ADMINISTRATION OF THE *PENSION BENEFITS STANDARDS ACT, 1985*

Annual Report

2000-2001

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, 2000 to March 31, 2001.

Section 40 of the Act 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 sincerely,

Nicholas Le Pan
Superintendent

Ottawa, December 2001

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You are invited to visit the OSFI web site 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:

(a) the operation of the PBSA 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 toward 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* – 2000-2001

Pension Plans Regulated by OSFI

As at March 31, 2001, there were 1,184 pension plans registered under the PBSA, covering 561,000 employees. During the period, 55 new plans were filed for registration, and 41 registered plans informed OSFI they were terminating or consolidating with other plans.

The 2,636 members affected by the 41 plans that wound up in 2000-2001 did not suffer any loss of benefits. 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, over 600 plans have been terminated and all but 5 were fully funded at wind-up. The 5 underfunded plans affected a total of 950 members whereas the fully funded plans covered over 80,000 beneficiaries. OSFI is currently overseeing the wind-up of two plans that had to reduce benefits. When the final loss to members is confirmed, these plans will be added to the list of underfunded plans.

There has been an overall increase in the number of pension plans that fall under federal jurisdiction and in the number of defined contribution plans relative to the total number of plans over the past five years. The increase in defined contribution plans is due largely to an increase in the number of pension plans for native organizations. If native organization pension plans are not counted, there has been a decline in the number of defined contribution plans relative to defined benefit plans which is consistent with the trend being experienced in the rest of the country.

The straightforward nature of defined contribution plans makes them the choice of small employers. This type of plan is simple to start and to terminate because the members' individual defined contribution accounts are easily transferable to individual or group RRSP accounts. On the other hand, defined benefit plans are generally sponsored by large, fairly stable companies such as banks, railroads and telecommunication companies. Although very few new plans are of the defined benefit type, not many of these plans have terminated.

A trend that is becoming more common is that of large defined benefit plans offering members the option of accruing future benefits on a defined contribution basis and, in some cases, offering the option of converting accrued defined benefits to cash for transfer into a defined contribution account. There are 65 such combination plans registered under the PBSA. They have been classified as defined benefit plans for consistency of data collection with Statistics Canada.

As of January 2000, there were approximately 15,500 pension plans in Canada covering slightly more than 5,000,000 members. Included in this number are pension plans for employees of the federal, provincial and municipal governments. These public sector plans accounted for almost half of total membership in Canadian pension plans. While membership in pension plans across Canada dropped throughout the 1990s, it increased in federally regulated plans.*

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* Statistics Canada's *Pension Plans in Canada, January 1, 2000.*

Pension plans under federal jurisdiction, for which the Superintendent has responsibility, comprise approximately 8 per cent of all registered plans in Canada, 11 per cent of plan membership and 20 per cent of assets. If only privately sponsored pension plans are compared, OSFI regulates 8 per cent of the plans, 17 per cent of the membership and 40 per cent of the assets. Unlike many provincial regulators, with whom public sector plans are registered, OSFI does not regulate public sector plans for the Canadian Armed Forces, the Royal Canadian Mounted Police or public servants.**

