

Office of the Superintendent - Pension Commission

Update #24

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Funding Defined Benefit Pension Plans Solvency Regulations

Reference: The Pension Benefits Act Sections 18(4), 26(1), 26.1, 26.3, 28(3), 28(6) 38; and Regulation 188/87R amended

The process by which The Pension Benefits Act of Manitoba, Chapter P32 ensures the orderly funding of defined benefit plans is described in various sections of the legislation, but can be summarized as follows:

1. the plan's actuary must review the plan's financial position and prepare an actuarial valuation describing the funding needs of the plan;
2. the employer is then responsible for remitting contributions on the basis of the valuation and in a manner required by legislation; and
3. the filing of an annual information return describing the funding that has occurred allows the Pension Commission to ensure that contributions are being made in accordance with the valuation.

This bulletin will attempt to explain the new requirements effective April 30, 1999 of The Pension Benefits Act of Manitoba (referred to as "the Act") and The Pension Benefits Regulation, ("the Regulation") with respect to each step in this process. However, the bulletin has no legal authority. The Pension Benefits Act of Manitoba and The Pension Benefits Regulation, 188/87 R amended should be used to determine specific requirements.

A "defined benefit provision" means a provision of a plan pursuant to which benefits are determined in any way other than solely by reference to what is provided by contributions made by or for the credit of a member together with interest. A "defined benefit plan" means a plan that contains a defined benefit provision. For simplicity, this bulletin will use the term "plan" rather than "defined benefit plan" or "defined benefit provision".

The Actuarial Valuation

1. Timing

In the case of a new plan, section 3(1) of the Regulation requires an employer to have a plan reviewed as of the effective date of the plan. Thereafter, an actuarial review must occur at the end of a fiscal year and at intervals not exceeding three fiscal years after the preceding review date. A review must also occur in the case of an existing plan, where an actuarial valuation report or cost certificate indicates that the solvency ratio is less than 0.9, at the end of the fiscal year following the review date. As well, the Superintendent of Pensions has the authority to request a review be made of the plan at any time.

By review, we mean a review conducted by a Fellow of the Canadian Institute of Actuaries with respect to the financial position of the plan and the contributions required to be made to the plan to meet the tests of solvency required by legislation.

The employer must file with the commission an actuarial report based on the review. In the case of a new plan, section 3(7) of the Regulation requires an actuarial valuation report to be filed not later than 60 days after the establishment of the plan. The plan is established on the date the persons authorized to establish the plan resolve to do so. The plan may have an effective date, which precedes the date it is established.

In the case of a review occurring after the effective date of the plan, a valuation must be filed not later than 270 days after the review date. The filing deadline applies to all valuations, which are filed with the commission, whether or not the valuation is due. A review is to be made every third year. However, if a review is made one or two years after the preceding review date and the employer wishes to make contributions on the basis of the new review, then the actuarial valuation report resulting from the new review must be filed within 270 days after the review date.

2. Contents of the Actuarial Valuation

Section 5 of the Regulation requires an actuarial valuation to be prepared in a manner that is consistent with the Standard of Practice for the preparation of actuarial valuation reports issued by the Canadian Institute of Actuaries. The Institute's "Standard of Practice for Valuation of Pension Plans" came into effect for valuations having an effective date on or after May 1, 1994.

Section 3(12) describes the contents of an actuarial valuation report. A report must include the following so far as is applicable:

(a) the estimated total dollar cost of benefits for all members, showing separately the employer contributions and the employee contributions relating to the normal actuarial cost

i. for the fiscal year following the review date, where that date falls on the last day of a fiscal year, or

ii. for the fiscal year in which the review date falls, where the date falls on any other day;

(b) the rule used to compute the normal actuarial cost (i.e., % of payroll, cents per hour, dollar amount, etc.) and to allocate the cost between the employer and the employees in respect of service in the period covered by the report or certificate;

(c) in respect of any unfunded liability, the date it was established, the unamortized balance the special payments to be made to amortize it and the date at which it will be amortized;

(d) where the person making the review determines that the plan does not have a solvency deficiency, a statement that, in the opinion of the person, the plan does not have a deficiency;

(e) where the person making the review determines that the plan has a solvency deficiency, the date it was established, the unamortized balance as of the review date, the special payments to be made to amortize it, the value of the assets and liabilities used to determine the amount of it, the assumptions and valuation methods used to calculate it and, based on the special payments, the date at which it will be amortized;

(f) where the person making the review determines the solvency ratio is not less than 1, a statement that, in the opinion of the person, the ratio is not less than 1;

