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InfoPensions - Issue 1 – May 2009

This is the first edition of InfoPensions - the Office of the Superintendent of Financial Institutions' (OSFI's) electronic newsletter previously known as PBSA Update. InfoPensions includes announcements and reminders on issues relevant to federally regulated private pension plans as well as descriptions of how OSFI applies selected provisions of the Pension Benefits Standards Act, 1985 (PBSA), its regulations and directives and other OSFI guidance. Plan administrators should obtain appropriate legal and actuarial advice on how the legislation and guidelines affect their particular pension plan.

This newsletter and previous PBSA Updates are available on the Pensions Page of the OSFI Web site. To automatically receive new issues of this newsletter by e-mail please go to the subscription link on the OSFI Web site.

Funding Relief Update – Asset Smoothing Specification

Solvency Funding Relief Regulations, 2009 were released by the Department of Finance on March 27, 2009 and pre-published in Part I of the Canada Gazette on April 4, 2009.

In March 2009, OSFI issued a specification on asset values used in pension plan solvency valuations. The specification provides that smoothing of assets up to 110% of market value is permitted in actuarial reports with effective dates of November 1, 2008 or later. It also provides that smoothing of assets up to 115% of market value is permitted on a temporary basis only for actuarial reports prepared in accordance with the *Solvency Funding Relief Regulations, 2009*. These Regulations provide that any deferral of funding that results from the use of an asset value in excess of 110% will be subject to a deemed trust.

While not addressed in the specification, the limit on smoothing of assets for going concern valuations remains at 110% of the market value. OSFI's Instruction Guide for the Preparation of Actuarial Reports for Defined Benefit Plans provides further details on asset smoothing.

Canada

Actuarial Instruction Guide

In August 2008, OSFI issued a Draft Instruction Guide for the Preparation of Actuarial Reports for Defined Benefit Plans. Comments on the Instruction Guide were requested and the finalized Instruction Guide, issued in March 2009, reflects changes made as a result of the comments and suggestions provided to OSFI.

OSFI has issued this Instruction Guide to inform the pension industry of our current filing and reporting requirements for actuarial reports for defined benefit plans filed pursuant to subsection 12(3) of the *PBSA.* The Instruction Guide consolidates policies published in PBSA Update since 2000 and addresses other issues that have emerged since. It replaces the Instructions for the Preparation of Actuarial Reports for Federally Regulated Defined Benefit Pension Plans that were issued in June 2000.

Finance Canada Consultation Paper

In January 2009, the Department of Finance released a discussion paper on improving the framework for federally regulated private pension plans. Written comments on the issues raised in the discussion paper were requested by March 16, 2009.

National public consultations on the legislative and regulatory framework for federally regulated private pension plans were held from March 13 to April 16, 2009. The consultation meetings were chaired by Ted Menzies, Parliamentary Secretary to the Minister of Finance and included both public sessions and private meetings with stakeholders in each location. The government expects any resulting legislative changes to be introduced by the end of 2009.

Follow-up on the Market Downturn Note

In December 2008, OSFI sent a memo to all defined benefit plan administrators reminding them to consider the implications of the market downturn on their plans and re-iterating the importance of scenario testing.

In January 2009, OSFI sent letters to administrators of selected defined benefit plans that were expected to face a material increase in funding requirements in 2009. Plan administrators were asked to respond to OSFI indicating what actions they were taking to resolve any issues which may impair the plan's ability to meet its funding obligations.

OSFI expects all plan administrators to be prepared to address any additional funding requirements as a result of the market downturn.

Risk Assessment Framework

OSFI has recently completed a review and redesign of its Pension Risk Assessment Framework. Part of this process involved a limited industry consultation on the proposed Framework and internal Guidance Notes. The Framework and Guidance Notes are now available on the Pensions Page of the OSFI Web site.

