

Goodbye Ontario solvency funding (in part)!

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- Ontario announced major changes to defined benefit pension plans registered in the province, moving away from traditional solvency funding requirements and providing an employer discharge for buy-out annuities
- impact of these funding related changes
- how these proposed changes will facilitate de-risking through the use of buy-out annuities
- implications of these changes for plan sponsors going forward

On May 19, 2017, Ontario announced various changes that are intended to promote the health and sustainability of defined benefit pension plans registered in Ontario. The proposed changes relate to funding and buy-out annuities and are the product of a lengthy consultation process on how Ontario should modernize the funding framework for defined benefit pension plans.

The move away from solvency funding and the proposed employer discharge on buy-out annuities are welcome changes for employers who sponsor defined benefit pension plans registered in Ontario.

The announcement notes that the government intends to introduce legislation in fall, 2017 to enable these changes and that the government will consult with stakeholders prior to finalizing the regulations that will ultimately bring these changes into force.

Funding

The announced changes follow the consultation on solvency funding that the province undertook last year. With the proposed changes that have been announced, the Ontario government has clearly tried to strike a balance between protecting benefits earned by plan members and reducing the funding volatility (and potentially affordability) for plan sponsors that maintain defined benefit pension plans.

The last several years have been extremely difficult for many plan sponsors. While we have recently seen an improvement in the solvency funded levels of some plans, with interest rates at record lows for many years, as well as market volatility and demographic issues (such as increased longevity), the solvency position of many registered pension plans in the country has suffered. As a result, plan sponsors have had to take advantage of various temporary solvency relief measures introduced by governments and/or face crippling solvency amortization payments.

Québec was the first province to eliminate solvency funding for all pension plans registered in the province with its reforms introduced in 2015. Unlike Québec, Ontario has opted to maintain solvency funding requirements for troubled plans, but to exempt from solvency funding requirements plans that have a solvency funded ratio of at least 85%. The announcement indicates that, based upon the Financial Services Commission of Ontario's most recent estimates, approximately 15% of plans would still need to be funded on a solvency basis under the new regime. However, the prospect of a solvency funding exemption may have the effect of incentivizing certain of these plan sponsors to (where possible) make lump sum contributions to increase the funded ratio above this threshold.

Similar to Québec's reforms, which introduced the concept of a "stabilization reserve," Ontario's new regime will require funding on a going concern basis, plus funding a reserve, known as a provision for adverse deviation (PfAD). In addition, Ontario, like Québec, will move the amortization period for funding going concern deficiencies from 15 years to 10 years and special payments will be consolidated into a single schedule. For more information on Québec's funding reform, please see [here](#).

Other key elements of today's announcement related to funding are as follows:

- To help balance the funding changes, and provide greater benefit security in the event that an employer is bankrupt and the plan is not fully funded, there will be an increase in the maximum coverage that can be provided under Ontario's Pension Benefits Guarantee Fund from \$1,000 to \$1,500. While not discussed in the announcement, we anticipate that there will be a corresponding increase in Pension Benefits Guarantee Fund premiums to finance the increased coverage.
- The new regime will include a framework for restrictions on contribution holidays and funding rules for benefit improvements.
- There will be additional requirements related to transparency, including requiring funding and governance policies and additional funding disclosure requirements to plan beneficiaries.

Buy-out annuities

In addition to the proposed funding changes, Ontario will introduce new rules that will facilitate de-risking through the use of buy-out annuities. As defined benefit plan administrators look for ways to reduce risks associated with their pension plans, one option is to purchase an annuity from an insurance company for pensions in pay. Where this is done, the insurance company assumes the responsibility to pay the pensions to those members. Under the current rules in Ontario, the employer retains responsibility with regard to the payment of the pensions, even though contractually the responsibility has been transferred to the insurer.

The proposed changes will include a discharge provision for an employer. That is, where an employer purchases buy-out annuities in respect of retirees or deferred plan members, this would satisfy the employer's obligation under the plan to provide the pension.

What do these proposed changes mean for plan sponsors now?

The proposed funding changes will impact single employer pension plans registered in Ontario. However, it is unclear from the announcement whether any or all of these changes will also apply to multi-employer pension plans or jointly sponsored pension plans that are

registered in Ontario.

The announcement provides that, as an interim step, there will be measures introduced in the near future to assist defined benefit plans that are required to file actuarial valuation reports on or after December 16, 2016, and prior to December 31, 2017. Once we receive more details on these measures, we will release a further update.

Plan sponsors need to review their plan documentation to determine what, if any changes, will be needed as a result of these upcoming changes. For example, plan texts should be reviewed to determine whether there is any language relating to contribution holidays or funding that is restrictive, given the impending changes. Similarly, for pension plans that already have funding policies, these may need to be revised in light of these changes.

The changes to the funding regimes in both Ontario and Québec may, in the right circumstances, create cost savings opportunities for employers with pension plans registered in Québec and/or Ontario, as well as other jurisdictions in Canada, through the implementation of plan mergers.

With going concern funding potentially becoming more important for the majority of pension plans in the province, sponsors may be taking a closer look at the actuarial assumptions underlying the going concern calculation. In doing so, it is important for the employer to be aware of what “hat” it is wearing and any potential fiduciary concerns.

We would also point out that it is important to be aware of these upcoming funding changes as employers enter into labour negotiations with any union.

As discussed in earlier Osler publications, there are a spectrum of de-risking options available to defined benefit plan sponsors and administrators. Ontario employers who are looking at de-risking options may now wish to consider whether to proceed with a buy-out annuity. If this is a consideration, the plan terms will need to be revised to ensure that the language permits the plan administrator the right to purchase annuities instead of paying lifetime pensions monthly from the plan fund.

Please reach out to any member of Osler’s Pension & Benefits Practice Group to discuss these proposed changes and what they may mean for your defined benefit pension plan.