(g) where the person making the review determines that the solvency ratio is less than 1, the solvency ratio, the value of the assets and liabilities used to determine it, and the assumptions and valuation methods used to calculate the liabilities;

(h) the surplus of the plan and, if known to the person who made the review, a description of how the surplus will be utilized;

(i) the market value of the assets and a description of the valuation methods used to determine the going concern assets;

(j) the value of the going concern liabilities with respect to each of the following, including a description of the assumptions and valuation methods used to determine that value;

- i. active members
- ii. former members who have not commenced receiving pensions under the plan, and any other persons who have a future entitlement to receive pensions under the plan, and
- iii. former members who are receiving their pension under the plan, and any other persons who are receiving payments under the plan;

(k) in the case of a review occurring after the effective date of the plan, a reconciliation of the results of the review, and identification of the sources of actuarial gains and losses since the immediately previous review date;

(l) in the case of a multi-unit plan in which the contributions of the employer are based on a fixed rate or amount,

- i. the rate or amount that is to be contributed by the employer and a member,
- ii. breakdown of the rate or amount referred to in subclause (i), stating the rate or amount that is attributable to the plan's normal actuarial cost, to the amortization of any unfunded or solvency deficiency, and to any contingency reserve, and
- iii. the average number of hours of service per member per fiscal year that is assumed for the purpose of the review.

(m) such other information as the superintendent may require to determine whether the plan meets the tests for solvency set out in section 4.

3. The Prescribed Tests for Solvency

An actuary is required to provide opinions on the financial condition of the plan and on the contributions required to be made to the plan on the assumption: (1) that the plan will be a going concern and will not terminate and (2) that the plan has terminated at the review date. In support of his or her opinions, the actuary prepares a going concern valuation based on the first assumption and a solvency valuation based on the second.

A going concern valuation will be familiar to the users of actuarial valuations. The purpose of a going concern valuation is to recommend the orderly funding of a plan to accumulate assets to provide for the plan's benefits in advance of their actual payment. As previously mentioned, the actuary must make a recommendation with respect to the normal actuarial cost of the plan for the fiscal year following the review date. Legislation defines the normal actuarial cost of a plan

as "the amount estimated to be the cost to persons required to contribute to the plan of the benefits of the plan for a fiscal year".

In addition to determining the plan's normal actuarial cost, the actuary must compare the plan's going concern liabilities, as accrued to the date of the review. If the liabilities exceed the assets, then the plan is said to have an unfunded liability. An unfunded liability might exist because the plan's benefits were improved retrospectively without the plan having sufficient assets to provide for the benefit improvements. An unfunded liability also might be created if the assumptions on which the last valuation of the plan were based are not met.

Regardless of why an unfunded liability is established, the Regulation provides that an employer is obliged to make special payments to the plan sufficient to amortize the unfunded liability over a period not exceeding 15 years from the review date relating to the establishment of the unfunded liability.

The requirement to prepare calculations on the basis of the plan's hypothetical termination is new to Manitoba's legislation. In examining the solvency of a plan, the actuary must compare the plan's liabilities determined on a plan termination basis to the value of solvency assets. If a deficiency exists, then an employer is obligated to make special payments to the plan sufficient to amortize the solvency deficiency over a period not exceeding 5 years from the review date relating to the establishment of the solvency deficiency. These payments are in addition to contributions required with respect to the normal actuarial cost and to special payments with respect to unfunded liabilities.

In preparing a solvency valuation, all benefits which would be payable upon the termination of the plan must be included in the liabilities of the plan. The assumptions used to calculate liabilities are set as at the review date and not as at some later date, such as the report date. For instance, legislation provides those members not yet eligible to commence a pension be given the right to transfer the commuted value of benefits from the plan on plan termination. As such the actuary would use the transfer value assumptions in accordance with the most recently adopted official guidelines or standards issued by the Canadian Institute of Actuaries, as amended to the relevant time, to value the benefits for these members (see update 36). The interest rate prescribed by those standards as at the date of the hypothetical termination would be used.

The actuary must also take into account the estimated expenses of administering the termination of the plan, which would be required to be paid out of the pension fund.