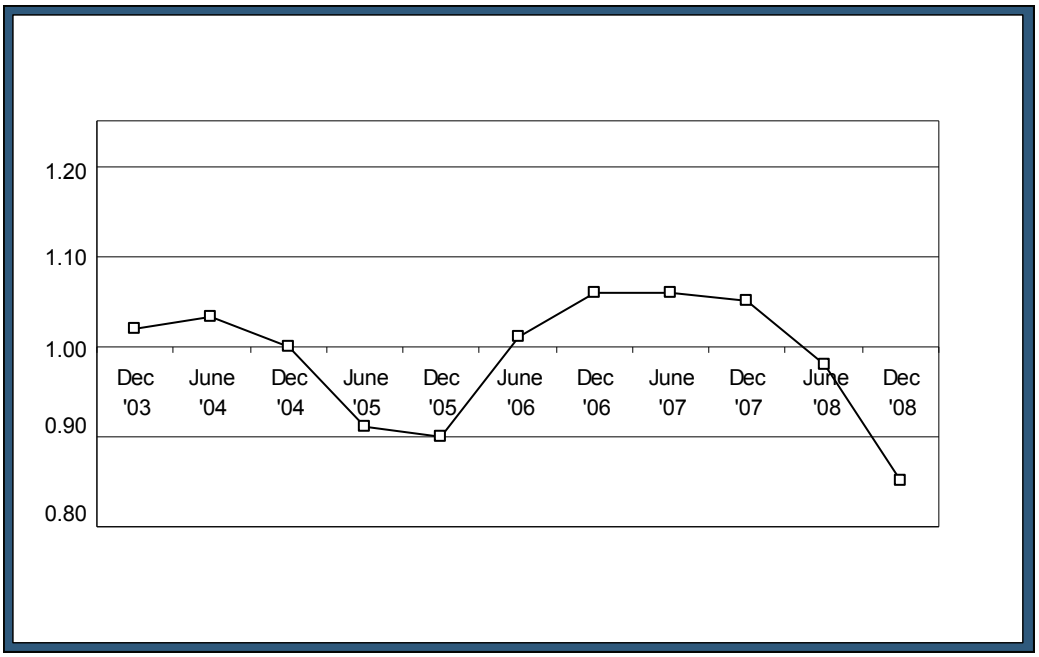
Estimated Solvency Ratios Results

OSFI regulates approximately 1,350 private pension plans operating in Canada. Of these, about 400 are defined benefit pension plans. OSFI estimates solvency ratios for all federally registered defined benefit pension plans to assist with the early identification of solvency issues that could jeopardize the security of promised pension benefits. Please see Update 26 for an explanation of how OSFI calculates ESRs and how the results are used.

According to OSFI's most recent estimates for December 2008, the solvency position of federally registered defined benefit pension plans deteriorated markedly in the last half of 2008. OSFI estimates that 83% of the 400 federally regulated defined benefit plans were less than fully funded on a solvency basis at December 2008, compared to an estimated 71% at June 2008.

At December 2008, 69% of these under-funded pension plans had ESRs below 0.9 and 43% had ESRs below 0.8. The weighted average ESR was 0.85 at December 2008 (0.98 at June 2008).

The average ESR at December 2008 is the lowest since OSFI started estimating the funded status of defined benefit pension plans in 2003. The deterioration was due primarily to a decrease in the value of pension plan assets over the period, reflecting significant losses on equity investments.



Defined Benefit Plan Termination – Investment Strategy

While reviewing requests for approval of pension plans' termination reports filed in accordance with subsection 29(10) of the *PBSA*, OSFI has become aware that some plans have developed deficits after the plan termination date. It appears that the investment policy for these plans was not reviewed at the time of the decision to terminate the plan.

Once a pension plan has been terminated under section 29 of the *PBSA*, the administrator must continue to ensure that the benefit entitlements on plan termination, as calculated in the termination report, are safeguarded until paid out. OSFI expects members to be paid the value of the pension benefit, calculated at termination, together with interest up to the date of payment to the member.

Interest on benefits until pay-out

OSFI's Draft Instruction Guide for Filing and Reporting Requirements for Defined Benefit Pension Plan Terminations (March 2008) stipulates on page 7 that OSFI expects that interest will be credited on a member's pension benefit credit until the benefit is paid out, at the rate of interest used in the determination of the pension benefit credit. Specifically, interest cannot be based on the return rate of the fund.

