32 plan terminations did not suffer any loss of benefits. Reasons cited for plan termination included decisions to switch to group registered retirement savings plans (RRSPs) or sale of business.

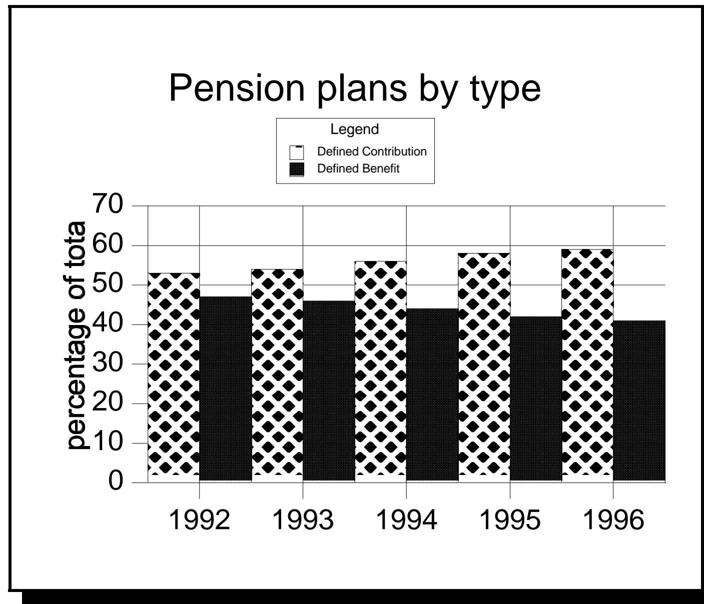
Types of Pension Plans and Distribution of Membership

While most pension plans (59 per cent) are defined contribution plans (money purchase plans), participants in defined benefit plans account for 90 per cent of the total membership of the 1,120 plans supervised by OSFI.

Distribution of Plans and Membership by Plan Type
(as at March 31, 1997)

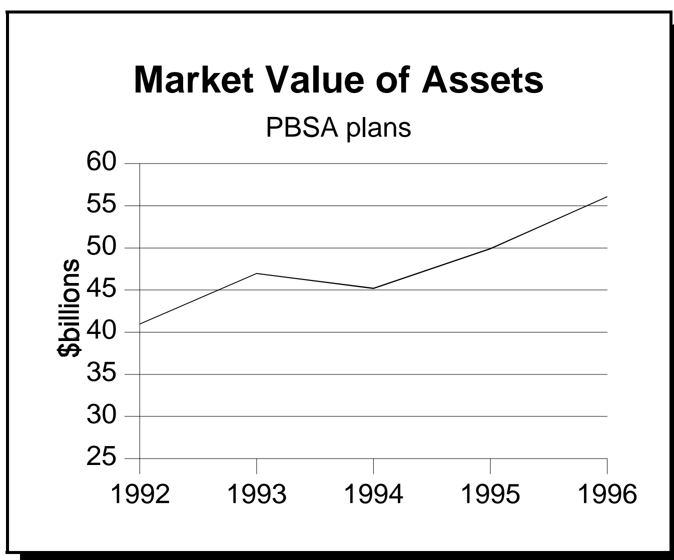
Plan Type	# Plans	% of Total	# Members	% of Total
Defined benefit				
• average best earnings	201		303,184	
• final average earnings	102		76,033	
• career average earnings	99		40,128	
• flat benefit	44		37,359	
• money purchase guarantee	11		5,345	
Total defined benefit	457	41%	462,049	90%
Defined contribution (money purchase)	663	59%	51,822	10%
Total	**1,120**	**100%**	**513,871**	**100%**

Thirty of the 457 defined benefit plans are negotiated contribution plans. Sixteen of these are of the flat benefit type, eleven are based on a career average earnings formula and three are money purchase plans with a guaranteed benefit.



