ADMINISTRATION OF THE *PENSION BENEFITS STANDARDS ACT, 1985*

Annual Report

2001-02

The Honourable John Manley, P.C., M.P.
Minister of Finance
Ottawa, Canada
K1A 0A6

Dear Minister:

I am pleased to submit to you the Annual Report on the Administration of the *Pension Benefits Standards Act, 1985* (PBSA) Report, pursuant to section 40 of the Act. The report covers the period from April 1, 2001 to March 31, 2002.

Section 40 of the PBSA provides that the Superintendent shall, as soon as possible after the end of each fiscal year, submit this report to the Minister and the Minister shall cause the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after the day the Minister receives it.

Yours sincerely,

Nicholas Le Pan
Superintendent

Ottawa, January 2003

cc: The Honourable Maurizio Bevilacqua

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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) provides that the Superintendent shall, as soon as possible after the end of each fiscal year, submit to the Minister a report 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 of the PBSA,

(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 businesses or undertakings in the Yukon, Northwest Territories and Nunavut. Also falling 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 (with the exception of Prince Edward Island which does not have private pension plan legislation).

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 *Pension Benefits Standards Act, 1985*

Pension Plans Regulated by OSFI

As at March 31, 2002, there were 1,189 pension plans registered under the PBSA, covering 557,000 employees. During the period, 42 new plans were filed for registration, and 32 registered plans, affecting 28,471 members, informed OSFI that they were terminating or consolidating with other plans.

Of the 32 plans that terminated in 2001-02, 3 plans wound-up in a deficit position, resulting in a reduction of benefits to 46 members. Since 1987, over 625 plans have been terminated and all but 8 were fully funded at wind-up. The 8 plans that were in deficit affected a total of 996 members; the fully funded plans covered over 100,000 beneficiaries.

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 largely a result of an increase in the number of pension plans for native organizations, which represent 40% of the new plans.

The straightforward nature of defined contribution plans makes them the choice of small companies. 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. Alternatively, defined benefit plans are generally sponsored by large companies such as banks, railroads, and telecommunication organizations.

A trend that has continued in 2001-02 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 70 such combination plans registered under the PBSA.

As of January 2001, there were approximately 15,400 pension plans in Canada covering 5,400,000 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.[1]

Pension plans under federal jurisdiction, for which the Superintendent has responsibility, comprise approximately 8% of all registered plans in Canada and 10% of plan membership. If only privately sponsored pension plans are compared, OSFI regulates 9% of the plans and 19% of the membership.[1]

1 Statistics Canada's *Pension Plans in Canada Jurisdictional Tables, January 1, 2001.*

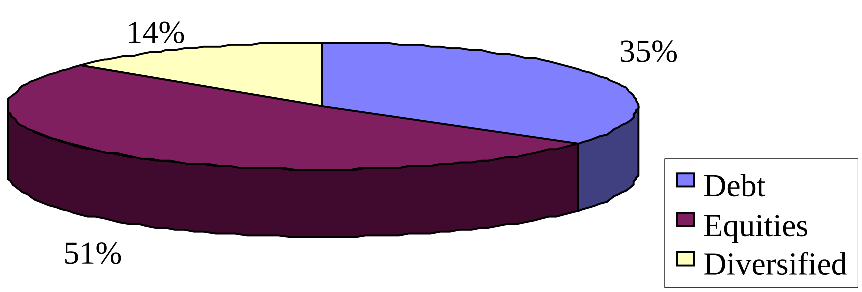
Market Value of Assets

The total market value of the assets of pension plans registered under the PBSA was approximately $91 billion at the end of the 2001-02 fiscal year. This represented a 2% decrease from the 2000-01 fiscal year, where the total market value of assets was $93 billion. The poor stock market performance is the main reason for this decrease.

Allocation of Assets

The following chart indicates how pension funds were invested as reflected in the pension plans' most recent financial statements filed during the 12-month period ending March 31, 2002. "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. Investment in equities represent 51% of the total investments. Of equities held in pension funds regulated by OSFI, 70% are directly invested in common and preferred shares. Debt securities account for 35% of total investments and diversified investments account for the remaining 14%. Foreign investments were reported at approximately $14 billion or 15% of total investments. Of the $14 billion in foreign investments, 92% are in equities.