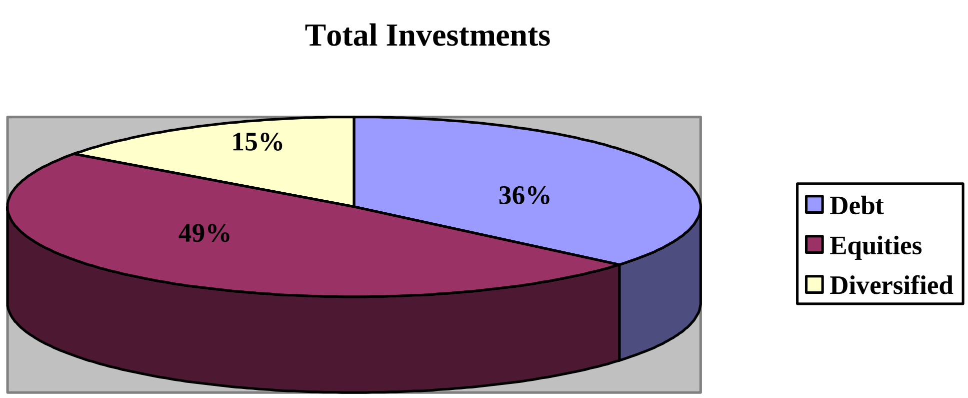
Market Value of Assets

The total market value of the assets of pension plans registered under the PBSA was approximately $93 billion at the end of the 2000-2001 fiscal year. The increase of $13 billion included receipt of Canada Post's pension fund of $7.2 billion, which had been administered under the *Public Service Superannuation Act*. The remaining $5.8 billion, or an increase of 7.25 per cent over last year, was due to contributions and to market conditions during the period. It should be noted that although the data is collected on plans with a year-end up to and including March 31, 2001, the majority of the plans have a year-end date of December 31, 2000, the date on which fund assets were reported. This was before the steep downturn in the market in 2001.

Allocation of Assets

The following chart indicates how assets were invested during the period. "Debt" includes government and corporate bonds, mortgage loans and deposits. "Equities" includes investments in pooled funds, stocks, and shares in real estate, resource and investment corporations. "Diversified" covers investments that are not included in the other two categories. The proportion invested in equities has increased by about 15 per cent over the past two years and represents 49 per cent of the total. As reported by plan administrators, almost 77 per cent of equities held in pension funds regulated by OSFI is directly invested in common and preferred shares. Debt securities account for 36 per cent of total investments and diversified investments account for the remaining 15 per cent.

Foreign investments were reported at approximately $19 billion or 20 per cent of total investments. Of the $19 billion foreign investment, 85 per cent was reported to be in equities.

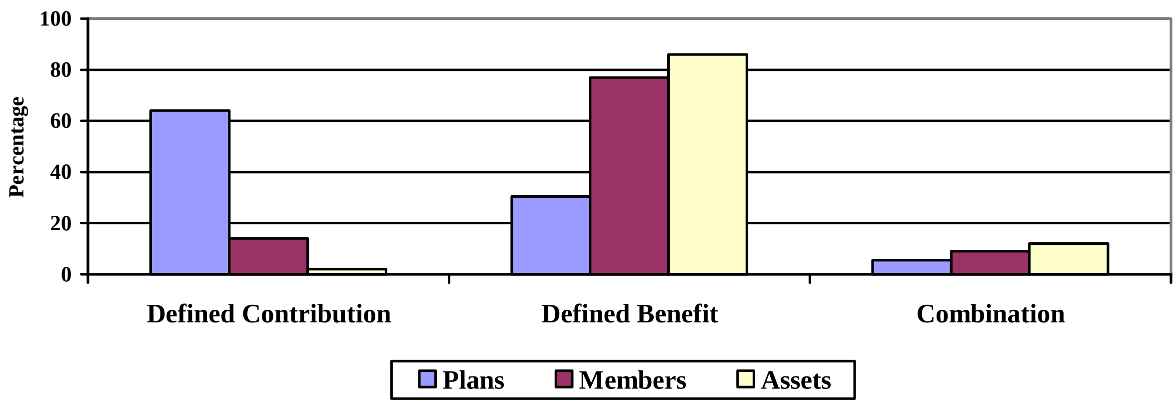


** Statistics Canada's Trusteed Pension Funds, Financial Statistics, 1998.
OSFI regulates the pension plans of 12 Crown Corporations, the data for which was removed for comparison with private sector plans in Canada.

