Details of Temporary Solvency Funding Relief for Certain Pension Plans in the Broader Public Sector

(Pension Benefits Act Regulation 909)

Overview

In June 2009, the Lieutenant Governor in Council enacted an amendment to the regulation under the *Pension Benefits Act* (PBA) to provide temporary solvency funding relief for defined benefit (DB) pension plans in Ontario. The measures apply to the first scheduled valuation report dated on or after September 30, 2008 and before September 30, 2011.

The relief measures include three options:

- Defer for up to one year the start of new special payments. This deferral applies to both the going concern special payments and solvency special payments.
- Consolidate any remaining solvency special payments from previous valuations into a new 5-year payment schedule.
- Amortize the new solvency deficiency over a period of up to 10 years, instead of the usual 5 years, with the consent of plan members. Consent is provided if no more than 1/3 of all active, deferred and retired members indicate that they do not consent.

Since the introduction of the 2009 solvency funding relief measures, many single-employer defined benefit pension plan sponsors and sponsors of defined contribution pension plans with minimum guaranteed benefits (hybrid pension plans) in the public sector and broader public sector (BPS), including universities, have approached the government seeking additional solvency funding relief.

In an effort to support sustainable public sector and BPS pension plans, the Minister of Finance announced in the 2010 Budget that the government is considering providing additional temporary solvency funding relief to certain single employer, DB or hybrid pension plans in the public sector and BPS, including Ontario university pension plans.

In exchange for the relief, plan sponsors would be expected to adopt plan changes that would make their plans more sustainable in the long term. Plan changes, as indicated in the 2010 Budget, could include (but are not limited to) the following:

- converting to joint sponsorship for future service;

- more equitable sharing of the normal cost of providing benefits between employers and members;
- linking some future benefits, such as inflation protection, to plan performance; and
- enhancing cost certainty and affordability through benefit adjustments that make plans more sustainable.

This process could include discussions with collective bargaining agents (CBAs).

Although the exemption from the requirement to fund on a solvency basis applies only to existing JSPPs, plans that convert to JSPPs in the future could be considered for relief from future solvency deficiencies. Existing solvency deficiencies would still need to be addressed.

Consideration would be given to the need for agreement between the plan sponsor and the representatives of plan members on issues such as the plan's governance structure, sharing of gains and losses, funding policies and contribution rate stabilization reserves, and the way in which accrued benefits are addressed in the event of a plan wind up.

There would be no additional funding from the province to finance pension deficits.

Further details were provided through separate announcements on August 5, 2010 and August 24, 2010. Links to these announcements on the Ministry of Finance website are provided at the end of this document.

Details of the relief measures, including eligibility criteria and additional conditions, would be outlined in an amendment to the regulations under the PBA, which is expected to come into effect by mid-May, 2011. Examples of steps that eligible pension plans could take and the measurement of financial impacts that are outlined in the "Savings Target" section below are not part of the amendment to the regulation. Rather, this is information that the Ministry of Finance would rely on in considering whether a pension plan has been made more sustainable in the long term. The Lieutenant Governor in Council will make the final decision on the regulation.

The proposed measures would provide temporary solvency funding relief in two stages with eligibility criteria attached to each stage. Details of the proposed relief measures and requirements for application are provided in the sections below.

If accepted into Stage 1, plan sponsors would file a valuation report with the Financial Services Commission of Ontario (FSCO) in accordance with the proposed regulation. Plan sponsors would have three years (3-year period) from the valuation date of this report to determine plan changes, a process that may include discussions with CBAs or other means in accordance with the plan's governance requirements. They would be required to make minimum payments during this 3-year period to ensure the solvency shortfall does not increase.

At the end of the 3-year period, plan sponsors would be required to prepare another valuation and submit a report (Stage 1 progress report) to the Ministry of Finance to demonstrate progress in meeting their funding plan targets. This report would be submitted to the Ministry of Finance no later than 6 months after the end of the 3-year period.

The results revealed in this report would be measured against established savings targets as detailed in the "Savings Targets" section, which outlines the conditions a pension plan would be required to meet in order to qualify for Stage 2 relief.

