New Brunswick proposes defined benefit pension funding reform

The New Brunswick government recently released proposed changes to the Pension Benefits Regulations (the Regulation) relating to the funding framework for defined benefit (DB) pension plans.

Highlights of the proposed funding framework include:

• Funding on an reduced solvency basis (85% as opposed to 100%);

• Requiring funding on an enhanced going concern basis with the addition of a Provision for Adverse Deviation (PfAD) funding requirement;
• Shortening the going concern amortization period from 15 years to 10 years;

• Permitting letters of credit (LOCs) for up to 15% of solvency liabilities; and

• Restricting the use of going concern excess for contribution holiday purposes.

The proposed rules would also require plan administrators to establish a written governance policy and make certain other minor changes.

**Reduced solvency funding requirements**

Under the proposed rules, DB pension plans will be required to be funded to at least 85% of their solvency liabilities, rather than the current requirement of 100%. The new solvency funding rules would apply to new and existing pension plans with valuation dates on or after December 31, 2019. Plans with a solvency ratio of less than 85% would have to fund the shortfall over a period of five years.

Pension plans that are currently exempt from solvency funding requirements will remain exempt under the new rules.

The proposed rules would also allow for solvency assets smoothing over a period of not more than five years.

**Enhanced going concern funding requirements**

Under the proposed rules, going concern deficiencies would have to be funded over 10 years, rather than the current 15-year period.

The proposed rules would also introduce a requirement to fund a PfAD on going concern liabilities. The PfAD would include a fixed 5% component plus a variable component based on the plan’s combined target asset allocation for non-fixed income assets which ranges from 0% to 17%, with higher PfADs for higher allocations to non-fixed income assets. Plans that are exempt from solvency funding requirements would also be exempt from the fixed 5% component of the PfAD.

**Restrictions on use of going concern excess for contribution holidays**

A plan administrator would only be able to apply a going concern excess to reduce any contributions relating to the normal cost provided that there is no going concern unfunded liability or solvency deficiency, and the plan’s assets would be greater or equal to 105% of the solvency liabilities and 105% of the going concern liabilities after the holiday. Further, a plan administrator would have to provide 60-days’ prior written notice to members and former members of the pension plan of their intent to utilize a going concern excess to reduce contributions.

**Letters of credit**

Sponsors of DB pension plans, other than multi-employer plans, would be able to use LOCs of up to 15% of solvency liabilities for the pension plan. The LOCs would have to meet certain prescribed requirements contained in a new Schedule A to the Regulation.

**Governance policy**

The establishment of governance policies for the proper administration of a pension plan has long been recommended by the Canadian Association of Pension Supervisory Authorities (CAPSA) in its Guideline No. 4. With the introduction of a legislative requirement to adopt a governance policy, New Brunswick would now join other jurisdictions,
such as Alberta, British Columbia, Manitoba and Quebec, which require governance policies be adopted for most or all pension plans. This requirement would apply to all pension plans, including defined contribution pension plans.

The governance policy would need to set out, among other things, the structures and processes for overseeing, managing and administering the plan. There would also be a need to identify the material risks that apply to the plan and to establish internal controls to manage those risks. As well, the roles, responsibilities and accountabilities of all participants who have authority to make decisions would need to be described and performance measures would need to be established for such participants. Other important components of the governance policy would include a code of conduct, conflict of interest procedures, and an ongoing process to identify the educational requirements and skills for the administrator.

While plan administrators would not be required to file their governance policy with the Financial and Consumer Services Commission, the New Brunswick Superintendent of Pensions could nevertheless request plan administrators to provide a copy.

Other changes

In addition to the above-mentioned changes relating to DB funding reform, certain other changes have been proposed. Individual pension plans, as defined in the Income Tax Regulations, will be exempted from the Pension Benefits Act and Regulations.

The minimum withdrawal amounts for Life Income Funds (LIFs) will be amended to correspond with the minimum withdrawal amount for a Registered Retirement Income Fund (RRIF) under the Income Tax Regulations.

Comment

The proposed rules were subject to public comments until July 13, 2020.

These proposed amendments to the Regulation, with the easing of solvency funding requirements, will generally be welcome to private sector employers in New Brunswick; however, current solvency exempt plans will potentially see an increase in their funding requirements. The changes are generally in line with Ontario and Nova Scotia funding reform, and mean that New Brunswick would join British Columbia, Ontario, Quebec and Nova Scotia in passing comprehensive DB funding reform.

With the proposed introduction of the PfAD, plans that currently include any margins for conservatism in their going concern funding assumptions may consider reviewing that practice with their actuary in preparation for the funding changes. Plans may also wish to review their asset allocations in light of the proposed rules, but it will be important to balance short and long-term considerations.