Distribution of Plans, Membership and Assets

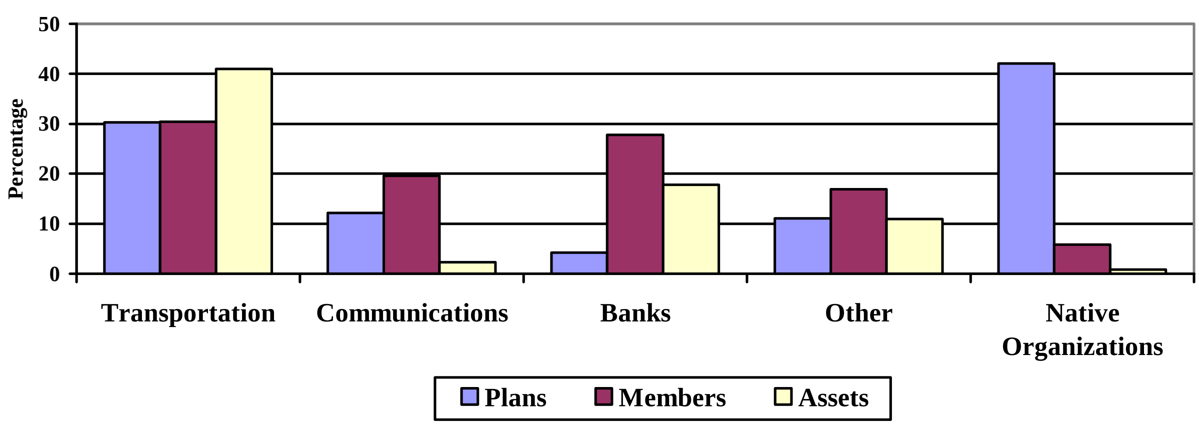
The chart below shows the distribution of plan membership and assets by plan type. Although defined contribution plans account for 64 per cent of federally regulated plans, they account for only 14 per cent of total membership and slightly more than 2 per cent of assets. Defined benefit plans, which include 25 negotiated contribution plans, account for only 30 per cent of the plans, but cover 78 per cent of members and 86 per cent of total assets. Combination plans, which in the past have been included in the defined benefit category, are shown in the graph. There are 65 such plans or 6 per cent of the total that have both defined benefit and defined contribution components. Membership and assets held in these plans account for 8 per cent and 12 per cent respectively.

Distribution of Plans, Membership and Assets by Plan Type at March 31, 2001



The following chart shows plans, membership and assets by industry. The assets held in the pension funds of companies involved in transportation, communication and banking comprise almost 90 per cent of all assets held in federally regulated pension plans. The category "Other" includes undertakings in the North, atomic energy, mines, seed mills, harbours, bridges and Crown Corporations not included in the other categories. Assets and membership in this category increased this year because of the transfer of the Canada Post plan which added 53,000 members and the aforementioned $7.2 billion in assets.

Plans, Membership and Assets by Industry at March 31, 2001



Legislative Changes

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 1998 amendments to the PBSA. The first package addressed pension plan surplus and the amortization of excesses and shortfalls resulting from the annual assessment. Surplus is discussed in the section under Pension Plan Surplus, and the fee amortization is explained on the last page of this report.

The second package of regulations will require plan administrators to provide more information to plan members and former members about the financial condition of the plan. This package also introduces a simplified pension plan for small employers.

The third package deals with minimum funding and includes a provision for full funding on plan termination, as well as some minor amendments. OSFI is in consultation with the pension industry and is currently discussing other proposals with provincial regulators. These include reducing the amortization period for solvency deficiencies from five to three years and not permitting amendments to the plan, such as benefit increases, if such an amendment had the effect of dropping the solvency ratio below a certain threshold.

In July 2000, the *Modernization of Benefits and Obligations Act* amended the PBSA, along with several other pieces of legislation, to provide recognition of same-sex common law partnerships.

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. The goal was to increase the level of understanding by plan administrators with respect to accountability for decisions, controls and actions that affect their pension plans.

There has been continuous consultation with the pension industry concerning governance issues including increased and more effective disclosure. OSFI also provided technical assistance to various organizations that sponsored formal training programs for trustees and other plan administrators. OSFI surveyed plan administrators on their governance practices; the results appear to indicate that good governance is increasing. Through on-site examinations and contact with plan administrators, OSFI will be able to determine whether regulations are needed to ensure that plans adopt good governance principles, or whether voluntary compliance has been satisfactory.