If substantial progress has been made in meeting the targets, it is contemplated that Ministry of Finance would recommend further funding relief to be provided to eligible plans (Stage 2 relief). Otherwise, the normal PBA funding provisions effective at the time would apply.

Plan changes identified during the 3-year period should be fully adopted no more than 5 years from the effective date of the Stage 1 progress report.

Please note that while the details of the proposed temporary solvency funding relief are anticipated to form a part of the proposed regulation, the savings targets would likely not form part of the proposed regulation.

Details of the Proposed Temporary Solvency Funding Relief as Proposed in the Draft Amendment to the Regulation

<u>Eligibility to Enter Stage 1</u>

It is contemplated that the Ministry of Finance would recommend that single employer, public sector and BPS pension plans qualify for Stage 1 of the proposed two-stage relief if they meet certain criteria as outlined in the 2010 Budget and subsequent announcements:

- the pension plan provides defined benefits;
- the pension plan is not a multi-employer pension plan;
- the pension plan is not a jointly-sponsored pension plan;
- the pension plan is sponsored by a public sector employer as defined in the regulation;

- members continue to accrue defined benefits under the pension plan (i.e., it is not a closed plan with past service benefits only or a plan with predominantly retired members);

- eligibility for Stage 1 relief would be based on the first valuation report (Stage 1 valuation report) dated on or after December 31, 2009 and filed after the regulation is made [expected by mid-May, 2011];

- the Stage 1 valuation report indicates that, as of the valuation date, either:

  - the ratio of the market value of the plan assets to the going concern liabilities is less than 0.9; or

  - the ratio of the solvency assets to the solvency liabilities, as defined under the *Pension Benefits Act*, is less than 0.9.

- a *funding* plan shall be submitted to the Ministry of Finance indicating estimated savings targets and possible steps to make the pension plan more sustainable in the long term;

- steps could include, among other things, prospective benefit adjustments, an increase in the portion of the normal cost paid by employees (up to 50% of the total), linking some future benefits to plan investment performance, or converting to joint sponsorship for future service.

<u>Stage 1 Relief</u>

During the three years of the Stage 1 relief period, the following provisions would apply:

- Annual filings of actuarial valuations would not be required, irrespective of whether the plan has solvency concerns as described in the regulations under the PBA;

- The prior year credit balance would be set to zero at the onset of Stage 1 relief;

- Commencement of new going concern special payments may be deferred by up to one year from the date of the Stage 1 valuation report;

- Going concern payment schedules established in valuation reports prior to the date of Stage 1 valuation report would continue;

- Solvency payment schedules established in valuation reports prior to the Stage 1 valuation would be suspended. Instead, during the <u>four</u> years following the date of Stage 1 valuation report, the annual minimum solvency special payments would be the greater of (a) and (b) below, less the going concern special payments due for the year:

a. The amount of the annual interest charge on the solvency deficiency identified in the Stage 1 valuation report, excluding any solvency asset adjustment and solvency liability adjustment; and

b. 50% of the special payments that are required to amortize the excess, if any, of 80% of the solvency liability over the solvency assets, as determined in the Stage 1 valuation report, over a four year period commencing at the date of Stage 1 valuation report.

- Limits on contribution holidays and accelerated funding requirements for benefit improvements during the 4-year period as detailed in the "Additional Conditions: Limits on Contribution Holidays and Benefit Improvements" section below would apply;

- Additional disclosure requirements to members and retirees. This could be accomplished through including such information in annual statements or issuing special notices.

<u>Exit Stage 1 Relief</u>

For plans which are not able to make substantial progress in meeting the savings targets and therefore not able to enter the Stage 2 relief, it is anticipated that the following provisions would apply no more than 3 years from the date of the Stage 1 valuation report (Stage 1 exit date).

- The plan should prepare an actuarial valuation report as of the Stage 1 exit date under s. 3 or s.14.

- This report should be filed with the FSCO no later than one year after the valuation date.