Fiduciary standards and investments

OSFI expects the plan administrator to follow a sound investment policy at all times. In particular, the administrator is expected to invest the plan assets with consideration for the obligations that the fund must secure at plan wind-up. The plan administrator has fiduciary obligations that include maintaining the desired level of benefit security by modifying the investment policy, acting prudently and seeking professional advice in areas where it does not have the required expertise. Once a pension plan has been terminated, the administrator must continue to take the necessary steps to ensure that the benefit entitlements calculated on termination are safeguarded until paid out.

On plan termination, the investment horizon has shortened considerably. Recent market events illustrate the potential volatility of asset values and the added risk of retaining a long-term investment policy after a plan has been terminated. The administrator needs to manage the risk that a deficit may develop because a decrease in the market value of the plan assets is not matched by a corresponding decrease in the liabilities.

In some cases, OSFI has requested that a plan administrator remit additional money to the pension fund so that the plan's members may be paid the full commuted value of the benefits, as calculated in the termination report, together with interest up to the date of payment to the members.

Unless the issue of appropriate investment strategy related to the plan termination is addressed in the request for approval of the termination report, defined benefit plan administrators can expect OSFI to ask for specific information on the results of the administrator's review of its investment strategy in light of the plan termination.

Pension Approvals Process & Timelines

As part of OSFI's commitment to increased communications with plan administrators, we would like to provide an update on the pension approvals process and how turnaround times are improving based on changes to that process.

Process

Relationship Managers review pension approval submissions when they are received and refer them to the appropriate member of the Approvals Team. At OSFI, the Approvals Team consists of a manager, two officers and an administration assistant. All applicants receive an acknowledgement of their submission giving the contact name of the approvals officer assigned to the case.

Upon receipt, the approvals officer reviews the package and requests any missing information from the plan administrator or agent who made the submission. The approval process is completed when all deficiencies are addressed, when the approvals officer has reviewed and analysed the case, including specialist actuarial and legal reviews when applicable, and when the plan administrator has been informed in writing of the Superintendent's decision.

Turnaround Times

As mentioned in Update 30, the time it takes to issue an approval decision can vary from one month to over a year, depending on the type of plan and approval, and how quickly the plan administrator/consultant is able to address deficiencies and enquiries. In the past year for example, on average, defined contribution plan termination approvals were completed in just over four months, while defined benefit plan terminations required almost nine months.

In fiscal year 2008-2009, OSFI received approximately 130 new requests for approval, an increase of about 20% over the same period in 2007-2008. During this 2008-09 period, OSFI has continued to focus on its approval process and this has contributed to a dramatic reduction in its backlog of approval requests. Very few cases outstanding for over a year still remain in process and most of these have had material deficiencies that prevented the completion of the approval process.

In the past year, OSFI has published additional approval instruction guides and is continuing its process of updating existing guides. These guides and standardized forms are available on the OSFI Web site at: Instructions and Guidelines. The waiting time to obtain an approval can be substantially reduced when administrators follow the requirements of these instruction guides, complete any available forms and submit approvals packages without delay.

OSFI will continue to seek opportunities to provide information to applicants on pension approval requirements, to streamline the pension approvals process and to continue to improve our performance.

Partial Terminations - Distribution of Surplus

In September 2005, three former members of the federally regulated pension plan applied for a judicial review of decisions by the Superintendent relating to the rights of members affected by a partial plan termination. The Federal Court Trial Division released its reasons for judgment in May 2007. All parties appealed the Federal Court's decision.

In June 2008, the Federal Court of Appeal issued its judgment which held that actuarial surplus does not have to be distributed on the partial termination of a federally regulated pension plan and that the standard of review applicable to the Superintendent's decision is reasonableness.

In March 2009, the Supreme Court denied the former members' application for leave to appeal the decision of the Federal Court of Appeal so the Appeal Court's decision remains the law for federally regulated private pension plans.