Further, plan administrators who have yet to establish a pension governance policy will need to take steps to establish one.
Alberta provides defined benefit funding and other forms of relief for administrators

Effective June 24, 2020, the Alberta Employment Pension Plans Regulation (the Regulation) was amended to provide for a number of COVID-19 relief measures in light of the COVID-19 pandemic and economic downturn. Among other measures, the amendment enables administrators of Alberta registered pension plans to apply to the Superintendent of Pensions for the temporary suspension of special payments and other forms of defined benefit (DB) and target benefit funding relief. The Alberta Superintendent of Pensions also released an updated guidance document, EPPA Update 20-04, summarizing the amended Regulation.

Suspension of special payments

Under the amended Regulation, administrators of DB and target benefit pension plans registered in Alberta can apply to be exempted from the requirement to make unfunded liability (i.e., going concern liability) and solvency deficiency payments (collectively known as special payments) through the end of 2020.

The Superintendent has indicated that any experience losses attributable to the contribution suspension must be identified in the plan’s next actuarial valuation report. These experience losses must be amortized over a period not exceeding 15 years.

PfAD suspension

The amended Regulation permits collectively bargained multi-employer plans that are otherwise required to make contributions in respect of a Provision for Adverse Deviation (PfAD) on current service contributions to seek an exemption from making such contributions in 2020.

Funding excess limit increased

The amended Regulation also permits Alberta plan administrators to apply for a temporary increase to the limit of funding excess to reduce or eliminate current service contributions for a single fiscal year.

Under the existing Regulation, DB plans that are funded above 105% on a going concern basis can use up to 20% of this funding excess to reduce or eliminate current service contributions. Approved plans will be permitted to use up to 40% of their going concern funding excess against their current service contributions for a single fiscal year.

Approval required

The aforementioned relief measures are not automatic. Rather, plan administrators seeking to access relief under the temporary measures must apply to the Alberta Superintendent of Pensions. The relief will not be effective until the Superintendent has approved the application, but can be retroactive to June 24, 2020.

An application for relief must provide that the plan will not move to improve benefits while receiving the relief. Applications should also include the plan’s estimated financial position (on both a going concern and solvency basis) as of the date of application, as well as the rationale for seeking funding relief.

Electronic information and records

The Regulation is amended to provide that any statement, notice, document or other record or piece of information required to be sent or filed may be provided electronically in accordance with the Alberta Electronic Transactions Act. Previously, the Regulation did not address electronic communication.

This amendment does not affect beneficiary designations, as electronic beneficiary designations are under separate legislation.

Witness signatures on waiver forms

Previously, on June 3, 2020, the Alberta Superintendent of Pensions issued EPPA Update 20-03, which provided for temporary relief to witness signature requirements for spousal waiver forms.

In order to allow plan administrators to comply with social distancing guidelines, requirements...
for witness signatures on spousal waiver forms contained in Schedule 6 of the Regulation have been relaxed. While such forms continue to require witness signatures, such signatures may be delayed by up to 60 days. A pension plan administrator may still pay benefits even if the witness statement on the waiver has not been signed during this period. After 60 days, if the waiver remains unsigned, the administrator must adjust benefits as if the member had not selected the option requiring the waiver form.

Despite these changes, the Superintendent’s office encourages administrators to obtain a witness signature wherever possible.

**Notices of member contribution rate reductions**

EPPA Update 20-03 also provided relief to the requirement to provide notice of changes to member required contribution rates.

Under section 44(1) of the Regulation, if member required contributions are to be changed, the administrator must provide members notice of the change at least 30 days in advance. In order to ease the burden on employers seeking to reduce contribution rates in light of the current economic situation, such notices may temporarily be issued within 60 days after implementation of the change. This change applies only to reductions in employee contribution rates and not to employer contributions.

The two changes in EPPA Update 20-03 come into effect retroactively to March 17, 2020, and will expire automatically 60 days after the public health emergency in Alberta comes to an end.

**Ontario extends deadlines for annual member statements and other requirements**

On June 18, 2020, the Ontario government filed Regulation 287/20 (the Regulation), which extends deadlines for certain filings and for issuing certain member notices and statements.

The Financial Services Regulatory Authority of Ontario (FSRA) has revised its guidance document Information No. PE0204INF to reflect the provisions of the Regulation.

**Providing notice of delayed member statements**

The Regulation provides extensions for requirements to issue annual statements to members and biennial statements to former and retired members that are conditional upon the plan administrator providing notice to FSRA of the delay on or before the deadline for providing the statement. For plans with a fiscal year that is the calendar year, this means that notice of a delay must be provided to FSRA on or before June 30, 2020.

