Alberta
Finance

Policy Bulletin #39
Letters of Credit

Issued November 2007

This Bulletin has been prepared to outline the legislative requirements and related guidelines under the *Employment Pension Plans Act* (the Act) and the *Employment Pension Plans Regulation* (the Regulation) related to the use of letters of credit to fund plan solvency deficiencies. It has no legal authority. The Act and Regulation should be used to determine specific legislative requirements.

Section 48.1 of the Regulation permits an employer to cover some or all of a plan's solvency deficiency through a letter of credit that meets certain prescribed criteria. The letter is provided to the fund holder in lieu of making cash remittances with respect to solvency special payments.

The actions required when using a letter of credit are very time sensitive. This Policy Bulletin and the Regulation should be fully reviewed to ensure requirements are understood and complied with.

EPPA Update 07-02 also provides further information on these changes.

Conforming Letter of Credit

Only a conforming letter of credit may be used for purposes of section 48.1 of the Regulation. To conform, a letter of credit must meet the following criteria.

A. A conforming letter of credit may be issued only by a financial institution that is

1. a Schedule I, II or III bank under the *Bank Act* (Canada), or Alberta Treasury Branches,

2. has a credit rating at least equal to

   a. A, from Dominion Bond Rating Service Limited
   b. A, from Fitch Ratings,
   c. A2, from Moody's Investors, and
   d. A, from Standard & Poor's Rating Services;

   and

3. is a member of the Canadian Payments Association.

B. A conforming letter of credit must:

1. state that it is an irrevocable and unconditional standby letter of credit,

2. be made out to the pension plan's fund holder in trust for the plan, for the express purpose that the issuing bank will deposit funds into the pension fund if circumstances require it to do so,

3. specify the effective date and the expiry date of the letter of credit (note this period may not be more than one year),

4. make the bank that has issued the letter of credit contractually liable to pay the amount specified in the letter of credit,

5. be issued in Canadian currency, and

6. provide that

   a. when the letter of credit is drawn down the bank that has issued the letter of credit will without question or delay pay the amount specified in the draw demand (such amount cannot exceed the amount of the letter of credit) to the fund holder for deposit in the pension fund,

   b. the insolvency or bankruptcy of the employer has no effect on the rights or obligations as set out in the letter of credit of either the fund holder or the bank that issued the letter of credit,

   c. the letter of credit is must be renewed, replaced, or subject to certain conditions, allowed to expire on its expiry date,

   d. the bank that issued the letter of credit must give notice 90 days in advance of the expiry date if it does not intend to renew the letter of credit,

   e. the letter of credit may not be assigned by the bank that issued the letter of credit unless the assignment is to another bank that meets the requirements of section (A) above, and

f. the letter of credit cannot be amended other than to increase or decrease the amount covered when the letter is renewed or to recognize when a new issuer has taken over due to a merger, or an assignment of the business of the original issuer.

Process

New Letter of Credit

Where an employer wishes to use a letter of credit to cover some or all of the solvency deficiency payments required by the Act, he shall negotiate a conforming letter of credit with a bank and forward it to the Superintendent for review. The letter of credit must be submitted at least 90 days prior to the due date of the first solvency deficiency payment to which the letter of credit may relate.

Within 30 days the Superintendent will respond either requesting revisions or approving the letter of credit.

Upon receiving the Superintendent's approval, in writing, that the letter conforms to the requirements of legislation, the employer shall then forward the original letter of credit, with a copy of the Superintendent's approval, to the fund holder on or before the due date of the first solvency deficiency payment to which the letter of credit relates.

Notification Prior to the Expiration of the Letter of Credit

At least 90 days prior to the expiry date of the letter of credit the employer shall advise the Superintendent and the fund holder that the letter of credit

1. will be renewed (i.e. will continue with the same bank), and the amount for which it will be renewed,

2. will be replaced (i.e. a new letter of credit with another bank will be provided) and the amount for which it will be replaced, or

3. will be permitted to expire because the employer will make contributions to cover the lesser of the amount of the letter of credit and the amount needed to fund the solvency deficiency, or there is no longer a solvency deficiency (in the latter case a revised actuarial valuation must be filed with the Superintendent).

