PENSION BENEFITS ACT
and
REGULATIONS

DISCUSSION PAPER

Pension Regulation Division **Department of Finance**
November 25, 1998

INTRODUCTION

In his budget address on June 4, 1998 the Honourable Don Downe, Minister of Finance, announced his commitment to a review of the *Pension Benefits Act and Regulations*(PBA)* in Nova Scotia. The Pension Regulation Division, Department of Finance, has completed the first phase of the review of the PBA and identified three categories of items for consideration.

A number of changes will be proposed, which can be classified as housekeeping changes, which would bring greater clarity to the PBA. Other suggestions for change are considered as minor, relating to harmonization of administrative practices with other pension legislation in the country. For the third category, relating to policy issues, we seek your input.

When considering reform, it is important to note that pensions are a very special form of property, established to provide financial security for employees during their retirement years. Members of pension plans are forbidden from dealing with their pension benefits as they would with other forms of property. There is strong public interest in ensuring that financial security exists at retirement age when income potential is limited.

This paper is being distributed to sponsors of Nova Scotia registered pension plans, pension consultants, financial institutions, other pension regulators and interested individuals. It is also available on the Internet at **www.gov.ns.ca/fina** under "**Pensions**". You are encouraged to provide comments on these proposals. If other issues need to be addressed, we would be interested in hearing about them.

Written responses should be sent to:

Superintendent of Pensions
Department of Finance
Pension Regulation Division
P.O. Box 371
HALIFAX, NS B3J 2P8

Responses can also be made through the Internet site above or directly to our e-mail address **"infofinance@gov.ns.ca"** or faxed to us at (902)424-0662. All responses should be filed with us no later than January 15, 1999. We hope to introduce any legislative changes in the spring sitting of the Legislative Assembly.

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A. OWNERSHIP OF SURPLUS

The PBA outlines the conditions which must be met before the Superintendent of Pensions can approve a refund of surplus held under a private pension plan to an employer. The "ownership" of surplus is not determined under the PBA but instead under the documents through which the particular private pension plan was created. Trust agreements, plan texts, contracts, and other documents from plan inception are reviewed to determine the ownership of surplus. Where pension plan assets are held in trust for the benefit of the members and the purpose of that trust has not been satisfied, the trust continues to apply for the benefit of the members. The terms of the pension plan and whether or not a trust exists impact on the ownership of surplus under the existing regime.

At present, there are no legislated rights under the PBA of plan members or plan sponsors to any share of surplus held in a pension plan. However, when an employer requests a withdrawal of surplus under an ongoing plan, any surplus attributable to member contributions must remain in the plan. Although ownership of that part of the surplus is not stated, the PBA doesn't permit the employer access to it. Additionally, both in an ongoing situation and on plan wind up, the surplus attributable to member contributions must be identified.

In considering proposals for legislating ownership, it is necessary to recognize the shift that has taken place with respect to how pension benefits are regarded. Originally viewed as a reward for long service, pension benefits are now seen as a form of deferred compensation, with ownership vested in plan members during accrual and not just at retirement.

PROPOSAL

1. Extend to plan wind ups the provision currently existing for ongoing plans that surplus arising from member contributions cannot be withdrawn by the employer.

2. For multi-employer pension plans where contributions to the pension plan are fixed under the terms of a collective agreement, and where the accrued benefits may be reduced if funding is inadequate, legislate that all surplus belongs to the members.

3. Establish in the PBA the entitlement of members to surplus when the plan assets are held in trust for the plan members without reservation. This would mean incorporating the rights of members to a surplus under trust law in the PBA.

4. Clarify that in all other instances, the surplus belongs to the plan sponsor and could be withdrawn by the plan sponsor in accordance with the existing requirements of the PBA.

References: PBA 83, 84 Reg. 24,25, 26

B. LIFE INCOME FUNDS

The Life Income Fund (LIF) was designed to provide plan members with an alternative method of receiving retirement income. Prior to the introduction of the LIF, plan members were required to receive income through the purchase of a Life Annuity from an Insurance Company at the date of retirement. The LIF allows members to delay the purchase of a Life Annuity until age 80, thus, giving them an opportunity to "time" their annuity purchase. Interest in removing the requirement to annuitize at age 80 has been expressed by some LIF owners.

PROPOSAL

Remove the requirement to annuitize at age 80 and revise the formula for determining the maximum annual withdrawal to ensure sufficient capital is retained to provide the LIF owner with a lifetime income.

References: Reg. 18A, 18B

C. MARRIAGE BREAKDOWN

There are two issues that have been raised with respect to the Section 61 of the PBA on Marriage Breakdown. Firstly, Section 61 does not provide enough guidance to plan members, spouses, family law practitioners, pension plan administrators or other interested parties on how a division of pension benefits is to be effected. Secondly, when Marriage Breakdown occurs after retirement, the PBA does not permit a division of a pension in pay.