There has been an increase in defined contribution plans relative to total plans over the past five years and a corresponding increase in membership from 6.5 per cent to 10 per cent of total membership. Assets held in defined contribution plans at year end were approximately $1 billion or 1.8 per cent of total assets. The reason for the proportionately low assets is that most defined contribution plans have been in existence for a short time. Further, when a member retires from such a plan, assets must be transferred as this type of plan cannot pay an annuity. Such is not the case for defined benefit plans which can carry billions of dollars to pay retirement benefits alone.

Market Value of Assets



The total market value of the assets of pension plans at the end of 1996 was approximately $56 billion, an increase of 12.5 per cent during the fiscal year with investment returns responsible for most of the growth. Over the past five years, the assets of federally regulated plans have increased by 38 per cent, again, largely as a result of investment returns.

Review of Plan Documents

The compliance model of regulatory supervision, which is required by the *PBSA* and under which the Division's staff has been operating, requires a review of all filings to assess compliance with the *PBSA*. Over 4,000 documents were received during the fiscal year. Among these were financial reports, valuation reports, annual information returns, lists of assets, plan texts, trust agreements, insurance contracts and collective agreements. While compliance review is still part of the mandate, the Division is now focusing its activities on plans that exhibit a high risk profile.

Solvency of Plans

Pension regulation in all jurisdictions permits pension plans to promise benefits beyond the level of their accumulated assets. This approach recognizes that a pension plan is a long term funding vehicle and is based on the expectation that employers will continue to make contributions over time.

Early detection of solvency and funding problems are key elements in monitoring the risk of a pension plan. Money purchase plans are fully funded as long as the contributions, as defined by the pension plan, are remitted. Defined benefit plans, on the other hand, have fluctuating contributions which are dependent on the funded status of the plan and various economic and demographic assumptions. An exception is the defined benefit plan where the contributions are negotiated and the employers are bound by the collective agreement to contribute a prescribed amount for the duration of the contract regardless of the funded status of the plan.

The valuation report 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 the deficits. These schedules are defined in the *Regulations* to the *PBSA*. Current service costs, for accruing benefits, are also determined by the actuary.

All defined benefit plans must submit a valuation report every three years. However, where the solvency ratio of a plan is less than 1, i.e., if the solvency is less than 100%, the plan administrator is required to file a valuation report annually. The solvency ratio, which is determined by assets over liabilities on a termination basis, indicates whether or not there are sufficient assets in the plan to pay all of the pension liabilities if the plan had terminated on the date of the test.

All but one of the plans currently reporting a solvency of less than 100% are meeting the funding standards of the *PBSA*. It is expected that the plan not meeting the standards will do so by January, 1998. While 35 plans had a solvency of less than 100%, 21 reported a solvency level of at least 90%. The continuation of these plans depends on the employers' commitment and ability to remit the contributions required to fund the future benefits and amortize any deficits in accordance with the schedule established by the actuary.

An actuarial valuation report must also be filed when a plan amendment affects the cost of benefits. One of the proposals of Bill S-3, which is discussed below, is to require the full funding of any increase in benefits where the solvency ratio is below a certain threshold. While most defined benefit plans are fully funded on a termination basis, economic conditions can quickly alter that status. During the fiscal year the Division has increased the monitoring of pension plan solvency which is critical to adequate funding and benefit security.

On-Site Examinations

During the period twenty plans were examined. In addition, on-site examination methods and procedures underwent a significant change. In accordance with a new risk-based approach, the compliance model was replaced with a risk assessment model. This required more attention to plan governance, investment policies, records, accounts, controls and procedures used in connection with the administration of the plans.

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

Surplus

The issue of entitlement to pension plan 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. When a pension plan has a surplus, questions of entitlement may arise.

Surplus refunds to employers are subject to the terms and conditions of an individual pension plan, whether or not plan members are required to contribute to the plan. The documents which establish and describe a pension plan may contain provisions which address entitlement to surplus. However, most older plans do not address entitlement as plan texts are either silent or ambiguous in this regard. In addition, most do not contain provisions which would allow the plan to be amended to grant a right to surplus.