For purposes of preparing a solvency valuation, the value of the assets of a plan

- a is determined as of the latest review date and on the basis of the market value of the assets or a value related to their market value by means of an averaging method over a period of not more than five years; and
- b includes any cash balances and accrued and receivable income; and
- c is the actuarial present value, determined in accordance with generally accepted actuarial principles using the same assumptions as are used in the solvency valuation of the plan's liabilities, of:
 - (i) previous special payments,
 - (ii) special payments payable in respect of benefits for employment before the effective date of the plan, if no benefits for that employment were provided under the plan before the establishment of those special payments; and

(iii) special payments that are payable over the five years following the plan's latest review date and not included in subclauses (i) and (ii)

Previous special payment means a payment that was within the definition of "special payment" before April 30, 1999.

Two final notes on the tests for solvency.

First, in a final or best average earnings type of plan, where the pension is based on a rate of salary at retirement date or on average of salaries over a specified and limited period, a projection of the salary of each member must be used to estimate the salary on which the pension payable at retirement date will be based when conducting a going concern valuation. A solvency valuation normally would not take into account a projection of salary.

Second, if the actuarial basis used in the actuarial valuation is such that an unfunded liability or solvency deficiency may not be revealed, as is the case with the Aggregate Method, then the actuary must perform supplementary calculations to show that the solvency tests are being met, and must certify to conducting those calculations and to the solvency tests being met.

Remitting Contributions

Section 26(1) of the Act requires that a plan be funded in accordance with the tests for solvency prescribed by the Regulation. An employer is required to make contributions that are sufficient to provide for all benefits in accordance with the prescribed tests for the solvency of the plan, which were previously described. Employees contribute to a plan only if so required by the plan.

Section 4 of the Regulation requires employer contributions to be made quarterly, both with respect to the normal actuarial cost and special payments. Section 2.3(1) of the Regulation requires the payment of those contributions to the plan's fund holder within 30 days after the end of the month for which those contributions are payable. In the case of employer contributions to a multi-unit pension plan, this section requires payment within 30 days after the end of the month for which the contributions are payable.

Section 2.3(1) also requires the remittance to the fund holder of any contributions made by the member within 30 days after the end of the month in which the contributions were received by the employer from a member or were deducted from the member's remuneration.

In the event that a review is being made, the employer contributions in respect of normal actuarial cost and special payments that are payable in respect of the first quarter after a review date may be made with employer contributions in respect of the second quarter, but the contributions must include interest from the date they would otherwise be required to be paid to the date of payment, at the same rate of interest used to determine the employer contributions under section 2.3(1)(c) of the Regulation.

Section 28(6) of the Act states that an employer who is required under a pension plan to remit a sum fails to do so within 60 days after the date required under the plan, the person to whom the sum was to be remitted must immediately notify the superintendent in writing.

A "person" means the administrator or a trustee or member of the board of trustees of the pension plan, the person charged with the investment of the funds of the plan, or the fund

holder. Fund holders include, an insurance company, a trust corporation, a society established under the Pension Fund Societies Act (Canada) or a corporation that is permitted to act as a fund holder under the Income Tax Act (Canada).

To protect money which is payable, but not yet remitted to the fund holder, sections 28(1) and (3) of the Act provide that the money which has been received by an employer from an employee, or has been withheld by an employer from money payable to an employee, or is due to be paid by the employer cannot appropriate or convert any part of the money to the employer's own use or to any use not authorized by the terms of the plan.

The Annual Information Return

Section 18(4) of the Act requires the employer of a plan to file an annual information return with the commission. The return is in a form prescribed by the commission and must be filed within 180 days after the end of each fiscal year of a plan.

On the return, the employer must report the amount of contributions actually paid to the plan with respect to the plan fiscal year under review.

SPECIAL ISSUES

Plan Amendments

Section 3(8) of the Regulation provides that, where an amendment to a plan affects the cost of benefits provided by the plan or the solvency or funding of the plan, or creates an unfunded liability, a re-evaluation of the plan's financial position is in order. The employer must have the plan reviewed, in which case a comprehensive actuarial valuation report and cost certificate must be prepared and filed. Alternatively, the employer must have the latest review revised. If the latter approach is to be used, the plan's actuary must be confident that the data, assumptions and actuarial methods used in the previous review remain appropriate.

The employer must file a new or revised actuarial valuation report within 120 days after the date the amendment is made. The date the amendment is made is the date on which the amendment is executed by whomever is authorized to amend the plan. The date the amendment is made is not necessarily the date the amendment is effective – for instance, a plan's benefits could be improved retroactively. As well, the date the amendment is made is unlikely to be the date the amendment is filed with the commission. Confirmation that the plan continues to qualify for registration typically occurs sometime after the amendment is made.

If a new review is made, the review date is deemed to be the last day of the fiscal year preceding the fiscal year in which the amendment was made, for purposes of the Regulation. This is particularly important with respect to the timing of the plan's next review.

