



SECTION: Funding of Plans
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Amendments to Regulation
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Highlights from Ontario Regulation 712/92

Regulation to amend Regulation 909 of Revised Regulation of Ontario 1990 concerning Solvency Valuation and Pension Benefits Guarantee Fund ("PBGF") Coverage

On November 26, 1992 the Ministry of Financial Institutions (Ministry of Finance) announced changes to Regulation 909 under the Pension Benefits Act affecting solvency funding and the PBGF. These changes, originally announced on December 18, 1991, were made following consultation with stakeholders, the actuarial community and pension professionals. The changes took effect on November 26, 1992.

As related policies and procedures are developed, they will be disseminated to the industry and published in the *PCO Bulletin*. [Editor's Note: An information session was held when policies and procedures were developed.]

I Solvency Funding

Under the new rules going concern funding is no longer dependent on solvency funding. Under the previous Regulation, going concern special payments had to be adjusted when new solvency payments were established. Now it is no longer necessary to adjust going concern special payments when a new series of solvency special payments is established.

II Solvency Valuation Methodology

The methodology of solvency valuation and funding is revised. Many of these revisions were made through clarification of terms.

Clarification of Terminology

Initial valuation date means the valuation date of the first report filed or submitted under section 3, 4, 13 or 14 with a valuation date after the Regulation date (November 26, 1992).

Solvency deficiency = (solvency liabilities + solvency liability adjustment + prior year credit balance) / (solvency assets + solvency asset adjustment).

Solvency assets represents the market value of invested assets excluding the value of qualifying annuity contracts.

Solvency asset adjustment includes the averaging of the market value of assets, as well as the present value of the special payments, including all special payments scheduled for payment within 5 years (or before 1/1/2003 if longer).

Solvency liabilities now are defined so that liabilities related to certain benefit provisions can be excluded provided that the exclusions are disclosed in the report.

Solvency liability adjustment is the adjustment for using an averaged interest rate. Although it is not specifically addressed in the Regulation, the methods of averaging assets and liabilities must be consistent.

Liabilities Related to Certain Benefit Provisions may be excluded from Solvency Liabilities

- * An employer may elect to exclude the pre-funding of existing plant closure benefits and permanent layoff benefits ("PCB"s and "PLOB"s). A formal election to exclude these benefits must be made by the employer.
 - Election must be made by the due date of the first report after the Regulation date - subsection 5(19).
 - If the election is made, an actuarial valuation must be filed annually - subsection 14(3).
 - If an employer does not elect to exclude these benefits, the benefits must be funded - subsection 5(18).
 - An employer may rescind the election, but once rescinded, is not permitted to re-elect - subsections 5(20) & (22).
 - Pension plans that do not provide PCBs or PLOBs as of the Regulation date cannot make an election to exclude these benefits from pre-funding - subsection 5(18).
- * The Regulation excludes the value related to *qualifying annuity contracts* from the calculation of solvency assets and solvency liabilities.
 - *Qualifying annuity contracts* are annuity contracts issued before 1/1/88 which provide only for benefits purchased before 1/1/93, unless they provide for redistribution of benefits on wind up.
- * Other benefits may be excluded from the calculation of solvency liabilities, as indicated in the Clarification of Terminology section. A formal election is not required to exclude these benefits, but the report must disclose the benefits that are excluded from the calculation of solvency liabilities - clause 14(8)(c).
 - "Grow-in" to consent benefits and special allowances can be excluded. Consent benefits and special allowances for which members have met all other eligibility requirements at the valuation date cannot be excluded.
 - Future pension benefit increases, such as indexing or step increases required under the pension plan, do not have to be pre-funded on a solvency basis.

- Early retirement windows available for less than one year, that have not been elected, are not required to be included in determining solvency liabilities.

III Reduction of Required Employer Contributions

* The concept of *prior year credit balance* was introduced to regulate the use of excess contributions.