- Any solvency deficiency identified in this report must be amortized over a period of no more than 5 years with the first payment starting no later than 12 months after the valuation date.

- Going concern special payment schedules established in valuation reports prior to this report would continue.

- Any new going concern unfunded liability identified in this report would be amortized over a period of no more than 15 years, with the first payment starting no later than 12 months after the date of the valuation report.

- Limits on contribution holidays and accelerated funding requirements on benefit improvements detailed in “Additional Conditions: Limits on contribution holidays and benefit improvements” below would remain in effect until the earlier of 10 years from the Stage 1 exit date or the date the second of two consecutive valuations are filed with FSCO where the transfer ratio is greater than or equal to 1.0.

- Disclosure to members and retirees about the plan’s exiting from the Stage 1 relief regime. This could be accomplished through including such information in annual statements or issuing special notices.

Stage 2 Relief

For plans that are able to demonstrate that substantial progress has been made in meeting savings targets, the following provisions would apply if the proposed regulation is made:

- The plan would prepare an actuarial valuation report as of the Stage 1 exit date (Stage 2 valuation report).

- The Stage 2 valuation report would be filed with FSCO no later than one year after the valuation date.

- Any solvency deficiency identified in the Stage 2 valuation report would be amortized over a period of no more than 10 years with the first payment starting no later than 12 months after the date of the Stage 2 valuation report.

- Solvency asset adjustment would include the present value of going concern special payments payable from the date of the Stage 2 valuation report to the end of the period this solvency deficiency is fully liquidated.

- Going concern special payment schedules established in valuation reports prior to the Stage 2 valuation report would continue.

- Any new going concern unfunded liability identified in the Stage 2 valuation report would be amortized over a period of no more than 15 years with the first payment starting no later than 12 months after the date the Stage 2 valuation report.

- Filing of subsequent valuation reports would be in accordance with the requirements of the PBA and regulations in effect at the time.

- Funding of any additional going concern unfunded liability in a valuation report subsequent to the Stage 2 valuation report would be in accordance with the PBA and regulations in effect at the time.

- Any additional solvency deficiency revealed in a report subsequent to the Stage 2 valuation report would be amortized over a period that is the longer of 5 years or the remaining period from the valuation date to the end of the 10 year period the solvency deficiency identified in the Stage 2 valuation report is fully liquidated.

- The solvency asset adjustment would include present value of going concern special payments and solvency special payments payable over the same period.

- Limits on contribution holidays and accelerated funding requirements on benefit improvements detailed in the “Additional Conditions: Limits on Contribution Holidays and Benefit Improvements” section below would remain in effect until the earlier of 15 years starting from the effective date of the Stage 2 valuation report, or the date the second of two consecutive valuations filed with FSCO, where the transfer ratio is greater than or equal to 1.0.

Additional Conditions: Limits on Contribution Holidays and Benefit Improvements

Proposed regulations under Bill 120 would prescribe conditions for contribution holidays and require accelerated funding of benefit improvements under certain situations. All pension plans registered under the PBA would be subject to Bill 120 and its related regulations once those regulations are made. It is proposed that plans seeking temporary solvency funding relief under this regime would be subject to additional conditions and limits, as follows:

- The transfer ratio of the plan shall not fall below 1.10 after the application of the contribution holidays;

- To the extent that a going concern unfunded liability is created or increased due to plan amendments that increase pension benefits or ancillary benefits, such an unfunded liability shall be amortized over a period of no more than 5 years with the first payment commencing in accordance with the funding requirements under the PBA and regulation in effect at the time.

- To the extent that the transfer ratio of the plan is reduced to below 0.90 due to plan amendments that increase pension benefits or ancillary benefits, a lump sum special payment should be made immediately to restore the transfer ratio to at least 0.90. The balance of the increase in the going concern unfunded liability shall be amortized over a period of 5 years as stated above.

Savings Targets

Almost all pension plans experienced significant investment losses during the great recession of 2008 - 2009. These investment losses, together with declining interest rates, have resulted in significant funding deficits in most pension plans. These funding deficits could be viewed as cyclical, structural or a combination of both to some degree.