Renewal or Replacement of a Letter of Credit

If the letter of credit is to be **renewed or replaced for the same or a greater amount**, then

1. a copy of the renewed letter of credit must be filed with the Superintendent at least 90 days prior to the expiry date;

2. within 30 days of receipt, the Superintendent will respond either requesting revisions or approving the letter of credit; and

3. upon receiving the Superintendent's approval, in writing, that the letter conforms with the legislation the employer shall then forward the original copy of the renewed letter of credit, with a copy of the Superintendent's approval to the fund holder at least 14 days prior to the expiry date of the letter of credit.

If the letter of credit is to be **renewed or replaced for a lesser amount**, then

1. a copy of the renewed letter of credit must be filed with the Superintendent at least 90 days prior to the expiry date along with

    a. proof that the employer has remitted sufficient funds to cover the reduction, or

    b. an actuarial valuation report and cost certificate showing that the solvency deficiency payment requirements have been reduced to the new level covered by the letter of credit.

2. within 30 days of receipt, the Superintendent will respond either requesting revisions or approving the letter of credit; and

3. upon receiving the Superintendent's approval, in writing, that the letter conforms with the legislation the employer shall then forward the original copy of the renewed or replaced letter of credit, with a copy of the Superintendent's approval to the fund holder at least 14 days prior to the expiry date of the letter of credit.

Expiry Without Renewal or Replacement

If the letter of credit is to be permitted to expire without renewal or replacement, then the employer must at least 90 days prior to the expiry date, provide the Superintendent with

1. proof that the employer has remitted sufficient funds to cover the solvency deficiency payments previously covered by the letter of credit, or

2. an actuarial valuation report and cost certificate showing that the solvency deficiency payments covered by the letter of credit are no longer needed.

Informing the Fund Holder

In addition, if the solvency payments are to be reduced or the letter of credit is being allowed to expire, the employer shall, at least 14 days prior to the expiry date, provide the fund holder with a new **Form 7 – Schedule of Expected Contributions** indicating that the plan has reduced solvency deficiency payment requirements, or no longer has a solvency deficiency.

If the fund holder has not received either a renewed letter of credit, a replaced letter of credit, a cash remittance equal to the letter of credit or confirmation that the letter of credit is no longer required at least 14 days before the expiry date of the letter of credit, **the fund holder must on the 13th day before the expiry date of the letter of credit draw down the full amount of the letter of credit.**

Plan Termination

If the pension plan is to be terminated, the letter of credit must be maintained (i.e. it cannot be cancelled and must be renewed or replaced at the full amount of the letter of credit if it is about to expire) until the Superintendent gives written direction. After reviewing and accepting the termination report of the plan the Superintendent will advised both the employer and the fund holder of the amount, if any, required to be remitted to the fund to make the plan fully solvent. The employer shall have 14 days from the date of that letter to remit the required amount to the fund holder. If, on the 15th day the fund holder has not received the amount noted in the Superintendent's letter, the fund holder shall draw down the lesser of the amount noted in the Superintendent's letter and the full amount of the letter of credit.

Duties and Obligations

It is the **responsibility of the employer** to who wishes to use a letter of credit to

1. ensure that the letter of credit conforms with the requirements of the Regulation,

2. that all filing requirements are met within the specified time lines, and

3. that the fund holder is advised, through provision of a revised **Form 7 – Schedule of Expected Contributions** if changes are made with respect to the use of the letter of credit.

It is the **responsibility of the fund holder** to

1. accept only an acknowledged letter of credit as a remittance under section 50 of the Act and 49 of the Regulation,

2. where required documentation of remittance has not been received by the prescribed deadline, draw down the letter of credit, and

3. if a cash lump sum is remitted to enable the letter of credit to expire, advise the Superintendent when the remittance is received.