Assume, for example, that a plan is amended by Resolution of the Board of Directors of the company on October 4, 1999, the employer is having a new actuarial valuation prepared and the fiscal year end of the plan is December 31. The employer would be required to file the actuarial valuation with the commission within 120 days of October 4, 1999. For purposes of determining when the next review is due, the new review would be deemed to have occurred on December 31, 1998. The employer would have the plan's next review no later than December 31, 2001, three years after the most recent review.

If the last review is revised, another actuarial valuation report must be conducted within three years of the date of the last review. Suppose in the previous example that the employer had chosen to revise the most recently filed valuation, which was prepared as at December 31, 1997. The employer still would be required to file the revised cost certificate within 120 days of October 4, 1999, and the next review would have to be conducted no later than December 31, 2000.

Plan Terminations

Section 26(3) of the Act requires that upon the termination or winding up of a pension plan, the employer is liable to pay all amounts that would otherwise have been required to be paid to meet the tests for solvency prescribed by the Regulation, up to the date of such termination or winding up, to the pension fund. This includes all payments in respect of current service, as well as special payments in respect of any unfunded liabilities, solvency deficiencies, and experience deficiencies which were due and payable by the employer at the termination date, as stated in as stated in the most recent actuarial valuation report or cost certificate filed with the commission under section 3 of the Regulation.

An employer is not obligated under legislation to make special payments with respect to an unfunded liability or solvency deficiency for the amortization period beyond the date of the termination.

Contribution Holidays

Where an actuarial valuation report or cost certificate filed under section 3 reveals that a plan does not have an unfunded liability or solvency deficiency, an actuarial gain

- a may be used to increase benefits;
- b may be applied to reduce the employer contributions, if the plan does not specifically provide that an employer may not reduce the employer contributions by the use of surplus; or
- c may be left in the plan.

In determining whether or not a plan permits the use of surplus assets to make employer contributions, the employer should be guided by the decision of the Supreme Court of Canada decision on *Schmidt v. Air Products Canada Ltd.* The Court's decision with respect to an employer's right to take a contribution holiday appeared to turn on this conclusion: "When permission is not explicitly given in the plan, it may be implied from the wording of the employer's contribution obligation. Any provision which places the responsibility for the calculation of the amount needed to fund promised benefits in the hands of an actuary should be taken to incorporate accepted actuarial practice as to how that calculation will be made. That practice currently includes the application of calculated surplus funds to the determination of overall current service cost."

Clause 4(3)(a) of the Regulation requires an employer to pay into a plan the normal actuarial cost allocated to the employer "as stated in the most recent actuarial valuation report or cost certificate filed". Therefore, an employer's obligation with respect to the payment of the normal actuarial cost cannot change until another actuarial valuation report or cost certificate is filed. As a result, a contribution holiday only can occur prospectively from the filing of an actuarial valuation, which supports the use of surplus in this way and cannot occur retroactively to the

date of review. If the plan has sufficient surplus assets, a contribution holiday could continue until the next actuarial valuation is filed.

More on Special Payments

The need to make special payments to fund unfunded liabilities and solvency deficiencies was discussed earlier. Section 4 of the Regulation provides guidance in their payment:

- Special payments must be made on at least a quarterly basis in an amount that is sufficient to amortize the unfunded liability or solvency deficiency over a period not exceeding 15 years and 5 years, respectively, from the review date relating to the establishment of the unfunded liability or solvency deficiency (not the date the actuarial valuation is filed).

Alternatively, the employer may make at least quarterly payments expressed in a manner that each payment is a constant percentage of future payroll of the members, projected as of the date of the original establishment of the unfunded liability or solvency deficiency, provided that the actuarial present value of all such payments is equal to the unfunded liability or solvency deficiency. If salaries are projected to rise, this would result in a schedule of special payments, which increase over time, rather than as a schedule of equal payments.