- The *prior year credit balance* is determined as follows for the first report after the Regulation date:
- $\text{prior year credit balance} = \text{prepayments} + \text{initial solvency balance (if positive)}$

and for subsequent reports:

- $\text{prior year credit balance} = (\text{previous prior year credit balance}) + (\text{total employer contribution made after last valuation date but before current valuation date})$ (aggregate employer contribution required under section 4).
- *Prepayments* are the excess going concern special payments as determined under the rules in effect before November 26, 1992.
- $\text{Initial solvency balance} = (\text{the aggregate special payments paid by the employer with respect to any solvency deficiency arising before November 26, 1992})$ (the aggregate special payments required to be paid with respect to any solvency deficiency arising before November 26, 1992 but calculated on the basis of the new rules).
- If the plan has a *prior year credit balance*, the employer may apply it to reduce the required employer contributions for both normal costs and special payments.
- Special payments included in the initial solvency balance cannot be included in prepayments.

IV The new solvency valuation rules are applicable as if they were effective on 1/1/88. Valuation and reporting requirements are revised accordingly

All solvency deficiencies must be redetermined in accordance with the new Regulation except where the employer elects not to redetermine.

Cases Where Solvency Deficiencies are to be Redetermined

- * Where solvency deficiencies are to be redetermined, the term *solvency liabilities* should be applied as described in the Clarification of Terminology section.
- * The Regulation provides that all solvency deficiencies arising before 12/31/97 can be amortized over a period ending on 12/31/2002 - clauses 5(1)(c), (d) & (e).
- * A report must be prepared with a valuation date not later than the last day of the fiscal year of the plan in which the Regulation date falls (for most plans this is December 31, 1992) - subsection 5(6).
- * This report must be filed within nine months of the valuation date and must contain, in addition to the usual information contained in a valuation report, the following information - subsection 5(7):
 - those items being excluded from solvency liabilities

- the prior year credit balance
- the amount of each redetermined solvency deficiency

- the special payments, and
- the initial solvency balance.

Cases Where an Employer Elects Not to Redetermine

- * An employer may elect not to redetermine solvency deficiencies if - subsection 5(9):
 - all reports due before the Regulation date were filed
 - the filed reports complied with all requirements in effect as of the valuation date of the report
 - all required payments were made
 - the actuary has signed a statement that prior reports were prepared in accordance with the requirements in effect on the valuation date of the report, and
 - the plan administrator has signed a statement that prior reports have been filed and all required payments have been made.

- * If this election is made, the Regulation still permits the previously disclosed solvency deficiencies to be amortized over a period ending on 12/31/2002 - clauses 5(11)(b) and 5(1)(d).

- * A report must be filed within nine months of the last day of the fiscal year of the plan in which the Regulation date falls - subsection 5(11).

- * This report must include the following items and information - subsection 5(11):
 - the statements of the actuary and plan administrator required under subsection 5(9)
 - the new special payment schedule
 - the initial solvency balance at the Regulation date, and
 - the prior year credit balance at the Regulation date.

Other Related Matters

- * Where there is a negative initial solvency balance, it must be paid - subsection 5(25).

- * A new mechanism was introduced in cases where a *solvency excess* exists, in other words, where solvency assets are greater than solvency liabilities - subsection 5(17):

Solvency excess (must be a positive value) means (solvency assets + solvency asset adjustment) - (solvency liabilities + solvency liability adjustment + prior year credit balance).

- If the solvency excess is greater than the present value of special payments under clauses 5(1)(c), (d) and (e) then the special payments shall be reduced to zero.
- If the solvency excess is less than the present value of the special payments under clauses 5(1)(c), (d) and (e) then the amortization period or periods for the special payment shall be reduced so the solvency excess is reduced to zero. The level of payments cannot be reduced.

V Actuarial reports must be submitted at least every three years. However, under certain circumstances, annual filing now is mandatory

- Plans that are less than 80 per cent funded on a solvency basis, or that have a solvency shortfall of \$5

million or more and are less than 90 per cent funded, are required to file solvency valuations annually - subsections 14(2) & (3).

For this purpose, both the funded ratio and the solvency shortfall are determined by comparing the solvency liability and solvency assets - subsection 14(2).