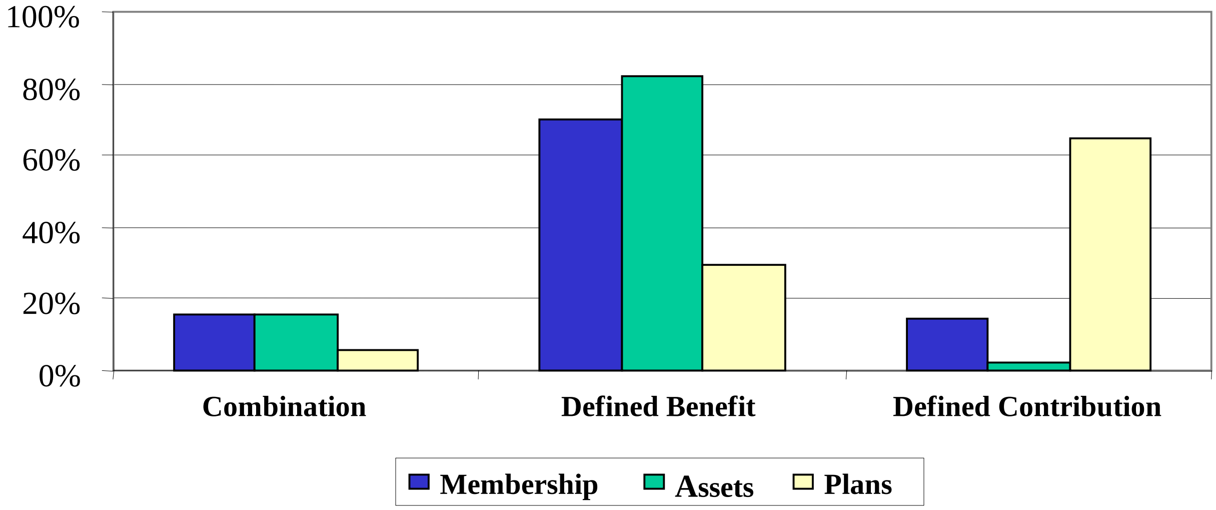
Total Investment



Distribution of Plans, Membership and Assets

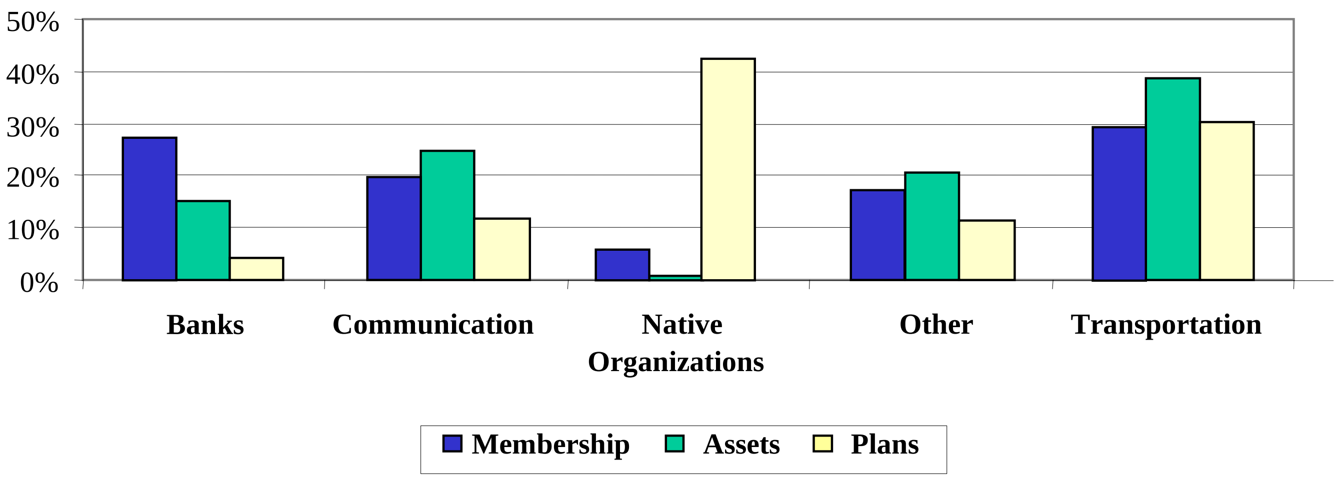
The following chart shows the distribution of plan membership and assets by plan type. Although defined contribution plans account for 65% of federally regulated plans, they account for only 14% of total membership and 2% of assets. Defined benefit plans account for only 29% of the plans, but cover 70% of members and 82% of total assets. Combination plans, which encompass both a defined benefit and defined contribution component, represent the balance and are also shown in the graph. There are 70 combination plans, or close to 6% of the total, which represent 16% of membership and assets of all plans.