- Each unfunded liability or solvency deficiency must be funded and reported separately. As noted earlier, the present value of some future special payments with respect to unfunded liabilities may be taken into account as a plan asset for purposes of determining whether the plan has a solvency deficiency. Those special payments must continue to be made even if special payments with respect to a solvency deficiency also are required.
- Where a solvency deficiency has been amortized, the plan's actuary may recalculate any special payments for any unfunded liability that has not been amortized.
- Where an actuarial valuation report or cost certificate reveals that the plan has actuarial gain, the gain must be used to amortize or, where it is not sufficient to amortize, reduce the outstanding balance of any unfunded liabilities with the oldest established liabilities being amortized or reduced before later ones. Further, where a gain has been used to reduce an unfunded liability, the special payments to be made may be reduced on a prorated basis over the remainder of the term.
- At any time, an employer may increase the rate of amortization of an unfunded liability or solvency deficiency by increasing the amount of the special payments, making special payments in advance or making additional payments of any kind. Where the rate of amortization is increased or an actuarial gain is allocated to amortize or reduce an unfunded liability, the amount of special payments for a later fiscal year may be reduced.
- Where special payments arise as a result of a plan amendment, the 15 and 5 year periods are treated as commencing from the date the amendment is made, not the review date.
- An actuarial valuation report or cost certificate must include, in respect of any unamortized experience deficiency established before April 30, 1999,
 - a. the date of establishment and the unamortized balance of the deficiency;
 - b. the special payments to be made to amortize the deficiency; and
 - c. the date at which the deficiency will be amortized.

Defined Contribution Plans Underwriting Annuities

A plan, which is purely defined contribution, is not required to file an actuarial valuation and fund on the basis of the valuation as described in this bulletin. However, we are aware that some defined contribution plans underwrite annuities for its members. In lieu of transferring money to an insurance company to purchase a life annuity, a member may purchase a life annuity from the plan itself.

For the purposes of the Act and Regulation, the annuity underwriting operation of such a plan is considered to be a defined benefit provision. This means that the requirements of legislation described in this bulletin must be followed

Multi-Unit Pension Plans

Section 26.1 of the Act deals with a special arrangement known as multi-unit pension plan. A participating employer's liability with respect to the funding of a plan may be limited to the amount that is provided for in the plan where the liability of the employer is limited pursuant to a collective bargaining agreement.

The plan's actuary must demonstrate that the rate and amount of contributions are sufficient to meet the tests for solvency set out in the Regulation. If sufficiency cannot be demonstrated, the actuary must propose remedial action and the trustees must act to make changes to the plan. Failing such action, the superintendent may direct the action of the trustees.

Members' annual statements must state that if assets are not sufficient on wind-up of the plan, pension benefits could be reduced.

Solvency Deficiency v. Solvency Ratio

The solvency deficiency was described earlier under the heading "The Prescribed Tests for Solvency". A solvency deficiency exists if the liabilities of a plan, determined on a plan termination basis, exceed the market value of its assets, together with the present value of certain future special payments. If a solvency deficiency exists, special payments are required to be made to the plan.

A plan's solvency ratio is the number obtained by dividing the market value of the assets currently held in the plan (plus any cash balances and accrued and receivable income or contributions) by the liabilities of the plan on a plan termination basis. In other words, the present value of certain future special payments is excluded from the determination of the value of assets. An employer shall not make a transfer that would impair the solvency of the plan unless the superintendent in writing consents to the transfer or directs the employer to make the transfer. Sections 2.4 (1)-(3) of the Regulation address transfer issues.

As well, if a plan's solvency ratio is less than 1, section 23(6) of the Regulation requires the employer to include on the annual member disclosure a statement that the plan's assets are not sufficient to cover the liabilities accrued with respect to benefits promised as at the latest review date, and that special payments are being made to make the plan solvent in accordance with pension legislation.

Cost Certificate v. Actuarial Valuation

Subsection 3(3) of the Regulation provides that a plan that contains a defined benefit provision must file an actuarial valuation report and a cost certificate. Subsection 3(5) states that an actuarial valuation report need not be filed if the cost certificate is sufficient to enable the Superintendent to determine whether the plan will meet the solvency tests.

This bulletin has discussed at length the content of an actuarial valuation report. Generally speaking, a cost certificate is a summary of the actuarial valuation report. It indicates the financial position of the plan, the funding recommendations and a summary of key assumptions. It also contains a certification section, which the actuary must complete.

Penalty

Section 38 of the Act states that every person who contravenes any of the provisions of the Act or the Regulation or who obstructs an officer or agent of the commission in the performance of duties is guilty of an offence and on summary conviction is liable to a fine of not less than \$2,000 and not more than \$100,000.

In addition to the fine, a justice who convicts a person of such an offence where monies in a pension plan or payable to a pension were lost will order the person to make restitution by paying to the plan the amount of the loss.

Where a corporation is guilty of an offence under this Act, the director or agent of the corporation who directed, authorized, assented to, acquiesced in, or participated in, the committing of the offence is a party to and guilty of the offence and is liable on conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted.

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