Interest Rate on Late Employer Contributions

Section 10 of the *Pension Benefits Standards Regulations, 1985 (PBSR*) requires an administrator to pay interest on outstanding payments (employee contributions, normal cost and any special payments) due to the plan. However, neither the *PBSA* nor the *PBSR* specify the interest rate that should be applied.

OSFI expects that for a defined benefit plan, in order to maintain the funding of the plan at the level assumed in the valuation report, the rate of interest applied should be the solvency discount rate for the solvency special payments, and the going-concern discount rate for the going-concern special payments and normal cost.

The interest rate that should be applied to outstanding payments to a defined contribution plan should be the rate of return of the fund for the applicable period or zero if the rate of return was negative during that period.

Revision of Instruction Guide for Asset Transfers - Defined Benefit Pension Plans

In July 2005, OSFI published the Instruction Guide for Asset Transfers between Defined Benefit Pension Plans. We are in the process of revising and updating this instruction guide where necessary, based on our experience of processing transfers since this instruction guide was published. We are also interested in receiving comments and suggestions for this update from users of the instruction guide. Comments can be provided to Chris Eccles, Senior Pension Analyst, Private Pension Plans Division at (613) 990-7109 or christopher.eccles@osfi-bsif.gc.ca or by facsimile to (613) 990-7394. Please provide any comments or suggestions by August 31, 2009.

Phased Retirement

Amendments to the tax rules and federal pension legislation relating to phased retirement were passed on December 13, 2007, as part of Bill C-28. The changes to the *PBSA* were brought into force on March 31, 2009 and Regulations respecting the information that plan administrators must provide to members entering into a phased retirement arrangement were published in Part II of the Canada Gazette (SOR/2009-100) on April 15, 2009.

Defined Benefit Plan Termination - Purchasing Annuities

OSFI has had a number of questions recently regarding the ability of a plan administrator to purchase annuities for members of a terminating plan before the termination report has been approved by the Superintendent. In accordance with subsection 29(10) of the *PBSA*, no annuities may be purchased before the termination report has been approved by the Superintendent.

OSFI's Draft Instruction Guide for Filing and Reporting Requirements for Defined Benefit Pension Plan Terminations specifies that the termination report should describe the process of annuity purchases, specifically addressing any risk of increasing annuity purchase rates.

Survey of Plan Administrators to Assess OSFI's Effectiveness

In February 2009, TNS Canadian Facts, an independent research firm hired by OSFI, conducted a survey with sponsors and advisors of the private pension plans OSFI regulates. The primary objectives of the research were to obtain an assessment of OSFI's effectiveness as a supervisor and regulator and to collect suggestions for improvements.

The confidential survey – which was conducted both on-line and via telephone interviews – sought to gauge the level of satisfaction with OSFI's regulations and guidance, supervision, and transaction aprovals. Respondents were also asked about their overall impressions of OSFI, how well OSFI identifies emerging risks and the usefulness of our Web site.

Nearly 800 administrators and professionals of private pension plans were invited to participate in the consultation. The response rate of almost 35% is considered excellent for surveys and OSFI wishes to thank all of those who took the time to provide their feedback.

The complete research report will be published on OSFI's Web site by early fall. Details will be provided in the next issue of InfoPensions.

Electronic Filing – Automated Data Transfer

Since 2007, pension plans registered with OSFI have been filing Annual Information Returns (AIR or OSFI-49) and Certified Financial Statements (CFS or OSFI-60) electronically. In April 2009, two significant changes were introduced to this process:

1. OSFI no longer requires administrators to submit signed copies of the returns. Printed and signed copies should, however, be maintained by the plan administrator.
2. OSFI has introduced an option that enables pension plans to upload these returns to a secure Web portal in lieu of sending electronic media through the mail or by courier. This new Automated Data Transfer (ADT) application is provided by the Bank of Canada who will ensure that returns submitted to them are passed on to OSFI. This application should improve the efficiency of the returns process. Detailed procedures on the required steps are available on the OSFI Web site.