If a plan experiences funding difficulties regardless of the economic environment, the funding deficit is considered to be more structural than cyclical in nature. The savings targets attempt to approximate the size of structural deficits. Under this proposed regime, a pension plan that has had structural funding challenges over the past decade would have higher savings targets.

Additionally, the savings targets will also serve as a measurement tool for the Ministry of Finance to consider whether steps taken towards sustainability were commensurate with the structural funding challenges faced by those plans seeking Stage 2 funding relief. It will also serve to guide plans with various funding challenges towards more equitable sharing of risk between members and employers in the long term.

The savings target is defined as:

savings target = 1 - Minimum (A, B) where:

> A is the average ratio of the market value of plan assets to going concern liabilities, up to 1.00, determined in the last three valuations filed and in the Stage 1 valuation
>
> B is the average ratio of solvency assets to solvency liabilities, up to 1.00, determined in the last three valuations filed and in the Stage 1 valuation

Terms

Stage 1 valuation = 1st valuation on or after December 31, 2009 and filed after the regulation is made

Stage 1 progress valuation = valuation performed no more than 3 years after the Stage 1 valuation date to qualify for Stage 2 funding relief

The present value of future service benefits and future normal costs shall be determined using an aggregate actuarial cost method calculated on a going concern basis.

All present values of future service benefit, normal cost and liabilities are determined as of the Stage 1 progress valuation date and should be calculated using the same actuarial assumptions used in the Stage 1 valuation.

PVFB(o) = present value of future service benefits under plan provisions as at the Stage 1 valuation date, excluding amendments made within the last five years leading up to the Stage 1 valuation date or plan amendments made prior to this period that are scheduled to come into effect during this period which may have enhanced the sustainability of the plan. Amendments to increase pension benefits or ancillary benefits that were made during this five-year period or scheduled to come into effect during this period should not be excluded.

PVFNC(o) = present value of future normal cost under the same plan provisions in calculating PVFB(o), expressed as a dollar amount and as a percentage of the present value of future pensionable earnings.

PVFB(n) = present value of future service benefits under plan provisions as at the Stage 1 progress valuation date, including plan amendments excluded from PFVB(o) and amendments adopted or to be adopted no later than 5 years after the Stage 1 progress valuation date.

PVFNC(n) = present value of future normal cost under the same plan provision in calculating PVFB(n), expressed as a dollar amount and as a percentage of present value of future pensionable earnings.

Accrued Liability(o) = accrued liability for active members under the same plan provisions in calculating PVFB(o).

Accrued Liability(n) = accrued liability for active members under the same plan provision in calculating PVFB(n).

Savings Targets for a DB Plan:

- The plan should determine a normal cost contribution rate as at the Stage 1 progress valuation date such that the present value of future normal cost contributions would at least equal the present value of future service benefits under the same plan provision in calculating PVFB(n). That is:

  PVFNC(n) = PVFB(n) and where PVFB(n) <= PVFB(o);

- The employer's share of the normal cost should not exceed its share under the same plan provisions in calculating PVFB(o). That is:

$$\frac{\text{ER PVFNC(n)}}{\text{EE PVFNC(n)}} <= \frac{\text{ER PVFNC(o)}}{\text{EE PVFNC(o)}}$$

- The plan should demonstrate that it has achieved one or both of the following:

  - Employer and members share more equally in the normal cost going forward

  - Adjustment to pension benefits / ancillary benefits in respect of future service and / or realignment of employer and employee normal cost going forward would satisfy the savings target. That is:

$$\left(\frac{[PVFB(o) - EE\ PVFNC(o)] - [PVFB(n) - EE\ PVFNC(n)] + [\text{Accrued Liability}(o) - \text{Accrued Liability}(n)]}{PVFB(o)}\right) >= \text{savings target}$$

Savings Targets for a Hybrid Plan:

If retaining the plan structure as a hybrid plan, or if the plan has converted to provide defined contribution benefits only for future service but retains the practice of converting a defined contribution benefit into a defined benefit within the plan at retirement, then the plan should demonstrate the following:

- PVFB(n) <= PVFB(o), where the present value of future service benefits includes benefits under both the defined contribution provision and the minimum guarantee benefit provision.

