Improved Funding Framework for Nova Scotia Pension Plans

The Road Forward

May 2019

NOVA SCOTIA

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Department of Finance and Treasury Board
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Introduction

The Pension Benefits Act and the underlying Pension Benefits Regulations establish rules and minimum requirements that pension plans registered in accordance with the act must adhere to. These rules and requirements have three important functions:

- Promote the development of an environment in which pension promises will be fulfilled
- Provide transparency of information about pension plans to help members, former members, and retired members make informed decisions about their pension plans
- Facilitate the implementation and continuation of pension plans

To help assess whether these objectives were being met, the Government of Nova Scotia released a discussion paper in September 2017 called *Pension Funding Framework Review and other issues affecting pension plans*. Following the close of the consultation, a summary of feedback received was released in April 2018 called *Pension Funding Framework Review: What We Heard*.

To promote a more stable and predictable regulatory environment for pension plans, Government is moving forward with some significant changes to the regulatory framework. This paper provides an overview of the legislative and regulatory changes being made. Input is being sought on technical issues, identified in the paper, in order to determine the best road forward for regulatory provisions.

Recent Legislative Reforms

On April 12, 2019, Bill 109 *Pension Benefits Act (amended)* received Royal Assent. The Bill brought forward three legislative reforms:

1. Introduced reserve accounts: Employers will be allowed to make special payments in respect of solvency deficiencies and other prescribed contributions into a separate reserve account within the pension fund. Upon wind-up of the pension plan, if the pension plan is in surplus and all pension obligations have been satisfied, the employer will be entitled to the funds in the reserve account up to a maximum equivalent to the plan's wind-up surplus. Withdrawals from reserve accounts will be subject to the Superintendent's approval. Unlike reserve accounts in some other jurisdictions, funds in the reserve account will not be accessible as long as the plan is a going concern. The reserve accounts will reduce the risk of trapped surplus on plan wind-up.

2. Removed limits on letters of credit: Letters of credit may be used to fund solvency deficiencies, but their use has been limited to a maximum of 15% of solvency liabilities. This limit is being removed. This will permit more flexibility in funding benefits, while allowing market forces to determine to what extent credit is available to an employer to fund solvency deficiencies.

3. Provided for a statutory discharge for annuity buy-outs: A statutory discharge will be provided to pension plans that purchase annuities to "buy out" pension obligations. To qualify, the annuity must be purchased from a regulated life insurance company. Benefits provided under the annuity must provide equivalent benefits to those that would have been provided by the pension plan and, if the pension plan is wound up, an entitlement to share any surplus with annuitants will remain for three years. In addition, safeguards will ensure the purchase of annuities does not adversely impact the funded position of those persons remaining in the pension plan. Notice of the intent to purchase an annuity must be provided to affected retirees and deferred members. After the annuity purchase, the discharge occurs once required documentation is filed with the Superintendent. Should it be discovered after the filing that the purchase referenced in the documentation did not comply with the requirements, the administrator is deemed, as of the date of filing, not to have been discharged.

These reforms will become effective on proclamation, which is anticipated to occur in fall 2019. Regulations are being developed to support these reforms. In particular, with respect to the first reform described above, regulations will prescribe contributions, other than payments made in respect of a solvency deficiency, that may be paid into a reserve account. Under consideration is permitting payments in respect of a going concern PfAD or margin, discussed further below, to be paid into a reserve account. Your feedback on what types of employer contributions should be permitted to be paid into a reserve account is sought.

Changes to Funding Framework for Defined Benefit Pension Plans

While Government first focused on reforms that require legislative amendment, there are additional reforms that will be achieved through regulations. In particular, while the obligations to fund defined benefit pension plans are broadly set out in legislation, the technical detail on funding requirements are contained in the regulations.

Regulatory Changes to Funding Rules

1. Permit defined benefit pension plan sponsors to elect, on a go-forward basis, to permanently fund their pension plans to an 85% solvency standard rather than the current 100%:

    - Solvency deficiencies up to the 85% standard must be amortized on a five-year basis with no consolidation of prior years' deficiencies permitted.
    - Similar to past rules for electing temporary solvency funding relief, the election may only move forward if fewer than one third of eligible plan participants objects. Eligible plan members may be represented by their union. The regulations will specify the manner in which the elections must be conducted, including the information that must be sent to plan participants in advance of their consenting or objecting to the proposal.
    - Subsequent to an election moving forward, new plan members must be provided information in respect of the solvency funding standard associated with the pension plan.

2. Enhance going concern funding rules:

    - Going concern deficiencies must be funded over 10 years rather than 15 years.
    - Special payments will be permitted to be consolidated with prior years' deficiencies into a single schedule.
    - A provision for adverse deviation (PfAD) or margin must be established. The PfAD will be applied to the pension plan's liabilities, but not to the current service cost. The PfAD must be funded in the same manner as the pension plan's other going concern obligations.