Upon providing this notice to FSRA, the deadline is automatically extended to December 31, 2020.

**Summary of major extensions**

The other extensions do not require advance notice to FSRA to come into effect.

The most significant extensions are summarized below. Certain other filings and notices relating to asset transfer applications and other matters have also been delayed.

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**MEMBER COMMUNICATION REQUIREMENTS**

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Previous deadline</th>
<th>New deadline</th>
<th>Which communication deadlines are extended?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual member statements and biennial statements to former and retired members</td>
<td>6 months after plan fiscal year end</td>
<td>December 31, 2020 after plan fiscal year end</td>
<td>Statements due on or after June 18, 2020 and before December 31, 2020</td>
</tr>
<tr>
<td>Member notice of plan amendment</td>
<td>60 days after registration</td>
<td>120 days after registration</td>
<td>Notices due on or after June 18, 2020 and before November 1, 2020</td>
</tr>
</tbody>
</table>
FSRA releases draft guidance on missing members

On June 23, 2020, the Financial Services Regulatory Authority of Ontario (FSRA) released a draft guidance document on the topic of missing members.

Information No. PE0203INF: Principles and Practices Regarding Missing Members provides guidance to plans in meeting their obligations towards members whom the plan is unable to locate or communicate with and for whom the contact information on file is out of date. This document also includes guidance on how plan administrators may approach winding up a pension plan in which there remain missing members.

FSRA’s guidance on this topic distinguishes between members who became missing before and after 2017, when the Pension Benefits Act (PBA) first required biennial communications to former and retired members. It is expected that there will be significantly fewer members in the second group.

Once adopted, FSRA’s guidance will replace the Financial Services Commission of Ontario’s (FSCO) Policy A300-900 - Searching for Plan Beneficiaries.

Communication and engagement strategies to prevent loss of contact with members

FSRA encourages administrators to use a variety of communication or engagement strategies to reduce the number of missing members, including:

- Use of electronic communications
- Promoting member activity / connectivity on a portal
- Regularly reminding members to provide the plan administrator with any changes to their contact information
- Putting additional emphasis on termination activities
- Communicating with approaching retirement
FSRA also proposes administrators consider obtaining member consent on enrollment or on termination of membership to permit the administrator to publish specified information and authorizing government offices to release information to the plan administrator, in order to help locate the member should the plan lose contact with him or her in the future.

**Search tools and internal policies**

FSRA provides a list of search tools for administrators to consider using in the conduct of missing member searches. The choice of appropriate search tools and processes is for administrators to make, and will depend upon the circumstances of the plan and any applicable privacy considerations. FSRA also provides recommended considerations for an internal policy on maintaining records and locating members.

**Winding up a plan with missing members**

Since an administrator’s obligations are not discharged until all entitlements have been settled, the wind up of a plan may have to be delayed while missing member searches are conducted. However, FSRA indicates that it may permit the wind up of a plan with un-located missing members who have locked-in pension benefits under the plan if the missing members are transferred to an ongoing plan or annuities are purchased on their behalf.

Additionally, in cases where the missing members’ benefits are small benefits, surplus entitlements or other cash entitlements, administrators are invited to contact FSRA to discuss alternative approaches to winding up their plans.

**Data collection**

FSRA states that, through the summer of 2020, FSRA will be collecting data on missing members from plan administrators on a voluntary basis as part of its regular data collection process. This data will be used to inform FSRA’s future initiatives in this regard, and to evaluate the effectiveness of FSRA’s new guidance on missing members.

**Biennial statement waiver**

Also on June 23, 2020, FSRA released a second draft guidance document, Approach No. PE0204APP: Waiver of Biennial Statements for Missing Former and Retired Members, which sets out the process by which Ontario-registered pension plans may apply for a waiver of the requirement to issue biennial statements. This document will replace FSCO Policy A300-901: Waiver of Biennial Statements for Missing Former and Retired Members.

**Public consultation**

Stakeholder comments are permitted until September 20, 2020.

**CRA temporarily ceases enforcements of requirements to pay**

As part of the Canadian government’s response to the COVID-19 pandemic, the Canada Revenue Agency (CRA) instructed employers and banks in March 2020 that they are not required to comply with or to make remittances based on existing “requirements to pay” (RTPs), which are a method the CRA uses to collect debts from taxpayers who have not paid amounts owing.

The CRA has since clarified that this measure applies beyond employers and banks to other parties responsible for complying with and remitting taxes based on RTPs. Consequently, employers and other pension plan administrators that ordinarily would be required to make deductions from a pensioner’s pension payments further to an RTP should cease doing so.

The CRA has indicated that the suspension of RTPs is temporary, and will continue to be re-evaluated. Employers and pension plan administrators with existing RTPs should remain apprised of the situation.