In addition to relying on good governance, OSFI depends on a risk assessment system and an early 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 is now fully integrated with the regular review process. The selection of plans for on-site examination is based on the risk to beneficiaries. In addition, some plans are selected randomly for on-site examination. OSFI generally performs on-site examinations of between 20 and 30 plans each year.

An ever-changing economic environment affects the amount of time that OSFI must spend on special situations. These include plan mergers and spin-offs as a result of sales of business and plan conversions.

OSFI is a member of the Canadian Association of Pension Supervisory Authorities (CAPSA), which 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 co-ordinated way. As a member of CAPSA, OSFI plays a role in resolving supervisory problems and inter-jurisdictional issues. CAPSA is currently seeking a more active and meaningful role in harmonizing regulatory requirements and enhancing the security of the pension promise.

During the period, the Minister signed a bilateral agreement with the Minister of Training and Employment Development for the province of New Brunswick whereby each signatory agreed that OSFI and the New Brunswick pension authority would apply the legislation of the other to a pension plan that is registered in the jurisdiction with the plurality of members. OSFI has a similar agreement with most other provinces.

OSFI works with several pension associations by participating in educational programs, giving speeches and co-operating in the promotion of good plan governance. These associations include the Association of Canadian Pension Management, the Pension Investment Association of Canada, the Canadian Pension Benefits Institute and several employee benefit foundations and educational institutions.

Solvency of Plans

Early detection of solvency and funding problems is a key element in safeguarding members' benefits. Defined contribution plans are fully funded upon remittance of required contributions on a timely basis. Defined benefit plans, however, have fluctuating contribution rates that depend on the funded status of the plan and various economic and demographic assumptions. As long as a plan meets the minimum funding standards, it is in compliance with the funding requirements of the legislation.

During the period under review, 33 plans reported a solvency ratio of less than 1. All but 1 were meeting minimum funding requirements and OSFI is working closely with the administrator of that plan. Of the remaining 32 plans, 27 have a solvency ratio above 0.85. Only 1 of the 5 plans with a solvency ratio below 0.85 has more than 15 members. The solvency ratio of a pension fund is the ratio of the market value of assets (includes adjustment for wind-up expenses and smoothing due to market fluctuations) to the liabilities assuming plan termination on a specific date. A plan with a solvency ratio of less than 1 is not necessarily a cause for concern, as long as the employer is financially sound 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 addressing refund of surplus became effective on April 1, 1999. Regulations supporting these amendments were passed in June 2001, which was after the period under review.

The major change in the legislation covers situations where the employer has not or cannot establish entitlement to surplus assets. The amended regulations set out the procedures to be followed before the Superintendent may consent to a refund of surplus. An instruction guide for an application of a refund of surplus has been released to the pension industry.

