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PBSA Update

Issue No. 8

PBSA Update is issued by the Pension Benefits Division of the Office of the Superintendent of Financial Institutions to improve communications between the Office and pension plan administrators whose plans are supervised pursuant to the *Pension Benefits Standards Act, 1985* (PBSA). Issue No. 7 was dated May 1992.

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Contents

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1. Contribution Holidays

Recently, in the course of an on-site plan examination, the Office discovered that the employer had failed to contribute to the plan, despite a plan provision that required the employer to match employee contributions.

The Office is of the view that contribution holidays are permitted under the PBSA and its Regulations. Some pension plans, however, contain provisions which prohibit or have the effect of prohibiting them. Before using surplus to pay for normal costs, plan administrators should always ensure that contribution holidays are authorized under the plan terms.

The Office's review of contribution holidays is primarily concerned with solvency, not contractual legality. It may happen, however, that in the course of its supervision the Office uncovers unauthorized contribution holidays. When this happens, the Office determines on a case by case basis whether it has a responsibility under the PBSA to intervene and require a repayment of the unpaid contributions.

2. Fees

The September 26, 1992 publication of the *Canada Gazette* announced that the basic fee rate for calculating PBSA fees payable with filings due in fiscal 1993-94 has been set at $13.10 per member up to 1,000 members and $6.55 per member in excess of 1,000. The minimum fee will be $262 and the maximum $131,000.

This is an increase of approximately 28 per cent over the 1992-93 basic fee rate of $10.25. Most of this increase is temporary and was anticipated by the Office. In fact, the Office did inform the pension industry of this coming temporary increase in the Fall 1991 issue of *PBSA Update*.

In brief, when the adopted the new fee structure in March 1991, plans were able to file before the April 1 effective date of the regulation and so paid only $5, rather than $10 per member. Early payment by certain large plans reduced the revenues received in the 1991-92 fiscal year by over half a million dollars. The regulation requires the Office to recover this deficit in the coming fiscal year. This shortfall accounts for an increase of $2.35 in the basic fee rate. Expected costs of operation in fiscal year 1993-94 account for the remaining portion of the rate, i.e., $10.75. This is an increase of 7.5 per cent over two years.

The Office is conscious of the burden the increased fees impose on pension plans and recognizes its responsibility to control the costs associated with the administration of the PBSA. We are considering concrete measures to stabilize PBSA fees and even reduce them if possible.

3. Filing of Lists of Assets/Certified Financial Statements

The revision of the regulations covering investment of pension funds has caused the Office to reconsider some of its filing requirements. For example, the lists of assets that are filed to confirm compliance with the old "legal for life" rules may not be as useful in the context of pending investment regulations which emphasize prudence. Moreover, the new regulations will call for the filing of a questionnaire of compliance with the new investment rules with the annual information return. Consideration is being given to including questions in the annual information return in order to permit some basic risk analysis of the fund's operations.

We think this would simplify the work of the Office and administrators. Lists of assets come in a great variety of formats, and so the Office must often call plan administrators for explanations or clarifications. A standard and less detailed format for reporting should help make our operations more efficient.

The Office is also considering incorporating into the Annual Information Return the information that many small plans now provide when they file certified financial statements. Larger plans will continue to be required to file audited annual statements. Again, the Office sees advantages to both plan administrators and to the Office when this information is provided in a standard format. A decision on this matter is expected to be made during 1993 for implementation with the filing of the first investment compliance questionnaire.

The Office invites comments and suggestions from plan sponsors in the next few months as we study this idea. Meanwhile, lists of assets will continue to be required from all plans and certified financial statements from plans that are exempt from filing audited financial statements.

4. New Investment Rules

In view of the importance of the financial information contained in auditors' reports, the Office intends to be less tolerant in the future and to require tight justification for qualifications. In cases where, in the opinion of the Office, qualifications are not justified, it will direct the plan administrator to take the necessary measures to allow the auditor to produce an unqualified report.

The Office wishes to thank plan administrators, their representatives and other interested parties for their comments on the proposed new investment rules for federally regulated pension plans that were circulated in May this year. Each submission was reviewed and changes were made where warranted. A new draft has been sent to the Department of Justice for its review.

Although it is not realistic now to expect that investment rules will be in force on January 1, 1993 as planned, the Office intends to have them in place early in 1993.

5. Qualified Auditors' Reports

Some pension plan auditors' reports which are filed with the Office are qualified. The reasons for the qualifications are numerous. They include the difficulty of accessing payroll information, the fact that the auditor is new to the plan, lack of access to financial information held by the financial institution administering the funds, etc. For cost and other practical considerations, the Office has been relatively tolerant with respect to these situations.

6. Real Estate Property Values

As administrators of pension plans with real estate investments may be aware, these markets have been experiencing considerable downward pressure in the last few years. In fact, the values of these types of properties have declined, in some cases very significantly. Under the PBSA, special actuarial valuations must be performed periodically in order to monitor pension plan solvency. These valuations require that pension plan assets be reported at market value or at market-related value.