Distribution of Plans, Membership and Assets by Plan Type as at March 31, 2002



The next chart shows plans, membership and assets by industry. The assets held in the pension funds of companies involved in transportation, communication and banking comprise 78% of all assets held in federally regulated pension plans. The category "Other" includes undertakings in the Yukon, Northwest Territories and Nunavut, atomic energy, mines, seed mills, harbours, bridges and some Crown corporations not included in the other categories.

Plan, Membership and Assets by Industry as at March 31, 2002



Legislative Changes

In February 2002, amendments were made to the Pension Benefits Standards Regulations, 1985. The changes require plan administrators to provide more information to plan members and former members about the financial condition of the plan. These amendments also introduced a simplified pension plan as a pension option for small employers.

OSFI engaged in consultation with the pension industry on minimum funding changes including a provision for full funding on plan termination, application of actuarial gains, and some minor amendments. OSFI also initiated discussion of other funding proposals with provincial regulators in an effort to harmonize pension plan funding across Canada.

Supervision of the *Pension Benefits Standards Act, 1985*

Approach to Supervision

OSFI's risk-based supervision includes desk reviews of required filings and on-site examinations of selected pension plans. The selection of plans for on-site examination is primarily based on the risk to beneficiaries, although some plans are selected randomly. OSFI generally performs on-site examinations of between 20 and 30 plans each year. However, in 2001, OSFI did not conduct as many on-site examinations, devoting more time to assessing the impact of equity market declines on plans and following up as necessary, using an approach that did not require on-site examinations.

OSFI has also continued to stress the benefits of good governance by participating in educational programs, giving speeches and co-operating with associations to promote good governance. These associations included 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.

OSFI is a member of the Canadian Association of Pension Supervisory Authorities (CAPSA), which was established in 1974 as a federal-provincial forum to discuss common issues faced by federal and provincial pension plan supervisory authorities. As a member of CAPSA, OSFI plays a role in resolving supervisory problems and inter-jurisdictional issues.

Solvency of Plans

Generally, 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 may occur.

Early detection of solvency and funding problems is a key element in safeguarding members' benefits. Defined benefit plans have fluctuating contribution rates that depend on the funded status of the plan and various economic and demographic assumptions.

During the period under review, 53 active plans reported a solvency ratio of less than 1 compared to 33 reported in last year's report, reflecting the decline in equity values resulting from the poor stock market performance. Last year, all but one plan met minimum funding requirements. OSFI is working closely with the administrator of that plan.

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. Such plans are required to file an actuarial report on an annual basis and fund the solvency deficiency over a five-year period. Funding of a pension plan is determined by the actuarial valuation report; filing annually accelerates the funding of any deficiency. Plans that report a solvency ratio greater than 1 are required to file an actuarial valuation report on a triennial basis.

Defined contribution plans are fully funded upon remittance of required contributions on a timely basis.

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.

The major change in the legislation concerning surplus provided a mechanism by which an employer could establish a claim to surplus assets. The amendments to regulations primarily set out the procedures to be followed by the employer before the Superintendent may consent to a refund of surplus. An instruction guide for an application of a refund of surplus has been published.

During the period covered by this report, the Superintendent consented to two refunds of surplus and OSFI also received three new applications for refunds of surplus.