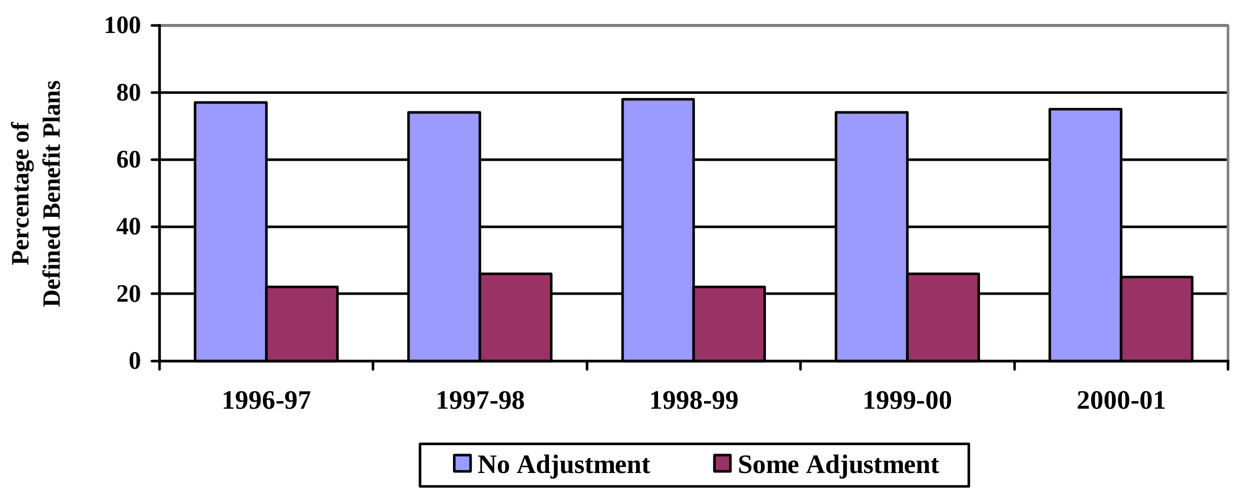
During the period covered by this report, the Superintendent did not consent to any refund of surplus.

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.

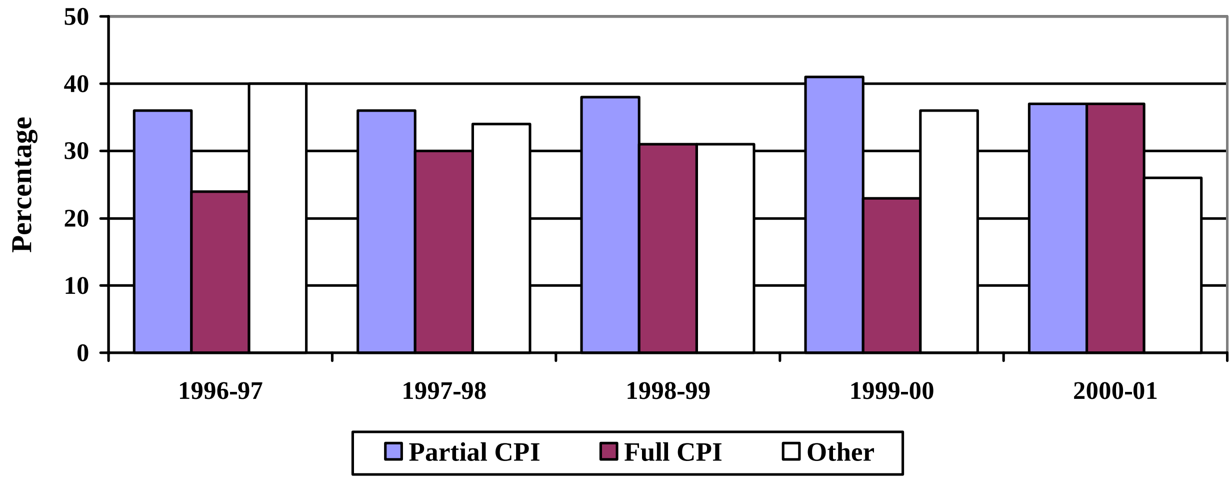
The following charts summarize inflation adjustments for 1996-1997 through 2000-2001.