Section 9(5) of the *PBSA* allows surplus to be refunded to the sponsor of a going concern plan if the Superintendent consents. The Superintendent consents only to those requests that comply with the *Regulations*. The *Regulations* define surplus, and set the conditions under which a refund may be made. The latter includes a requirement to notify members of the employers' intent to request a refund of surplus. In general, after a surplus refund, the surplus remaining must exceed the greater of 25 per cent of the solvency liabilities of the plan or two times the annual employer contribution rate, as determined by the actuary. Few plans currently have levels of surplus above these thresholds and OSFI receives very few requests for a refund of surplus from on going plans.

When a plan terminates the accrued benefits must be paid out to members and former members. Often a surplus remains in the fund. In such a case, the Superintendent must consider a refund request from the employer. Approval will be given only if the employer has clear entitlement as defined in all of the plan documents. Where entitlement is ambiguous, the plan sponsor and the plan beneficiaries may go to court to determine ownership or agree to share the surplus.

During the period covered by this report, the Superintendent approved four requests for refunds of surplus to plan sponsors of terminated plans. The total amount refunded was $963,780. In the previous year, five requests were approved for a total of $13.7 million, $13.5 million of which was in respect of one large plan.

Communications

The Division's publication *PBSA Update* informs pension plan administrators and other professionals in the pension industry of changes to the *PBSA* and *Regulations*. The newsletter also serves to remind plan administrators and their representatives of particular *PBSA* standards and to inform them of changes in administrative policies and procedures. The most recent issues of *PBSA Update* were mailed to stakeholders in January and August 1997. Amongst other important topics, these editions provided some insight about our new approach to supervision. Readers are encouraged to send their comments to OSFI on any matters covered in the newsletter or related to OSFI's supervision of pension plans.

Pension stakeholders have also been invited to visit the OSFI web site where *PBSA Update,* the legislation, the *PBSA Annual Report*, and various policy papers may be viewed.

New Approach to Supervision

In the past some federally regulated pension plans have experienced funding and solvency problems. Fortunately, just a few were wound up without sufficient assets to pay the promised benefits. OSFI's experience with these plans has demonstrated the importance of good plan governance and funding rules to promote the timely and cost effective delivery of benefits.

OSFI has also had to deal with plans which failed to meet one or more of the prescribed standards under the *PBSA* including vesting, locking-in of benefits, members rights to information, etc. Currently, where a pension plan fails to remedy a situation of non-compliance within a prescribed period, there is no enforcement method available to the Superintendent short of terminating the plan.

OSFI has been asked to intervene in plan situations which are more appropriately the responsibility of plan administrators. The most common example of this involves disputes over terms and conditions of a plan which are not required by legislation. Such experience has led to a review of the *PBSA* and the recognition that OSFI's authority with respect to the supervision of pension plans may be too limited. The Superintendent requires the authority and power to address both supervisory and prudential issues discussed above.

Legislation Changes

In July 1996, the federal government released a White Paper on the enhancement of the supervision of private pension plans. The paper set out the government's proposals to improve the supervisory regime for pension plans regulated under the *PBSA* and ensure that it remains up to date and effective in the changing environment in which private pension plans operate. The paper was widely distributed and written submissions were considered before policy positions were finalized.

The proposed amendments would extend OSFI's mandate contained in the *Office of the Superintendent of Financial Institutions Act*, to clarify its supervisory role in regard to pension plans. In particular, it would acknowledge OSFI's role in monitoring the solvency of pension plans, in promoting policies that are designed to monitor and control risk, and in taking steps, or requiring that steps be taken, to deal promptly with problem plans.

In addition, the revised OSFI mandate would help clarify that it is the administrator's responsibility to ensure continuing compliance with the *PBSA*, to oversee the operation of the plan and to deal with problems that may emerge.