- Annual reports are required when PCBs and PLOBs are excluded from solvency liabilities - subsections 14(2) & (3).
- Plans established for less than three years are exempt from the annual filing requirement - subsection 14(4).
- Subsection 3(1) is revised to clarify that if a solvency deficiency is created or changed as a result of a plan amendment, an interim report must be filed.

VI Certain changes relate to the payment of termination benefits

- $Transfer\ ratio = \{solvency\ assets\ } \text{ the lesser of (prior year credit balance, sum of all required normal costs and special payments until next valuation date)} \div solvency\ liabilities.$
- Where the transfer ratio drops below 0.9, or by more than 10 per cent, the transfer values can be paid out only with the approval of the Superintendent of Pensions - subsections 19(4) & (5).
- The plan administrator is required to notify the Superintendent if there is reason to believe the transfer ratio has dropped.
- On termination of employment, the value of benefits excluded from solvency funding may be paid out only if the sponsor provides for additional funding or with the approval of the Superintendent - subsections 19(9) & (10).

The requirement also prevents the purchase of a guaranteed annuity contract when the benefits are not funded - subsection 19(9).

The requirement does not prevent the payment of benefits if the member elects to receive them in the form of periodic payments from the plan.

VII The Regulation also is amended to provide for changes related to Pension Benefits Guarantee Fund (PBGF) coverage and levies

* The following benefits are excluded from PBGF coverage:

- consent benefits, other than consent benefits for which the member has met all other eligibility conditions on the date of wind up
- special allowances, other than special allowances for which the member has met all eligibility conditions on the date of wind up
- benefit increases which become effective after the date of wind up, including indexation of benefits
- early retirement window benefits which are available for less than one year and have not been elected, and
- PCBs and PLOBs, other than those PCBs and PLOBs for which a member has met the age and service eligibility requirements.

* The PBGF assessment rate is changed:

- | <u>Levy</u> | <u>On Portion of PBGF Assessment Base</u> |
|-------------|---|
| 0.5% | up to 10% of PBGF liability |
| 1.0% | 10% to 20% of PBGF liability |
| 1.5% | 20% and over of PBGF liability |

- plus \$1 per Ontario plan beneficiary including actives, deferreds and all beneficiaries receiving benefits from the plan - clause 37(4)(a)(i)(A) and subsection 37(5).

- *PBGF assessment base* = PBGF liabilities) (solvency assets x PBGF liabilities ÷ solvency liabilities).

- There is a cap of \$100 per Ontario beneficiary - clause 37(4)(a)(i)(B).

- An additional 2 per cent levy applies on the solvency shortfall related to benefits excluded from solvency funding but covered by the PBGF - clause 37(4)(a)(ii).

- There is an overall cap of \$4 million per pension plan - clause 34(4)(b).

* Other changes to PBGF assessment include:

- The assessment date is defined as 9 months after the fiscal year end - subsection 37(2).

- New PBGF assessment rules apply to assessment dates after 12/31/92 - subsection 37(3).

- Formerly, when an actuarial report was submitted late, the PBGF assessment was based on the previously submitted report. Under the new rules, the PBGF assessment is based on the report covering the time period for which the assessment is made - subsection 37(8).

- If a revised report is filed at the request of the Superintendent, the assessment must be recalculated based on the revised report - subsection 37(9);
 - if the new assessment is higher, the difference must be paid within 60 days
 - if the new assessment is lower, the difference will be refunded.

- In future years, PBGF levies may be reduced if the sponsor has made payments in excess of the required minimum between the date of the solvency valuation and the date the assessment is determined - subsection 37(12).

- New plans are exempt from the PBGF assessment for three years - subsection 37(13).

- The late payment interest charge on PBGF assessments is increased from prime (as of the assessment date) to prime plus 3 per cent - subsection 37(14).

- A PBGF assessment of less than \$25 per plan is waived - subsection 37(16).