Given the difficulties real estate markets are facing, the Office wishes to remind pension plan auditors, administrators and actuaries that, for purposes of solvency valuations, special attention should be paid to ensure that these investments are carried at values that closely reflect current market conditions.

7. Sanctions on Payment of Pension Benefits to Persons in Yugoslavia (Serbia and Montenegro)

The federal government, in response to the United Nations Security Counsel Resolution recommending sanctions against Yugoslavia, passed a regulation, effective June 3, 1992, that prohibits the payment, sending or transferring of any money, cheques or bank deposits to any person in Yugoslavia (Serbia and Montenegro).

As a result, payment of pension benefits and contributions and transfer of credits to pension plan members, former members or beneficiaries in Yugoslavia is prohibited.

Pursuant to section 14 of the regulation, it is technically possible for persons to seek a certificate exempting them from the prohibition. However, we understand that such an exemption is unlikely.

Administrators who wish to apply for a certificate may apply to Douglas Forsythe (613) 996-2471 or Michel Voghel (613) 992-2486, at the Department of External Affairs.

As of the date of publication, the regulation is still in effect.

8. Securities Lending Guidelines

The Office has prepared guidelines on securities lending for pension plans. Copies of the guidelines are available on request.

The Office realizes, however, that many of the larger plans are engaged in or are considering a securities lending program. Therefore, sponsors of pension plans with assets in excess of $100 million, according to most recent financial information reviewed by the Office, will receive a copy of the guidelines with their copy of this issue of *PBSA Update.*

9. Suspension of Benefits

Over the past few years, the Office has reviewed several pension plan texts that were written to provide for the suspension of pension payments to pensioners who are subsequently rehired by their former employer and opt to rejoin the pension plan. The Office has stated that this provision is inconsistent with the requirements of the standards legislation. Because vested plan members become entitled to receive periodic amounts of pension at retirement, imposing the suspension of benefits would be a breach of subsection 16.(1) of the PBSA.

Recently, the Office has reviewed this matter further and changed its position. The Office's position is now that the PBSA would not prohibit suspension of a pension benefit at the option of the pensioner, i.e., the suspension must not be imposed on the pensioner.

Further, suspension should not interfere with the rights of the spouse arising from an entitlement to a death benefit (i.e., joint survivor) or arising from a court decision upon marriage breakdown. Finally, the pension payments would have to be recalculated at the time of the subsequent retirement on an actuarial equivalent basis.

Consequently, if a plan sponsor wishes to include this provision in its pension plan, the Office will require an amendment to the plan text containing the three conditions described above.

10. Valuation Interest Rate

Although the Office does not impose specific standards on actuarial assumptions, plan sponsors and actuaries are reminded that, pursuant to subsection 9(2) of the PBSA, the Superintendent has the duty to direct a plan administrator to change actuarial assumptions if he is of the opinion that they are not adequate or appropriate.

In recent years, economic assumptions used in ongoing valuations of many defined benefit pension plans reviewed by the Office have become more liberal. The actuarial profession and regulators have found this change acceptable mainly because, until recently, actuarial assumptions were often very conservative to begin with and because actual market interest rates and investment earnings in the past decade were very high relative to assumed rates.

With the substantial decline in interest rates in the last year or so, the Office is concerned that some actuaries are using economic assumptions that are approaching or even exceeding the limits of what the Office considers adequate. In these situations, the Office intends to assume its responsibility firmly and wishes to make actuaries and plan sponsors aware that it will reject actuarial reports than in the Superintendent's opinion are not based on adequate assumptions. In this process, the Office will refer actuarial reports to the Canadian Institute on Actuaries for its opinion whenever this is necessary.

11. 1993 Regulatory Plan

The Office will propose housekeeping amendments to the Regulations which are expected to be considered in 1993. These proposals and amendments are subject to legal review and, in some cases, further government approval. These amendments will include:

- Making British Columbia, New Brunswick and Saskatchewan designated provinces.
- Transitional funding standards for pension plans already in operation that subsequently become subject to the PBSA.
- Exempting non-resident plan members and members who cease to be Canadian residents from application of certain provisions of the PBSA.
- Exempting pension plans that specifically provide benefits in excess of the *Income Tax Act* limits from application of the PBSA.
- Exempting bridging and some disability benefits payable under a pension plan, from the requirement for a joint and survivor form of benefit. The disability benefits that the amendment will address are those that cease when the member returns to work or attains retirement age.

The Office is also considering proposing an amendment to permit life income funds (LIFs) as an optional retirement payout vehicle.

Comments?

The Office welcomes readers' comments on any matter covered in *PBSA Update or* related to our supervision of pension plans. If you have any suggestions that you think would improve communications between our office and the pension industry or on other matters pertaining to the legislation, please write to:

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