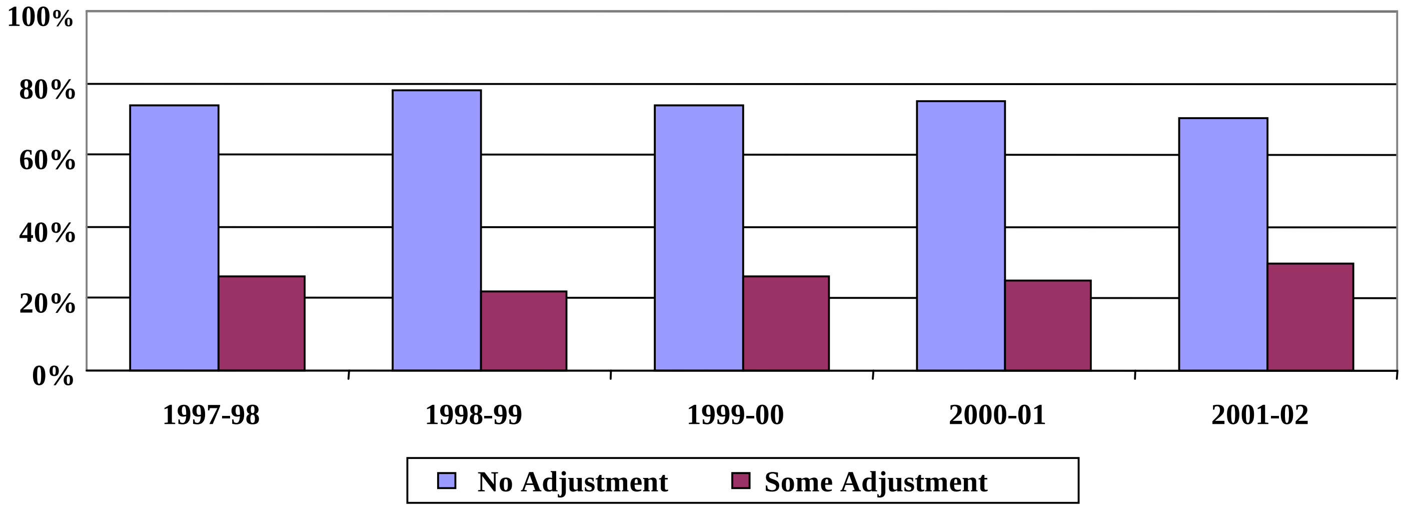
Report on Inflation Adjustments to Pensions

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 charts summarize inflation adjustments for 1997-98 through 2001-02.

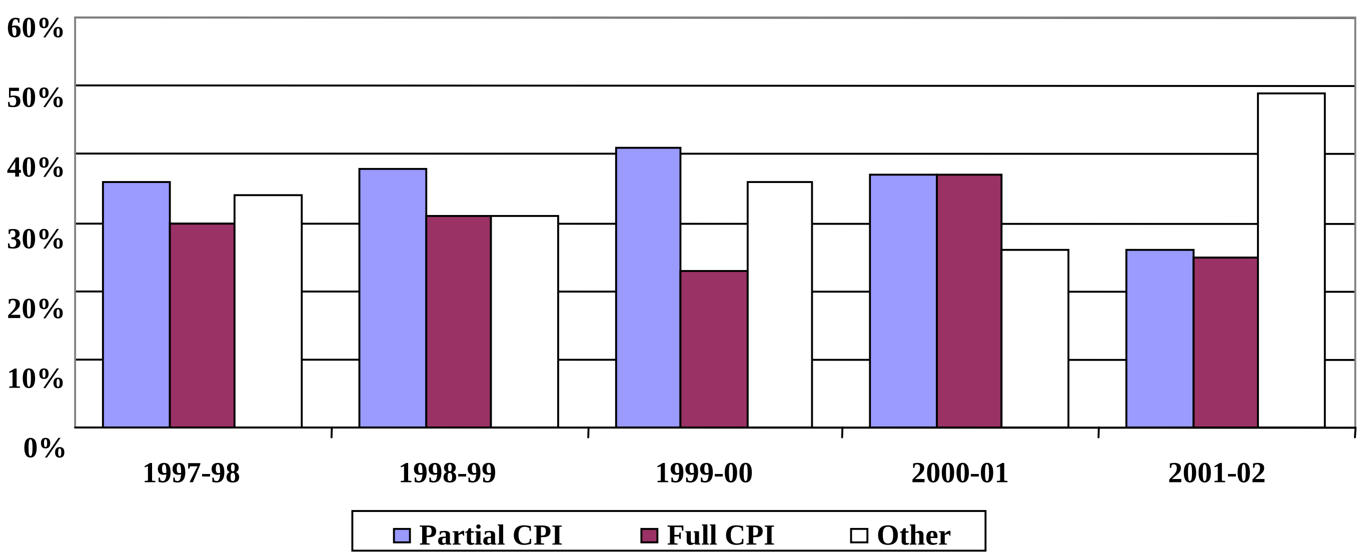
The chart below shows that 29% of defined benefit pension plans reported that they increased pensions in pay in 2001-02. Of those plans that provided such an adjustment, 26% also increased deferred pensions.