Adjustments to Pensions



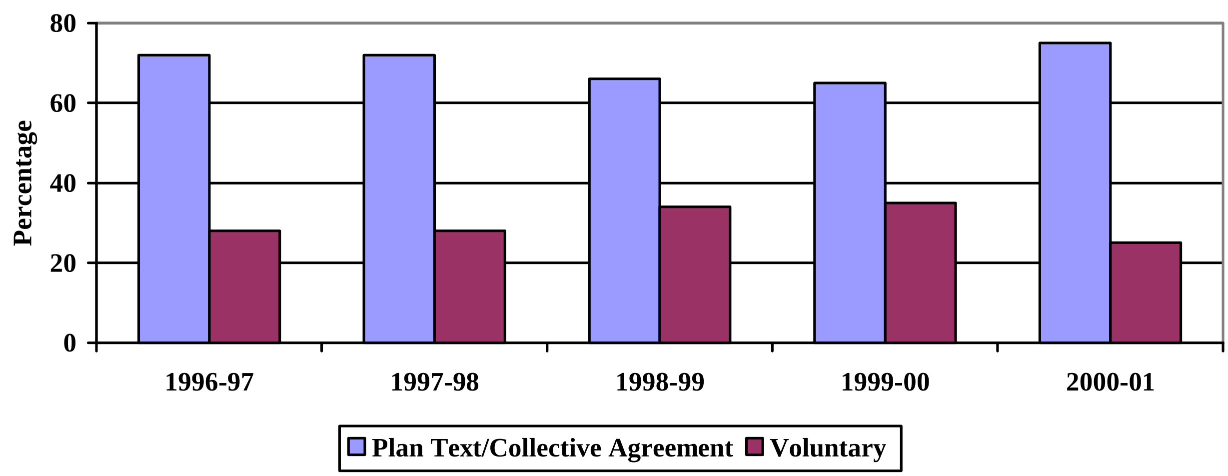
This chart shows that 25 per cent of defined benefit pension plans reported that they had increased pensions in pay in 2000-2001. Of those plans that provided such an adjustment, 32 per cent also increased deferred pensions.

Basis for Adjustment



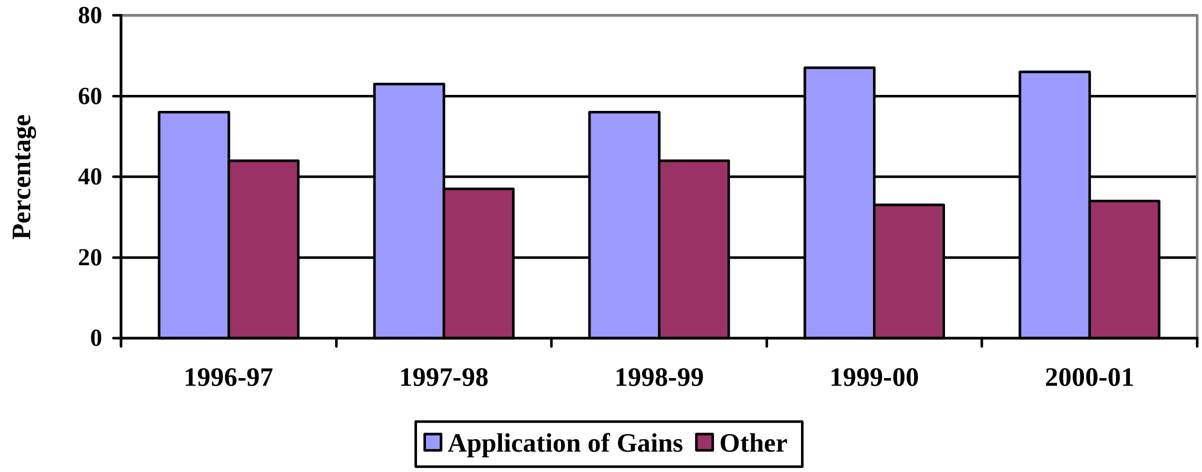
This chart shows that, in 2000-2001, 37 per cent of the plans that made adjustments to pensions based increases on a partial increase in the Consumer Price Index (CPI), and 37 per cent based increases on the full CPI increase. The remaining 26 per cent used some other formula such as excess interest, a flat dollar amount, or a percentage of pension payment to calculate the increases.

Reason for Adjustment



During the period 2000-2001, 75 per cent of adjustments were made as a result of collective agreements or requirements of the plan text and 25 per cent were voluntary. Last year's figures were 65 per cent and 35 per cent respectively.