The major policy initiatives undertaken in the paper are designed to:

- enhance plan governance measures, placing more emphasis on the importance of the duties and responsibilities of plan administrators and allowing the employees more access to the administration of their plan;
- provide additional supervisory powers to the Superintendent, including the authority to issue formal directions to plans where, in the opinion of the Superintendent, imprudent or unsafe practices exist;
- require the administrator to provide more information to plan members on the financial condition of the plan;
- clarify certain requirements in respect of investment policies and propose alternatives for enhancing funding requirements; and
- make some technical changes to clarify and facilitate the administration of legislative requirements.

Bill C-85 was tabled in March 1997 and reached the stage of second reading but died on the order paper when the election was called. The Bill was reintroduced in the Senate as Bill S-3 in October 1997.

CAPSA Activities - Federal Provincial Harmonization

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

- ensure that pension plans that have members in more than one jurisdiction are regulated in a coordinated and orderly manner;
- discuss and resolve supervisory problems and issues of an interjurisdictional nature relating to pension plans;
- consider and, if appropriate, recommend measures for the benefit of pension plan members and sponsors; and
- communicate with industry groups and professional associations on pension plan issues.

The following officials in charge of administering federal or provincial pension benefits standards legislation are represented at 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, Pension Commission of Ontario
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 at CAPSA when the legislation comes into force. In the meantime, PEI, representatives of Revenue Canada, Finance Canada and Statistics Canada have a standing invitation to attend CAPSA meetings.

CAPSA meetings are held twice a year where jurisdictional reports and papers are tabled and discussed. The proposed new multi-lateral reciprocal agreement and regulatory harmonization have been the main topics of discussion at recent CAPSA meetings. With respect to the latter, OSFI has taken on the task of designing a universal Annual Information Return for use by all of the regulatory bodies and Revenue Canada.

Other harmonization initiatives in the area of data collection, supervisory approach and investment regulations are also being considered. OSFI is currently discussing an arrangement with some jurisdictions whereby our pension plan examiners, under contract, would perform on-site examinations on their high risk plans. The development of a model law for pension plans as a way to harmonize pension law in the future is in the initial stages of discussion.

Agreements with Provincial Authorities

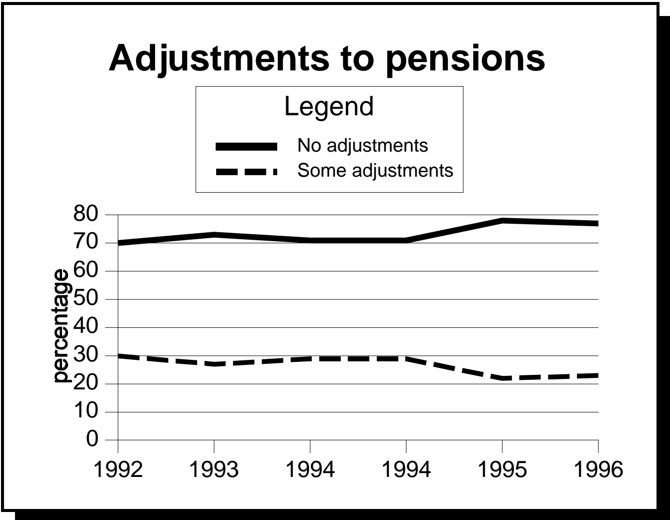
Prior to the extensive pension reform beginning in the mid-1980s, the relatively few differences among the various legislation had enabled regulatory bodies to reach reciprocal agreements under which jurisdiction of registration was based on province of work and nature of employment. The regulatory body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

Since existing agreements merely allow a single regulator to apply numerous rules to a given plan, CAPSA has developed a new multi-lateral reciprocal agreement. The objective of the proposed agreement 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 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 have the power to enter into such agreements while others, including the federal government, must amend their legislation to gain such power. To date, no government has signed the agreement.