Adjustments to Pensions



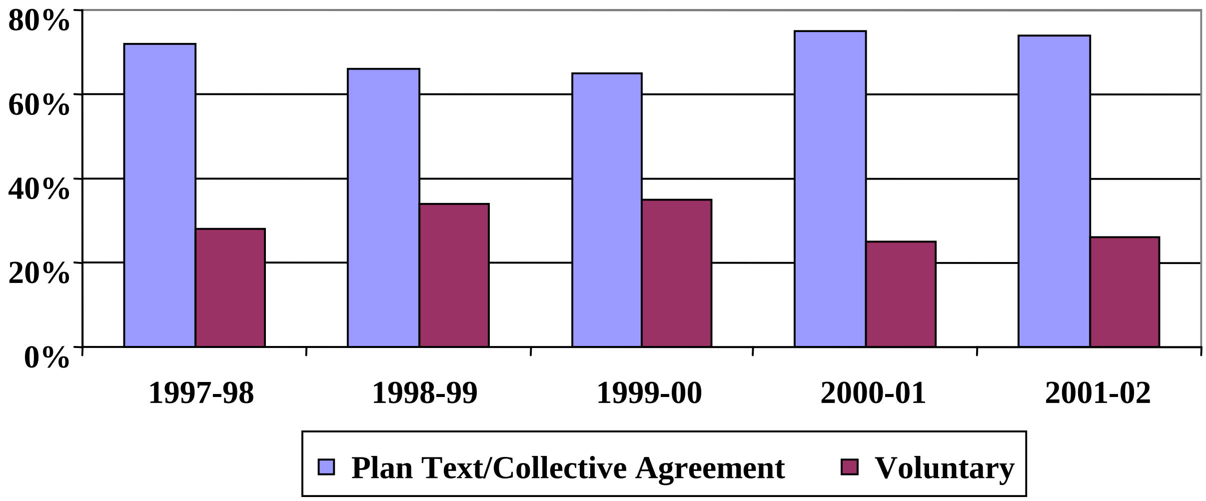
The following chart shows that, in 2001-02, of the defined benefit plans that made adjustments to pensions, 26% based increases on a partial increase in the Consumer Price Index (CPI), and 25% based increases on the full CPI increase. The remaining 49% used some other formula such as excess interest, a flat dollar amount, or a percentage of pension payment to calculate the increases. When the combination plans are taken into account, the pension adjustments are 23% for partial CPI, 22% for full CPI and 55% for other.

Basis for Adjustment



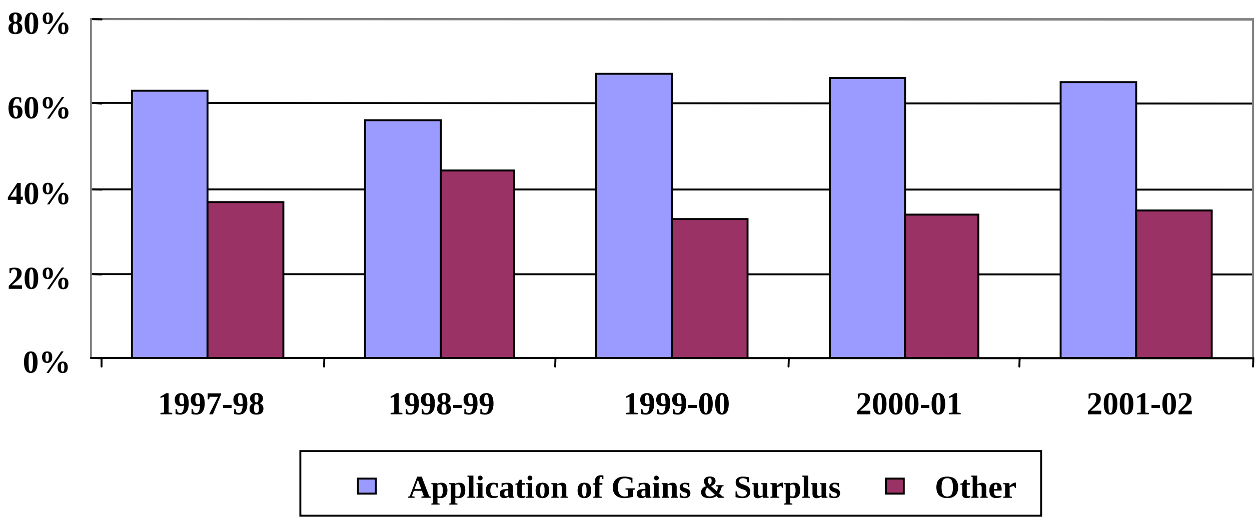
The next chart indicates that, during the period 2001-02, 74% of adjustments were made as a result of collective agreements or requirements of the plan text, and 26% were voluntary. Last year's figures were 75% and 25% respectively.