PROPOSAL

Change the PBA and Regulations to clarify how a division is to occur, including:

1. Division can only occur by order of the Supreme Court of Nova Scotia on divorce of married spouses or breakdown of common-law relationships.

2. The value of the pension benefit to be divided is determined on a termination basis, as if member had terminated employment.

3. The pension benefit accrued during marriage determined "pro rata on service" method.

4. Pensions in pay may be split at source, with non-member spouse maintaining surviving spouse rights on death of member. In effect, it becomes a split of an income stream and not a division of assets.

5. Value of accrued pension benefit (not in pay) may be transferred out of plan or held within plan for non-member spouse, at non-member spouse's option.

6. The non-member spouse's age will determine the commencement date of income if the entitlement is transferred out of a plan to a locked-in Registered Retirement Savings Plan.

7. The non-member spouse may not receive more than 50 % of the pension benefit accrued during marriage.

References: PBA 61, Reg. 37, 46

D. MULTI-EMPLOYER PENSION PLANS - "GROW-IN" BENEFITS

A multi-employer pension plan is a plan established for employees of two or more employers who contribute or on whose behalf contributions are made by virtue of a collective agreement. The contribution rate is determined in the collective agreement, and benefits may be reduced retroactively if funding is inadequate.

The PBA does not require partial plan wind-ups when individual employers cease to participate in a multi-employer pension plan. The affected employees usually find work for another employer participating in the plan. This differs from the requirements for other employers .

Section 79 of the PBA provides "grow-in" benefits upon a partial or complete wind up of a pension plan, for those members who have a combination of age plus years of membership equal to at least fifty-five. Such persons are entitled to receive an unreduced early retirement pension on the date they would have been entitled to under the terms of their plan, assuming that their plan would not have been wound up. In this way, members are entitled to "grow" into their retirement benefits as if the plan had not been terminated prematurely.

The requirement for multi-employer plans to fund for "grow-in" benefits on total plan wind-up when partial windups are not required when a participating employer terminates participation is inconsistent. Special contributions required to fund "grow-in" benefits in the event of plan wind-up could be better utilized to fund improvements to benefits offered under the plan.

PROPOSAL

Exempt multi-employer plans from the requirements of Section 79 of the PBA which enhances benefits on plan wind-up.

References: PBA 79, Reg. 11,14

E. SAME SEX BENEFITS

The PBA mandates survivor benefits to opposite sex spouses. Pension plans are allowed to provide benefits over and above those mandated by legislation, and therefore the current Act allows plans to offer survivor benefits to same sex partners. In 1991, the Nova Scotia's Human Rights Act was amended such that discrimination based on sexual orientation is against the law. Prior to mid 1998, however, Revenue Canada did not permit such benefits to be offered under a registered pension plan.

On April 23, 1998 the Ontario Court of Appeal declared the exclusion of same sex partners from the Income Tax Act definition of "spouse" as it applies to registered pension plans unconstitutional under the Charter of Rights and Freedoms. The Court rewrote the definition of "spouse" so that it refers to "the person of the opposite sex or the same sex". The Federal Government did not appeal this decision. Now that Human Rights legislation requires recognition of conjugal partners of the same sex for survivor pension benefits and Revenue Canada permits such recognition, should the definition of Spouse under the PBA be amended to require recognition of same sex spouses?

PROPOSAL

Change the definition of spouse in the PBA to require recognition of same sex partners.

References: PBA 2(aj), 5

F. ACCESS TO LOCKED-IN MONEY

I Financial Hardship

Section 72 of the PBA limits access to locked-in pension benefits by a member. The intent of this section is to preserve pension assets for retirement. The PBA also protects pension assets from seizure by creditors and they are excluded from consideration by social assistance agencies and employment insurance because of their locked-in status. However, people in financial difficulty seek access to locked-in funds to meet their immediate needs.

Under certain situations under the Maintenance Enforcement Act, locked-in funds can be seized by the Director of Maintenance Enforcement for maintenance arrears.

Unlocking assets could expose the assets to consideration by Social Assistance Agencies and Employment Insurance as they would not be locked-in. Potentially, creditors would also be able to access the money.

Financial hardship is difficult to measure. Limited access could be approached on a presumed hardship basis or on a discretionary basis. Using presumed hardship may result in situations where access is granted without bonafide hardship. A discretionary approach would require great resources and time and would involve subjectivity on an individual level, but would recognize catastrophic unforseen events.