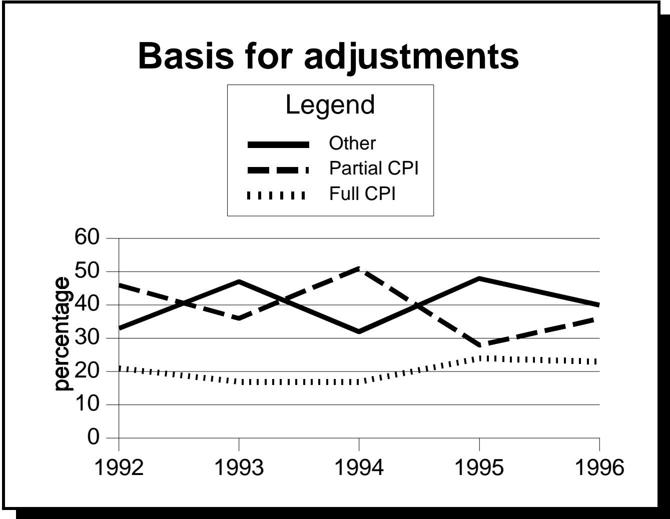
Report on Inflation Adjustments to Pensions

As required by the *PBSA*, plan sponsors report annually the extent to which they have adjusted pensions to provide inflation protection and the source of funds for these adjustments. The practice of adjusting pension benefits in payment is in respect of pensions arising out of defined benefit plans.

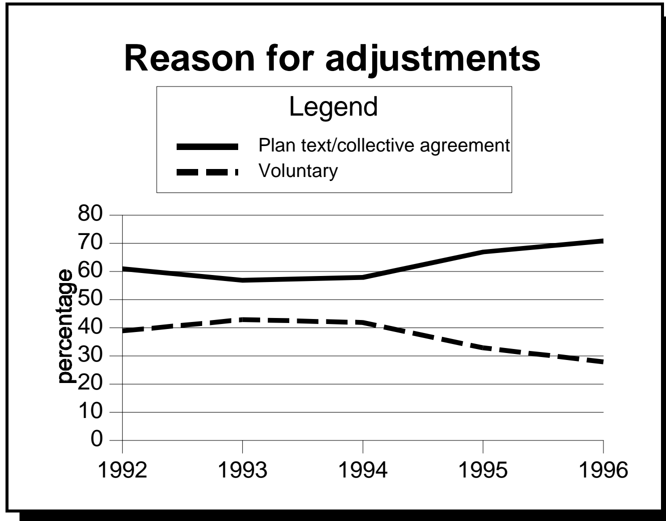
The following charts summarize inflation adjustments as reported by pension plan sponsors for the calendar years 1992 through 1996. It is based on information filed at the time of report preparation.



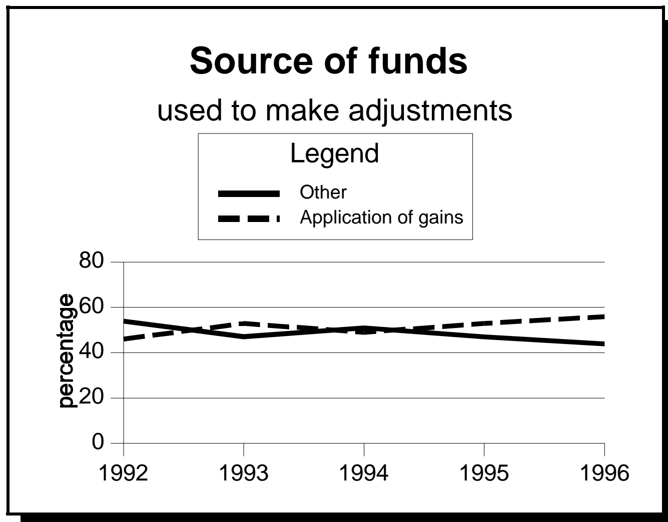
Of the defined benefit pension plans that have filed annual information returns in respect of the 1996 plan year end, 23 per cent reported that they had made some adjustments to pensions. This is up from 22 per cent in 1995, but down from the years prior to 1995.



Of the plans that made adjustments during the period, thirty-six per cent adjusted benefits to reflect part of the increase in the Consumer Price Index (CPI) and twenty-three per cent adjusted benefits to reflect the full increase in the CPI. The remaining 40 per cent used some other formula such as excess interest, a flat dollar amount or a percentage of pension payments to calculate the adjustment to pensions.



