

Memorandum



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To: Our Ontario Pension Clients
From: Consulting Department
Date: May 23, 2012

Re: Solvency Funding Relief Revisited and Implementation of Some Pension Reform Measures

Introduction

The purpose of this memo is to inform our clients with Ontario registered pension plans of the recently announced Solvency Funding Relief Measures as well as the implementation of various Pension Reform Measures effective on July 1, 2012.

Solvency Funding Relief Revisited

With the release of the 2012 Ontario Budget, the government announced that they were proposing a repeat of the temporary Solvency Funding Relief Measures that were last effective for the period September 30, 2008 through September 30, 2011.

While the full details are not yet available or final (this will require the passing of new legislation and the eventual release of the revisions to the Regulations of the Pension Benefits Act) the following are the key highlights, as we currently understand them, that would apply to reports with valuation dates on or after September 30, 2011:

- ✓ Consolidation of existing solvency payment schedules into a new five-year payment schedule (i.e. if you were paying \$10,000 per month in solvency special payments for the next two years you could reamortize this deficit over five years and pay \$4,300 per month)
- ✓ If no more than one-third of the aggregate of all active, deferred and retired plan members indicate that they object, extending the solvency payment schedule to a maximum of 10 years for any new solvency deficiency determined in the report (i.e. if the new solvency deficiency would have resulted in additional required contributions of \$10,000 per month for five years then this amount could instead be amortized over ten years and you would pay \$5,600 per month)
- ✓ Deferring for one year from the valuation date the start of new going-concern and solvency special payments
- ✓ Allow plan sponsors to use letters of credit to cover up to 15% of the plan's solvency liabilities

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While it is proposed that the first two items would again be temporary and available only for the first funding valuation between September 30, 2011 and September 30, 2014, the last two items are proposed to be permanent additions to the Pension Benefits Act.

In response to the Solvency Funding Relief Measures outlined above, we propose the following steps:

- The preparation of draft funding valuations as at December 31, 2011 may be delayed until the amendments to the Pension Benefits Act and Regulations are final (clients in this situation have already been contacted)
- Clients who do not have a funding valuation required as at December 31, 2011 may wish to consider moving up the timing of their next funding valuation by a year or two to take advantage of these Solvency Funding Relief Measures

Pension Reform Measures

On April 30, 2012 and May 3, 2012, the Ontario Ministry of Finance issued draft Regulations under the Pension Benefits Act to bring into force previously announced changes relating to vesting, small benefits, grow-in benefits and wind-ups effective July 1, 2012. These changes apply to plan members employed in Ontario as well as to pension plans registered in Ontario.

Immediate Vesting and Locking-In

Effective on July 1, 2012, all pension benefits will be immediately vested and locked-in. Previously the law, and consequently many pension plans, required two years of plan membership before benefits were vested.

New "Small Benefit" Thresholds

Previously pension plans were permitted to force a terminating plan member to take their "small benefit" entitlement in the form of a cash payment if the annual benefit payable at the member's normal retirement date was less than 2% of the YMPE in the year of termination. The YMPE in 2012 is \$50,100 so therefore the threshold for 2012 is an annual pension of \$1,002.

Effective on July 1, 2012 the threshold will increase such that a cash payment will be permitted if the annual benefit is less than 4% of the YMPE in the year of termination or the commuted value is less than 20% of the YMPE in the year of termination (i.e. \$2,004 and \$10,020 respectively for 2012).

Clients that wish for us to reflect the increased "small benefit" rules prior to a formal plan amendment must notify us accordingly and we will reflect your direction in an updated Administration Policy Summary form.

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Grow-in Benefits

Effective on July 1, 2012, plan members with at least 55 “points” (age plus service) who are terminated involuntarily without cause will be entitled to grow-in benefits. Grow-in benefits provide eligible members with access to the subsidized early retirement benefits that they would have otherwise received if they had remained an active employee until retirement. Previously grow-in benefits were only provided upon a partial or full wind-up of the plan; however, related to the elimination of partial wind-ups (details below) these benefits have been extended to members who are involuntarily terminated at any time.