PROPOSALS

1) Adopt a **presumed hardship - formula based** approach. Quebec, for example, permits pre-retirement access to a Life Income Fund (LIF) for certain account holders whose projected income for the following twelve months is less than 40% of the Yearly Maximum Pensionable Earnings (YMPE)(a projected income of less than $14,760 in 1998). The measure provides a temporary income. Applications to withdraw funds may be made annually. The applicant may withdraw an amount up to 40% of the YMPE less 75% of taxable income. The withdrawn funds are paid monthly in amounts that do not exceed one-twelfth of the annual amount. Application is made to the financial institution holding the locked-in funds. The applicant makes a declaration addressing the formula-requirements and agrees to request a suspension of payments if his or her income reaches the threshold level of 40% of the YMPE. The financial institution may rely on the information and documentation supplied by the applicant. The application may be processed quickly because there is no need for independent verification of the information. There is no appeal for those who do not qualify and no discretion for greater withdrawals. Quebec's provision came into effect in January of 1998.

References: PBA 2(aj), 5

2) Adopt a **presumed hardship - specific situation** approach as is currently under consideration in Ontario. The United States, for example, permits withdrawals from 401(k) pension plans (similar to defined contribution pension plans) when the plan holder has "an immediate and heavy financial need". The following expenditures are deemed to constitute immediate and heavy financial need:

   a) the purchase of a principle residence;
   b) payment to prevent eviction or foreclosure;
   c) payment of a dependent's post secondary education;
   d) payment of medical expenses not reimbursed.

   The holder may not withdraw more than is necessary to satisfy the need and must first use all other sources of funds from the employer. In these instances the individual is still actively employed. Note that a) and c) are not truly financial hardship situations.

   Also under consideration in Ontario is **discretionary approval for demonstrated hardship**. The United States also permits withdrawals of amounts in 401(k) plans by employees who demonstrate to their employers that they have an "immediate and heavy financial need" and have exhausted all other means. Such an approach is based on discretionary need without regard to the source of need.

   Adopt a **combination of presumed hardship and discretionary** approach. This approach would provide routine access for basic cases while permitting flexibility for exceptional cases.

   Allow access through **borrowing** of locked-in funds. Such an approach, similar to the federal Government's current "RRSP Home Buyers Plan" would allow temporary access and provide incentive to restore retirement savings after dealing with the financial hardship.

3) **No change** given the importance and special status of pension assets. Such an approach recognizes the public interest associated with ensuring constituents have retirement income at a time when other sources of income are limited. Premature access may simply pass the financial hardship on to future generations and governments. Given the aging population the impact of such an intergenerational transfer may be large. If the PBA is changed to permit individuals limited access to their locked-in funds, the special status given to those funds could potentially be lost. Under bankruptcy laws, the pension funds may be required to be released, and the pension assets could possibly become the first payer in social assistance programs and employment insurance. Early depletion of locked-in retirement money will also reduce the amount of income received by spouses through survivor benefits currently mandated by legislation.

References: PBA 2(aj), 5

II Possible Access for Considerably Shortened Life Expectancy

The PBA provides that pension plans may permit variation in the terms of payment of a pension or deferred pension by reason of mental or physical disability that is likely to considerably shorten the life expectancy of a member or former member. If the originating pension plan does not so provide, variation of payment is not permitted, even if life expectancy is considerably shortened due to disability.

PROPOSAL

Allow variation of payment under a LIF or locked-in RRSP if a person's life expectancy is considerably shortened due to mental or physical disability, without regard to the existence of such a provision in the originating pension plan.

III Small Amounts In Locked-In RRSP's and LIF's

The PBA required that money in locked-in Registered Retirement Savings Plans can only be paid out through a Life Annuity or a Life Income Fund(LIF). The PBA permits unlocking at termination of employment when the annual pension is less than 2% of the Year's Maximum Pensionable Earnings(YMPE) under the Canada Pension Plans. However, locked-in amounts when accumulated to retirement may be lower than the minimum amount which a financial institution will sell an annuity or a LIF.

PROPOSAL

1. Adopt unlocking of locked-in RRSP or LIF where aggregate balance in all LIF and locked-in RRSPs is not greater than 40% of the YMPE, providing the member is at least age 65/ (Quebec model). For 1998, for example, a person age 65 could unlock locked-in pension assets if the total locked-in value of all LIFs and locked-in RRSPs was less than $14,760.00.

2. Raise the limit on the cash out or of small benefits at the time of termination. The amount of increase would be such to maximize harmonization with the most jurisdictions. For example five provinces currently allow for a lump sum payment at termination when the annual pension provided is less than 4% of the YMPE or if the commuted value is less than 10% of the YMPE. For 1998, for example, annual pensions less than $1, 476.00 could be commuted and paid as a lump sum or if the commuted value of a deferred pension benefit is less than $3,690.00, the benefit could be paid as a lump sum.

References: PBA 2(aj), 5