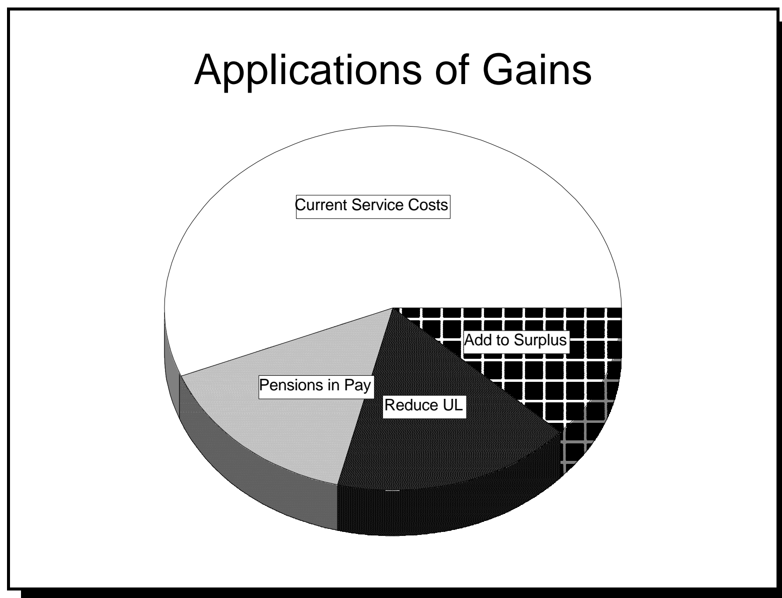
For the past five years, the majority of adjustments to pensions have been contractual as opposed to voluntary. In 1996, 71 per cent of adjustments were as a result of a collective agreement or a requirement of the plan text, while 28 per cent were voluntary. There has been a noticeable trend to fewer voluntary increases over the past few years.



During the past year, more than half of the defined benefit plans that made adjustments to pensions used gains or surplus funds. The remainder used resources outside the pension fund, created unfunded liabilities, or used some combination of the above to improve pensions.

Application of Gains from Pension Funds

Actuarial 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 deficit, 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 gains in excess of losses over 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 are paid for from gains. In fact a plan can experience a loss, but use an existing surplus to increase pensions. This year's chart is slightly different from previous years as it includes all applications of gains reported by plans.



Data provided in the annual information returns indicated that 276 out of 457 defined benefit plans reported gains. Of these, 62 per cent used the gains for current service costs, 17 per cent used the gains to increase pensions in pay, 19 per cent used gains to reduce unfunded liabilities (UL) and 13 per cent did not use the gains in any way.

Revenue and Expenditure April 1, 1996 to March 31, 1997

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* supervisory 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. This provision ensures that plan sponsors pay the full cost of administering the *PBSA*, and no more.

Total fees received during the fiscal year ending March 31, 1997 amounted to $3,178,000 compared to $2,774,000 the previous year. The total expense of administering the *PBSA* for fiscal 1996-97 was $2,604,000 compared to $2,772,000 for 1995-96.

The reason for the large excess of revenues over expenditures is due, in part, to gains over estimated revenue as a result of the increase in the fee base the previous year and the payment of overdue fees by some plan sponsors. On the expenditure side, savings were realized in the delivery of the program. In addition, a small surplus was carried over from previous years. All of these factors contributed to the significant drop in the fees for the following fiscal year.

Income, Expenditure and Fees for *PBSA* Supervision

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

For plans with a year end between October 1, 1997 and September 30, 1998, the basic fee rate has been established at $8 per plan member up to 1,000 members, and $4 per member in excess of 1,000. There is a minimum fee of $160 per plan, and a maximum of $80,000. As required by the *Pension Benefits Standards Regulations*, the basic fee rate was published in the Canada Gazette before October 1, 1997.

End