VIII An employer with plans whose total assets exceed \$500 million may elect to treat the plans as qualifying plans

- An employer whose pension plans have, in total, over \$500 million of assets and who elects to treat the plans as qualifying plans may elect to be exempt from solvency funding requirements - subsections 5.1(1) & (2).

- Qualifying plans are required to pay a PBGF assessment at a flat rate of 2.5 per cent, subject to a cap of \$5 million per plan - subsection 37(6).
- Where the assets of the qualifying plans of an employer fall below \$500 million, solvency funding must resume but PBGF assessments continue at 2.5 per cent - subsections 5.1(6) (7), (8) & (9).
- An employer with qualifying plans may rescind the election, but once the election is rescinded, re-election for treatment as a qualifying plan is not permitted - subsections 5.1(3), (12) & (13).
- At wind up or partial wind up, a qualifying plan is required to fund any shortfall in one year instead of the usual five - subsections 35(4) & (5).
- A qualifying plan may elect to file one catch-up valuation report in lieu of the valuation reports required to be filed under the former regulation - section 5.3.
- Qualifying plans that file a catch-up report also must file and pay a catch-up PBGF assessment in lieu of the PBGF assessment due under the former regulation - section 5.4.

IX Other Regulation Changes

- * The Superintendent of Pensions, with the approval of a majority of the Commission members, is empowered to direct an independent actuary to prepare and file a valuation report on behalf of a plan administrator if the valuation report is more than one year overdue and the Superintendent is of the opinion that a valuation is necessary to ensure that the plan is sufficiently funded - subsections 4(6) to (12).

The Superintendent can charge a fee to the plan administrator for the cost incurred in preparing this report.

- * Section 7 is revised
 - Subsection 7(3) now states - In any year for which no special payments are required to be made for a pension plan under section 5, an actuarial gain may be applied to reduce any employer contributions for normal costs.
 - Subsection 7(4) now states - In any year for which no special payments are required to be made for a pension plan under section 5, any actuarial gain not applied under subsection (1) or (3) may be applied to pay the annual assessment to the Guarantee Fund otherwise required under subsection 37(1) to be paid by the employer.
- * Audited financial statements are now required only for those plans where the market value of assets is over \$3 million - subsection 76(2).
- * Annual information returns for defined benefit plans are due within nine months of the fiscal year end of the plan. The six month period still applies for defined contribution plans - subsection 18(1).

For more details on the impact of solvency funding, see PCO Bulletin 3/4 (March 1993), page 13, index no. F800-051.

Summary of Filing Requirements Under the Solvency Regulations

Type of Filing	Mandatory or Optional	Expected Number of Plans Affected	Valuation Date	Filing Due Date
Ss.5(5) Report to redetermine past solvency deficiencies	mandatory unless elected under 5(8)	technically all DB plans, probably a few hundred	fiscal year-end after Nov.26,92	9 months after valuation date
Ss.5(8) Statement that past solvency deficiencies will not be redetermined	optional	all DB plans affected, most expected to elect	fiscal year-end after Nov.26,92	9 months after valuation date
Ss.5(11) Report showing restated solvency payments, initial solvency balance and prior year credit balance	if election made under ss.5(8)	most pension plans	fiscal year-end after Nov.26,92	9 months after valuation date
Ss.5(18) Notice to exclude plant closure benefit from funding	optional	probably tens	n/a	before first funding report is filed
Ss.5(20) Notice to rescind election under Ss.5(18)	optional	?	n/a	n/a
Ss.5.1(1) Notice of election to be a qualifying plan	optional	very few	n/a	n/a
Ss.5.1(12) Notice of rescission of election of being a qualifying plan	optional	?	n/a	n/a
Ss.5.3(1) Initial special report for the qualifying plans in lieu of reports not filed	optional	very few	between Nov.27,91 and Nov.26,92	May 26,93
Ss.18(1) Annual Information Return	mandatory	all DC plan	n/a	6 months after fiscal year-end
		all other plans	n/a	9 months after fiscal year-end
Ss.19(5.1) Basis of determining commuted value of benefits	if plan provides for transfer values higher than CIA minimum	probably very few	n/a	n/a