- The employer's share of the total normal cost, i.e., employer normal cost contribution to the defined contribution provision and to the minimum guarantee benefit provision, should not exceed its share under the same plan provision in calculating PVFB(o). That is:

$$\frac{ER\ \ PVFNC(n)}{EE\ PVFNC(n)} <= \frac{ER\ \ PVFNC(o)}{EE\ PVFNC(o)}$$

  (for purposes of this calculation, the present value of future benefits and contributions includes benefits and contributions under the defined contribution provision, as applicable)

- Actions that have been taken to reduce the plan's risk resulting from a review of the conversion process, excess investment return indexing provision and non-reduction guarantee provision, and the financial impact as a result of taking such actions.

- The aggregate financial impact from all actions taken would produce a saving to the plan that would meet the savings target below:

$$\left(\frac{[\text{PVFB (o)} - \text{EE PVFNC (o)}] - [\text{PVFB(n)} - \text{EE PVFNC(n)}] + [\text{Accrued Liability (o)} - \text{Accrued Liability (n)}]}{\text{PVFB(o)} + \text{Accrued Liability (o)}}\right)$$

>= savings target

For purposes of demonstrating the financial impact of actions taken to reduce the plan's risks, such as revision of the conversion process and/or other post-retirement benefit adjustment provisions, those actions could be modeled for inclusion in the determination of whether the savings target has been achieved.

Also, for the purposes of this calculation, the present value of future service benefits, contributions, accrued liabilities include benefits, contributions and accrued liabilities under both the defined contribution provision and the minimum guarantee benefits provision, as applicable.

If the plan has been converted to a "pure" defined benefit plan, the plan should demonstrate that:

- The future service benefit accrual rate should not exceed the current minimum guarantee benefit level.

- The plan should determine a normal cost contribution rate as at the Stage 1 progress valuation date such that present valuation of future contributions would at least equal the present value of future benefits under the same plan provisions in calculating PVFB(n). That is:

  PVFNC(n) = PVFB(n) and where PVFB(n) <= PVFB(o);

- The employer's share of the normal cost should not exceed its share under the same plan provision in calculating PVFB(o). That is:

$$\frac{\text{ER PVFNC(n)}}{\text{EE PVFNC(n)}} \leq \frac{\text{ER PVFNC(o)}}{\text{EE PVFNC(o)}}$$

  (for this calculation, present value of contributions includes contributions to defined contribution provision as applicable)

- Actions that have been taken to reduce the plan's risk resulting from a review of the conversion process, excess investment return indexing provision and non-reduction guarantee provision for benefits accrued up to the effective date of conversion and the financial impact as a result of taking such action.

- The plan should demonstrate that it has achieved one or both of the following:

  - Employer and members share more equally in the normal cost going forward;

  - The aggregate financial impact from all actions taken would produce a saving to the plan that would meet the savings target outlined in the DB section. That is:

$$\left(\frac{[PVFB\ (o) - EE\ PVFNC\ (o)] - [PVFB(n) - EE\ PVFNC(n)] + [\ Accrued\ Liability\ (o) - Accrued\ Liability\ (n)]}{PVFB(o)}\right)$$

$>=$ savings target

For purposes of demonstrating the financial impact of actions taken to reduce the plan's risks, such as a revision of the conversion process and/or other post-retirement benefit adjustment provisions, those actions could be modeled for inclusion in the determination of whether the savings target has been achieved.

Also, for purposes of this calculation, the present value of future service benefits, contributions and accrued liabilities include benefits, contributions and accrued liabilities under both the defined contribution provision and the minimum guarantee benefits provision, as applicable.

Application and Process

Plans which intend to apply for the 2-stage solvency funding relief should apply by submitting an application to the Ministry of Finance prior to filing the Stage 1 valuation report in order to be considered by the Ministry for solvency relief. The application should be sent to:

Public Sector Pension Plan Solvency Relief Application
Pension Policy Branch
Ministry of Finance
5th Floor, Frost Bldg S.
7 Queen's Park Crescent
Toronto ON M 7A 1Y7

There will be a number of windows of opportunity to apply.