3. Strengthen restrictions on contribution holidays:

    - In order for an employer to take a contribution holiday, a pension plan will be required to retain at least a 110% funded level on a going concern basis and a 110% funded level on a solvency basis after the holiday is taken.
    - Your feedback is sought as to whether the 110% funded level is the appropriate standard. Permitting contribution holidays only when the plan is clearly in a solid funded position will help reduce funding volatility and provide greater stability over the long term.

Establishing a PfAD

Two options are being considered as the required methodology for calculating a pension plan's PfAD. Comments in respect of the following two options or other proposed options for determining a PfAD are welcome.

The PfAD calculated under either Option 1 or 2 would be supplemented by an additional amount if the pension plan were to use a discount rate that exceeds a certain level. The level currently being considered is equal to Ontario's Benchmark Discount Rate, which varies depending on specific aspects of the plan's investments.

Option 1: The PfAD is determined by the two-dimensional grid below which considers the ratio of the duration of assets to the duration of liabilities, a measure of interest rate risk, and the percentage of a plan's assets invested in variable income securities, a measure of market risk:

Asset/Liability Duration Ratio

% Assets in Variable Securities	0%	25%	50%	75%	100%
0%	7	5	3	1	0
20%	9	7	5	3	1
40%	11	9	7	5	3
50%	12	10	8	6	4
60%	14	12	10	8	6
70%	17	15	13	11	9
80%	19	17	15	13	11
100%	22	20	18	16	15

Option 2: The PfAD is determined based on the percentage of a plan's assets invested in variable income securities plus a fixed component to apply to all plans (for example, 5%).

% Assets in Variable Securities	Variable PfAD Component	Fixed PfAD Component	PfAD
0%	0	5%	5%
20%	1%	5%	6%
40%	3%	5%	8%
50%	4%	5%	9%
60%	5%	5%	10%
70%	8%	5%	13%
80%	11%	5%	16%
100%	17%	5%	22%

In the short term, the above changes to funding rules may reduce funding costs for some plans and increase funding costs for other plans. Over the long term, funding requirements should be less volatile. Further changes to or exceptions from the funding rules, including temporary solvency funding relief, should not be needed, which will result in greater predictability of funding rules.

A three-year transition period is proposed to be put in place for pension plans whose contribution requirements increase as a result of the new funding regime. Your feedback is sought on the necessity for a transition period and on the length of the transition period.

The new funding regime will allow for a high degree of benefit security to be maintained. Members will be involved in helping to determine whether a new solvency funding standard is appropriate, as plans electing the new solvency funding standard must notify their members and provide an opportunity for them to object.

Solvency Exempt Pension Plans

Some defined benefit pension plans are currently exempt from solvency funding requirements. These plans will continue to be solvency exempt. However, the enhanced going concern funding rules will apply to all defined benefit pension plans. This will promote a higher degree of stability in the funded position of these plans over time.

Regulatory changes will allow for annual cost certificates for solvency exempt plans with solvency concerns. Pension plans that are exempt from solvency funding requirements, but exhibit solvency concerns (i.e., the ratio of the pension plan's solvency assets to solvency liabilities is less than 0.85), will no longer be required to file annual valuations. They will instead be required to file annual cost certificates. A full actuarial valuation will still need to be filed every three years. This change will help reduce cost and red tape for solvency exempt pension plans. The Superintendent will have the ability to require that a full valuation be filed more frequently than every three years if deemed appropriate.

Other Regulatory Issues

Government is also implementing the following general pension reforms to improve the regulatory environment:

- Allow for individual pension plan exemptions: Individual pension plans established in respect of owners or significant shareholders will be exempt from solvency funding and certain filing requirements under the Pension Benefits Act. Some reporting requirements will remain in place. This will reduce red tape and regulatory conflicts between pension-related and tax-related requirements.
- Incorporate federal permitted investment rules: Federal permitted investment rules will be incorporated by reference into regulations such that any changes made to these rules in the future will automatically apply in Nova Scotia.
- Improve ability for solvency exempt plans to improve benefits: Pension plans that are exempt from solvency funding requirements will be able to make benefit improvements funded over five years if, at the time of the benefit improvement, they are fully funded on a going concern basis and 85% funded on a solvency basis.

Timelines

Government is pleased to be moving forward with these changes. It is anticipated that the reforms will become effective in fall 2019.

Summary of Feedback Requested

We are requesting feedback on the following technical issues, as we determine the best road forward for regulatory provisions:

1. types of employer contributions that should be permitted to be paid into a reserve account
2. most appropriate going concern provision for adverse deviation/margin
    a. Preference of option 1 over option 2 (please provide rationale)
    b. Other options that should be considered (please provide rationale)
    c. Whether there should be a different PfAD for solvency exempt or public sector plans
    d. Use of an additional PfAD to apply for pension plans using aggressive discount rates
    e. Definition of variable income securities
3. proposed three-year transition period for pension plans that must pay increased contributions under the new rules
4. proposed contribution holiday threshold (110% funded on both going concern and solvency bases)

Deadline to submit your comments: June 21, 2019

Address for email submissions:
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Privacy disclosure:
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