We will provide updated Separation Notification forms to clients that are impacted by these new grow-in rules. The new form will include a check box to indicate whether or not the member was terminated involuntarily without cause.

We note that the rules in this area are complex and are not yet final. We will work closely with clients to address all the issues if/when a plan member is terminated involuntarily without cause.

Wind-Ups

Effective July 1, 2012, it will no longer be permissible for the Superintendent of Financial Services or for a Plan Sponsor to declare a partial wind-up for pension plans in Ontario. This change is viewed favourably by most plan sponsors since it eliminates the uncertainty around pension plan administration that can sometimes arise during times of significant employee terminations; however, this change also has implications for plan sponsors of combination DB/DC pension plans (i.e. frozen DB pension plans that have a DC component for future service).

Up until July 1, 2012, the DB component of combination plans could be wound up independently (technically this would have been treated as a partial wind-up under the Pension Benefits Act). However, starting on July 1, 2012 with the elimination of partial wind-ups it will no longer be permissible to wind-up only the DB component of the plan and leave the DC component to carry on. Both the DB and DC components will need to be wound up at the same time (and perhaps succeeded by a new standalone DC pension plan or Group RRSP for future service) or alternatively the DC component will need to be spun off as a standalone DC pension plan just prior to the full wind-up of the remaining DB pension plan. The elimination of partial wind-ups may therefore cause an additional administrative burden for sponsors of combination DB/DC pension plans who intend to eventually wind-up the DB component of the plan.

Even though partial wind-ups are being eliminated, it will still continue to be permissible for the Superintendent of Financial Services or for a Plan Sponsor to declare a full wind-up. Moreover, the Regulations will permit additional circumstances when the Superintendent may declare a full wind-up. These circumstances include:

- when a plan has no active members (i.e. it has only deferred vested and retired members); or
- when a plan is closed to new members and existing members no longer accrue benefits (i.e. a frozen plan).



Financial Implications

The financial implications of immediate vesting and the extension of “grow-in” benefits have already been considered in the existing solvency or hypothetical wind-up valuations performed for pension plan funding purposes. Therefore there will be no immediate impact to the pension plan’s liabilities or funding requirements; however, termination values will be greater under these new rules so the ultimate cost of the pension plan may increase.

The magnitude of the impact will depend on the future experience of the plan as well as the nature of the plan’s early retirement provisions. Some plans may experience no cost impact if all members are already vested and if there are no early retirement subsidies in the plan; whereas other plans may experience more significant impacts if they have higher levels of previously non-vested terminations and/or generous early retirement benefits. Again, these benefits (if any) have already been included in the solvency or hypothetical wind-up valuations.

Next Steps

Solvency Funding Relief Measures

Clients with December 31, 2011 funding valuations have already been notified of the proposed Solvency Funding Relief Measures and in certain cases the preparation of the valuation reports may be delayed until the amendments to the Pension Benefits Act and Regulations are final.

Clients who do not have a funding valuation required as at December 31, 2011 are welcome to contact us to discuss these Solvency Funding Relief Measures and how they may apply to their particular situation.

Pension Reform Measures

Effective on July 1, 2012, when administering the pension plans for our clients we will apply the new rules with respect to immediate vesting and grow-in. We will also provide clients impacted by the new grow-in rules with an updated Separation Notification form.

Clients should also consider the need to amend their pension plan documents to reflect the changes that are effective July 1, 2012, once the Regulations are final. In the meantime, clients that wish for us to reflect the increased “small benefit” rules prior to a formal plan amendment must notify us accordingly and we will reflect your direction in an updated Administration Policy Summary form.

As a reminder, Actuarial Solutions Inc. does not and cannot provide legal advice and we therefore suggest that our clients consider reviewing this correspondence with their legal counsel.

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