The first window is from the date of posting of this document to March 23, 2011. Eligible pension plans with a valuation date as at December 31, 2009 or with a valuation date in 2010 could apply during this window.

Other windows of opportunity for eligible pension plans with valuation dates in 2011 and 2012 will be announced at a future date.

The application should include, at a minimum, the following documents:

- The estimated savings target of the pension plan in accordance with the "Savings Targets" section above;

- A detailed *funding plan* showing how the pension plan could be modified such that its provisions are consistent with the intent of the relief regime;

- The *funding plan* should identify prospective plan changes which could be introduced or discussed with CBAs during the 3-year period under the Stage 1 relief and would become effective no later than 5 years after the end of Stage 1 relief. Such prospective plan changes could include changes to benefits, contributions, or both.

  - To the extent possible, when identifying examples of prospective plan changes that could measurably reduce future costs, include rough estimates of potential savings, expressed in dollars as well as a percentage of present value of future pensionable earnings and future liabilities on a going concern basis, using the assumptions in the Stage 1 valuation report.

- An indication that this *funding plan* has been shared with plan members and their representatives / collective bargaining agents (CBAs) and will be shared with retirees;

- Identification of the CBAs representing members of the pension plan (if any), the number of members represented by each CBA (and those not represented) at the valuation date, and the date(s) at which collective bargaining agreements expire.

- Identification of amendments to the pension plan which have already been made in the last five years leading up to the date of Stage 1 valuation report or plan amendments made prior to this period that are scheduled to come into effect during this period which may have enhanced the sustainability of the pension plan.

- Identification of amendments made prior to entering Stage 1 that are scheduled to come into effect after entering Stage 1 that may have increased the cost of the pension plan.

- Copies of plan documents, amendments and valuation reports filed since December 31, 1999.

The Ministry of Finance will consider whether the application satisfies the criteria for Stage 1 relief. If the plan is considered to have satisfied the criteria, the Ministry will make a recommendation to the government that a regulation be made to provide the described funding relief.

A pension plan that is provided with funding relief through the proposed regulation would have up to three years from the Stage 1 valuation date to determine pension plan changes, a process that may include discussions with CBAs, that are consistent with the intent of this proposed solvency funding relief regime.

The administrator of the plan would be required to provide the Ministry of Finance with a report (Stage 1 progress report) within 6 months after the end of the 3-year period of Stage 1 relief. The report should detail all pension plan changes that have been identified or discussed with the CBAs and are to be fully adopted not later than 5 years after the end of the 3-year period under Stage 1 relief (See “Savings Targets” above for details).

If a pension plan is considered to have made substantial progress in meeting the savings target, the Ministry would consider recommending to the government that a regulation be made to provide the Stage 2 funding relief.

It is proposed that pension plans whose sponsors do not successfully adopt sufficient plan modifications during the 3-year period under Stage 1 relief (including decisions taken previously) would not receive extended solvency relief and would be transitioned back to the normal funding rules in place at the time (see “Exit Stage 1 Relief” above for details)

Whether or not a pension plan would receive the extended solvency relief (Stage 2 relief), an actuarial valuation report should be filed with FSCO no more than 12 months after the end of the 3-year period under Stage 1 relief.

Applying for this two-stage solvency funding relief would not preclude eligible sponsors from electing Option 1 under the 2009 temporary solvency funding relief (i.e., the deferral of up to 12 months of the start of new going concern special payments).

It is contemplated that the regulations will name those pension plans that receive solvency relief in 2011.

<u>Links to Previous Announcements</u>:

August 5, 2010

http://www.news.ontario.ca/tcu/en/2010/08/putting-university-pension-plans-on-a-sustainable-track.html

August 24, 2010

http://news.ontario.ca/mof/en/2010/08/mcguinty-government-taking-additional-steps-to-strengthen-ontarios-pension-system.html