It is the **responsibility of the obligated issuer** of a letter of credit to

1. advise the employer at least 90 days prior to the expiry date of a letter of credit if the obligated issuer is not prepared to renew the letter of credit, and

2. immediately, upon demand by the fund holder, pay to that fund holder the amount requested.

The issuer may not cancel, void or in any way revoke the letter of credit during the period that it covers.

Timelines for Remittance Apply

Letters of credit are a deemed remittance under the Act and as such must be provided to the fund holder within the prescribed time lines unless a written extension for remittance has been granted by the Superintendent and a copy of that extension has been given to the fund holder.

Impact on Actuarial Valuations

Funds promised under a letter of credit are not assets of the plan and may not, therefore, be used for purposes of a going concern valuation or for determining the plan's solvency ratio or funded ratio.

Amounts already committed to the fund through a letter of credit whose effective date is prior to the valuation date may, however, be included in the plan assets for the purposes of determining the solvency deficiency of the plan.

For further information, please contact

Superintendent of Pensions
Alberta Finance
Room 402, 9515 - 107 Street
Edmonton, AB T5K 2C3

Telephone: (780) 427-8322
Fax: (780) 422-4283
Internet: **www.finance.alberta.ca**

For toll-free dialling, contact your local Alberta Government R.I.T.E. line by calling 310-0000.

Letter of Credit Q & A

General

What is a solvency deficiency?

A solvency deficiency is the amount by which a plan's liabilities exceed its assets. In simpler terms, if all of the employees under the pension plan were to retire today, would the plan have enough funds to cover the payout? If not, there is a solvency deficiency.

What are the general rules for solvency deficiencies?

By law, the employer has to pay off the deficiency by a series of special payments over not more than five years.

Why is this method not always effective?

Changes in bond interest rates can quickly take a plan from a deficit to a surplus position, leaving the plan with excess funds.

What is a letter of credit?

A letter of credit is a secure pension funding option that ensures money is available for a pension plan if and when it is needed, without requiring the employer to actually make the special payments into the plan. Letters of credit are issued by acceptable financial institutions (e.g., chartered banks).

Why are letters of credit being introduced in Alberta – what is their purpose?

The use of letters of credit will enable employers to address temporary fluctuations in an ongoing pension plan's solvency status. All letters of credit are reviewed by the Superintendent of Pensions before they can be used for funding purposes.

Is this process in place elsewhere?

Yes. The federal government has already introduced similar rules for the plans it regulates and several other pension jurisdictions are looking at doing the same.

Of interest to employees

Is my benefit any less secure if my employer uses a letter of credit to fund solvency deficiencies?

No. If called upon, the issuing financial institution must deposit the amount of the letter of credit into the pension fund. Further, a letter of credit may be issued only by a financial institution that has an "A" or better credit rating from one of four credit rating agencies listed in the **legislation** (http://www.finance.alberta.ca/publications/pensions/eppa.html).

What happens if my employer goes bankrupt?

A bankruptcy will not affect the pension plan. If the employer goes bankrupt, the financial institution that issued the letter of credit must pay the amount of the letter of credit to the pension fund.

Can a letter of credit be cancelled?

An employer can cancel a letter of credit, but before a letter of credit can be cancelled or allowed to expire, the employer must provide the Superintendent of Pensions with evidence that:

(a) it is no longer needed because the solvency deficiency no longer exists;
(b) the employer has deposited into the pension fund an amount equal to the letter of credit; or
(c) the letter of credit has been replaced by a new letter of credit.

Of interest to employers

What can be covered by a letter of credit?

Some or all of the required solvency deficiency payments of a pension plan may be covered by a letter of credit.

How do letters of credit work?

A letter of credit is issued by a financial institution to a beneficiary (e.g., pension plan) against the credit of the applicant (e.g., employer).

The financial institution will pay the amount defined by the beneficiary, up to the amount stipulated in the letter of credit. Therefore, the obligation to honour (usually payment) is shifted from the applicant to the financial institution.