The suspension of active RTPs is one of a number of measures introduced by the CRA during the COVID-19 pandemic intended to assist individuals and businesses having difficulty filing tax returns or experiencing cash-flow challenges.
Tracking the funded status of pension plans as at June 30, 2020

This graph shows the changes in the financial position of a typical defined benefit plan with an average duration since December 31, 2019. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2019. The estimate of the solvency liabilities reflects the CIA guidance for valuations effective April 30, 2020 or later. The following graph shows the impact of three typical portfolios on plan assets and the effect of interest rate changes on solvency liabilities of medium duration.

The evolution of the financial situation of pension plans since December 31, 2019

During the month of June, Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian equity markets as well as global equity markets (CAD) showed positive returns. However, alternative investments showed negative returns. With a return of 2.9%, the low volatility portfolio (LDI\(^1\)) outperformed the 60/40 portfolio (2.2%) and the highly diversified portfolio (HD) (1.8%).

The prescribed CIA annuity purchase rates as well as the commuted value rates used in the calculation of solvency liabilities slightly decreased during the month. As a result, the solvency liabilities increased slightly for a medium duration plan. For this type of plan, an investment in the LDI, in the 60/40 and in the HD portfolio resulted in an increase of the solvency ratio.

\(^1\) Liability driven investment
The table shows the impact of past returns on plan assets and the effect of interest rate changes on solvency liabilities of a medium duration plan, based on the plan’s initial solvency ratio as at December 31, 2019. The graph shows the asset allocation of the three typical portfolios.

<table>
<thead>
<tr>
<th>Initial solvency ratio as at December 31, 2019</th>
<th>Evolution of the solvency ratio as at June 30, 2020 for three different portfolios</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>90.3%</td>
</tr>
<tr>
<td>90%</td>
<td>81.2%</td>
</tr>
<tr>
<td>80%</td>
<td>72.2%</td>
</tr>
<tr>
<td>70%</td>
<td>63.2%</td>
</tr>
<tr>
<td>60%</td>
<td>54.2%</td>
</tr>
</tbody>
</table>

Since the beginning of the year, driven by positive returns in the Canadian universe bonds, Canadian long-term bonds as well as Canadian long-term provincial bonds, the LDI portfolio, the 60/40 portfolio and the HD portfolio returned 5.2%, 1.0% and 0.9% respectively. The solvency liabilities fluctuated over that same period from 11.2% to 12.1% depending on the duration of the group of retirees. The variation in the plan’s solvency ratio as at June 30, 2020 stands between -9.8% and -3.6%.

Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Comments

1. No consideration has been made for contributions paid to the plan or for benefits paid out of the plan.

2. Solvency liabilities are projected using the rates prescribed by the CIA for the purpose of determining pension commuted values.

3. The underlying typical defined benefit plan is a final average plan with no pension indexing, including active and inactive participants representing 60% and 40% of liabilities, respectively.

4. Assets are shown at full market value. Returns on assets are based on three typical benchmark portfolios.
Impact on pension expense under international accounting as at June 30, 2020

Every year, companies must establish an expense for their defined benefit pension plans. The graph shows the expense impact for a typical pension plan that starts the year at an arbitrary value of 100 (expense index). The expense is influenced by changes in the discount rate based on high-quality corporate and provincial (adjusted) bonds and the median return of pension fund assets.

Expense Index from December 31, 2019

The table below shows the discount rates for varying durations and the change since the beginning of the year. A plan’s duration generally varies between 10 (mature plan) and 20 (young plan).

Discount rate

<table>
<thead>
<tr>
<th>Duration</th>
<th>December 2019</th>
<th>June 2020</th>
<th>Change in 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>3.06%</td>
<td>2.61%</td>
<td>-45 bps</td>
</tr>
<tr>
<td>14</td>
<td>3.13%</td>
<td>2.72%</td>
<td>-41 bps</td>
</tr>
<tr>
<td>17</td>
<td>3.17%</td>
<td>2.78%</td>
<td>-39 bps</td>
</tr>
<tr>
<td>20</td>
<td>3.20%</td>
<td>2.81%</td>
<td>-39 bps</td>
</tr>
</tbody>
</table>

Since the beginning of the year, the pension expense has increased by 20% (for a contributory plan) mainly due to the decrease in the discount rates.

Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Comments

1. The expense is established as at December 31, 2019, based on the average financial position of the pension plans used in our 2019 Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits report (i.e. a ratio of assets to obligation value of 95% as at December 31, 2018).

2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (50% equities and 50% fixed income), which reflects the average asset mix in our 2019 Survey.

3. The actuarial obligation is that of a final average earnings plan, without indexing (two scenarios: with and without employee contributions).
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