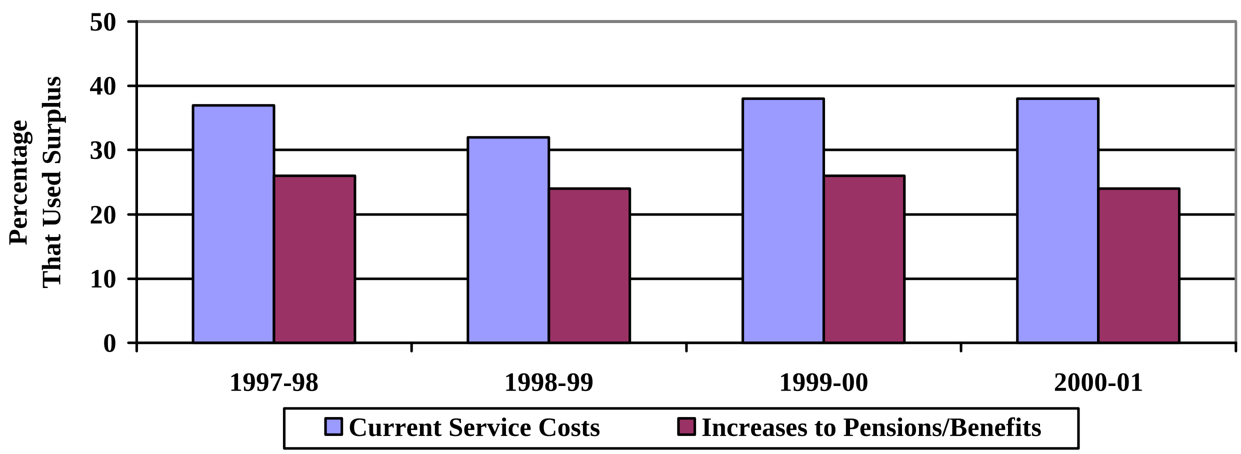
Source of Funds For Pension Adjustment



During the period under review, 66 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. This is consistent with the previous year.

Report on Application of Surplus/Gains

Application of Surplus/Gains



Data provided in the Annual Information Returns indicated that 102 defined benefit plans used surplus/gains to improve pensions and/or benefits and 164 such plans used such surplus/gains in lieu of 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, 2000 to March 31, 2001

Pension plans are assessed a fee when applying for registration under the PBSA and when filing the Annual Information Return. Total revenues during the fiscal year ending March 31, 2001 were $3,765,000, down from $3,875,000 a year earlier. The cost of administering the PBSA for fiscal year 2000-2001 was $3,239,000, down from $3,589,000 the previous year. The decline in revenue reflects a slightly lower assessment base than the base used in 1999-2000. The expenditure is back to the level of previous years because fewer resources were required to handle the special situations.

The following table shows revenues and expenditures over the past seven years and the fee rate applicable during each period.

Revenue and Expenditures
For Fiscal Year April 1, 2000 to March 31, 2001
($000s)

Year	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**	**1999-00**	**2000-01**
Revenue	$2,911	$2,774	$3,178	$2,736	$2,347	$3,875	$3,765
Expenditures	$2,632	$2,772	$2,604	$3,016	$3,190	$3,589	$3,239
Annual Assessment Per Member*	$10.25	$9.60	$10.50	$10.00	$8.00	$12.00	$12.00

Basic Assessment

As a result of the surplus generated in 1999-2000, OSFI was able to reduce the annual basic assessment to $11.00 for fiscal year 2001-2002, as published in the *Canada Gazette* on September 30, 2000 and further reduce the annual basic assessment to $10.00 for fiscal year 2002-2003 as published in the *Canada Gazette* on September 29, 2001.

The regulations established in 1991 to implement full cost recovery were amended in 2001. The amendment provides a measure to reduce large fluctuations in the basic fee from one year to the next because excesses and shortfalls will henceforth be amortized over a five-year period.

* The minimum and maximum annual assessment per plan is derived by multiplying the annual assessment by 20 and 10,000 respectively. With an annual assessment of $10.00 per member, the minimum annual assessment is $200 and the maximum is $100,000.