Memorandum

MAY 23, 2017

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New Funding Framework for Defined Benefit Pension Plans in Ontario

Introduction

On May 19, 2017, the Ontario Government announced that it was moving forward with changes to the funding framework for Defined Benefit Pension Plans - a process that was launched last year with the government's review of the current solvency funding framework and the release of a consultation paper on this topic.

At this time, only a brief announcement has been issued by the Ontario Government, with the more technical rules and regulations expected to be released later in the year. Nevertheless, we will take this opportunity to review the details the Ontario Government has released in their announcement.

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Changes to the Funding Rules

Key Changes to the Funding Rules

The key highlights of the new funding framework are:

- Required funding on an enhanced going-concern basis; with changes to the going-concern funding rules including the shortening of the amortization period from 15 years to 10 year to fund any going-concern funding deficiency, and consolidating the special payment requirements into a single schedule.
- Required funding of a reserve, or Provision for Adverse Deviations, within a plan.
- Required funding on a solvency basis in the event that a plan's funded status falls below 85 percent.

PBGF Benefit Improvement

The Ontario Government also announced that they will be increasing the monthly pension that is guaranteed by the Pension Benefits Guarantee Fund from $1,000 to $1,500. As you may know, the Pension Benefits Guarantee Fund is a program that provides protection to Ontario members and beneficiaries of privately-sponsored defined benefit pension plans in the event of plan sponsor insolvency.

Additional Changes and Announcements

In addition to the key changes to the funding rules, the Ontario Government also announced the following additional complementary changes:

- Providing a discharge of liabilities when buy-out annuities are purchased for retirees or deferred vested members.
- Providing funding rules for benefit improvements, and restricting contribution holidays, to improve benefit security.
- Increasing transparency by requiring plans to develop funding and governance policies and ensuring beneficiaries receive updated information on the status of their plan.
- That special measures will be implemented in the coming weeks to assist plan sponsors that are required to file a funding valuation between December 31, 2016 and December 31, 2017, and would otherwise face the new solvency funding requirements in this valuation.
- That the government will review the rules governing the wind-up of defined benefit pension plans and study a proposal to establish an agency to administer pension benefits of wound-up plans on an ongoing basis.

Commentary

With this brief announcement, the Ontario Government has outlined its decision to modernize the funding framework for defined benefit pension plans registered in Ontario by strengthen the going-concern funding rules, as opposed to modifying the solvency funding rules. Nevertheless, it has decided to maintain the solvency funding framework for plans that are less well funded (i.e. a funded status of less than 85%, presumably determined on a solvency basis).

We are still awaiting further details and regulations on the specifics of how this new funding framework will operate. As such, we are unable to speak to the exact specifics of the implications of this change for any particular pension plan at this time. Nevertheless, we wish to provide the following observations:

- The elimination of the solvency funding framework will likely be met favourably by plan sponsors, as the low interest rate environment experienced in recent years has resulted in the solvency valuation being the driving force in determining the contribution requirements for pension plans.

- However, until we obtain further details on the enhanced going-concern basis and the Provision for Adverse Deviations, the exact implications of this change on the funding requirements will not be known with certainty.

- The discharge of liabilities for a buy-out annuity purchase will be also be met favourably by plan sponsors. Furthermore, with the funded status of many pension plans improving in recent months, we may see plan sponsors show a preference for buy-out annuities over buy-in annuities.

- The rules that will be put in place to deal with benefit improvements may have consequences for collective bargaining. In particular, we note that the new funding framework may require a more accelerated funding pattern for benefit improvements.

- It is likely that contribution holidays will become less prevalent, and/or plan sponsors may be required to file an annual cost certificate to confirm their eligibility to continue a contribution holiday.

- It appears that plan sponsors may now be required to develop funding and governance policies for their pension plans.

- We are confounded by the Government's comment that they will be moving forward with a review of the rules governing the wind-up of a plan and studying a proposal to establish an agency to administer pension benefits of wound-up plans on an ongoing basis. Our current expectation is that this will only apply to the pension plans that the Government assumes following the insolvency of a plan sponsor, and that this would not apply the wind-up of plans for a plan sponsor who continues as a going-concern.

- Plan sponsors ought to be aware that the increase in the monthly pension that is guaranteed by the Pension Benefit Guarantee Fund may result is an increase in the PBGF Assessment Fee that is imposed on plan sponsors each year – and could even result in an overhaul of how the PBGF Assessment Fee is determined. As noted in our blog published on October 7, 2016, we are not proponents of increasing the benefits under the PBGF.

- Plan sponsors who are preparing valuation reports with a valuation date between December 31, 2016 and December 31, 2017 may wish to hold off on finalizing the valuation until the special measures are released by the Government in the coming weeks.

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Next Steps

Please be assured that we will keep you informed as future developments unfold on this topic.

Please feel free to contact your consultant (Jason, Dean, Carly or Joe) if you would like to discuss any of the above.

Learn more about Actuarial Solutions Inc. and how we can help:

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