Reason for Adjustment



The following chart shows that, during the period under review, 65% 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 two years.

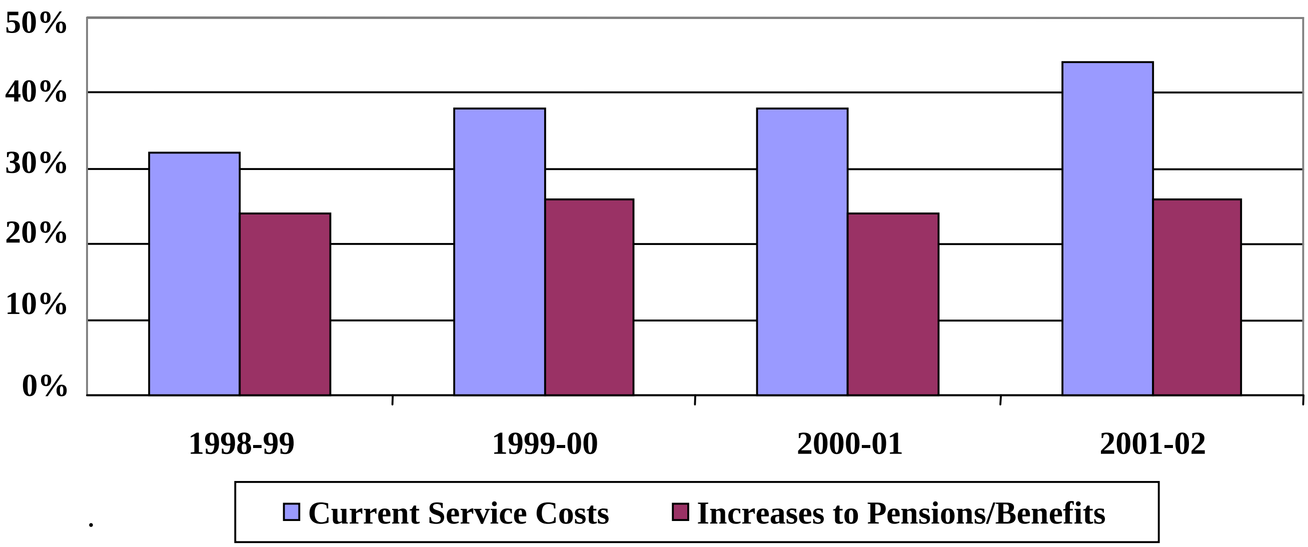
Source of Funds For Pension Adjustment



Report on Application of Surplus/Gains

The next chart indicates that 26% of defined benefit plans used surplus/gains to improve pensions and/or benefits and 43% of 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.

Application of Surplus/Gains



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Revenue and Expenditure from April 1, 2001 to March 31, 2002

OSFI's costs of pension plan regulation and supervision are recovered from pension plans by way of an annual assessment.

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, 2002 were $3,439,000, down from $ 3,765,000 a year earlier. The decline in revenue reflects the lower fee rate and a slightly lower assessment base than the base used in 1999-2000. The cost of administering the PBSA for fiscal year 2001-02 was $3,439,000, up from $3,239,000 the previous year, due to increase in human resource costs.

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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, evidenced during the 1997 to 2000 period. Excesses and shortfalls of revenues over expenditures are now amortized over a five-year period.

The following table shows revenue, expenditure and the fee rate over the past seven years.

Revenue and Expenditure
For Fiscal Years 1995-96 to 2001-02
($000)

Year	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Revenue ($000)	$2,774	$3,178	$2,736	$2,347	$3,875	$3,765	$3,439
Expenditure ($000)	$2,772	$2,604	$3,016	$3,190	$3,589	$3,239	$3,439
Basic Fee rate* Per member	$9.60	$10.50	$10.00	$8.00	$12.00	$12.00	$11.00

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 2001-02, as published in the *Canada Gazette* on September 30, 2000. The surplus generated in 2000-01 was applied to further reduce the annual basic assessment to $10.00 for fiscal year 2002-03, as published in the *Canada Gazette* on September 29, 2001. However, as the costs of administering the PBSA will increase and the fee base is expected to remain stable or decline, the basic fee rate has been increased to $11.00 for the fiscal year 2003-04, as published in the *Canada Gazette* on September 27, 2002.

* 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.