LAWSON LUNDELL LLP

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Pension and Employee Benefits Bulletin

Pension Reforms Announced by the Minister of Finance

On October 27, 2009 the Minister of Finance Jim Flaherty announced a number of proposed changes to the pension framework in Canada. Most of the proposed changes will be made to the *Pension Benefits Standards Act*, 1985 (Canada) (the "PBSA"), which governs federally regulated pension plans. However, two of the proposed changes will have broader application if implemented, and will apply to all registered pension plans in Canada, including those regulated by a provincial pension regulator.

This bulletin outlines the changes being proposed, divided between the proposed changes applicable to all registered pension plans and the proposed changes applicable to federally regulated plans. The Minister has not yet released draft legislation, therefore, what follows is a summary of the more significant changes being proposed.

Proposed Changes Applicable to All Registered Pension Plans

1. Increase to the Pension Surplus Threshold: The current surplus limit in the *Income Tax Act* that prohibits further employer contributions (and correspondingly requires contribution holidays), will be increased from 10% to 25%.

2. Investment Rules: The changes will remove the quantitative limits in respect of resource and real property investments, limit pension funds to investing a maximum of 10% of the market value (rather than book value) of assets of the pension fund in any one entity. Finally, the changes will prohibit self-investment meaning that an employer will no longer be permitted to invest *any* amount of the pension fund in its own debt or shares. Currently, such investments are permitted provided the employer's shares are sold on a designated stock exchange.

Proposed Changes Applicable to Federally Regulated Pension Plans

1. Fully Fund on Termination: Plan sponsors will be required to fully fund pension benefits on plan termination, thereby closing the current loophole that allows plan sponsors of federally regulated pension plans to walk away from terminated, underfunded plans. After the amendments are made, the PBSA will require plan sponsors and/or employers to fully fund a plan on its termination. The ability of a sponsor to walk away from an underfunded plan has always been more theoretical than practical. However, this change will bring the federal PBSA in line with the pension standards statutes in most provinces.

2. Availability of Contribution Holidays: Plan sponsors will only be permitted to take a contribution holiday if the plan is more than fully funded with a solvency margin of at least 5% of solvency liabilities.

3. No Administrator Declared Partial Terminations: Currently the PBSA permits a partial termination to be declared by either the Superintendent or the administrator of the plan. The proposed changes will eliminate the administrator's power to declare a partial termination.

4. Immediate Vesting: This is a very interesting proposed change which will give each plan member an immediate vested right to a pension upon joining a pension plan, eliminating the need for the member to participate in the plan for 2 years before vesting occurs. The backgrounder document provided by the Minister does suggest that waiting periods can be used to ease the administrative burden created by short-term employees. However, it is, nonetheless, a significant change.

5. Enhanced Disclosure Requirements: The information that is required to be disclosed to plan members will be expanded in order to better explain the financial condition of the plan.

6. New Standards for Minimum Funding Requirements: The Minister has announced that new standards will be used for establishing the minimum funding requirements on a solvency basis. Rather than using the current solvency ratio for determining funding, plans will be able to use the average solvency ratio from a 3 year period to determine the funding required. The amortization period is not being extended.

7. Increase to the Pension Surplus Threshold: The current surplus limit in the *Income Tax Act* that prohibits further employer contributions (and correspondingly requires contribution holidays), will be increased from 10% to 25%.

8. Letters of Credit: Sponsors will be able to use letters of credit in lieu of making solvency payments, for up to 15% of the plan's assets.

9. New Rules for Distressed Plans: The changes will give the Superintendent's office greater flexibility when dealing with significant funding difficulties, such as in employer bankruptcy. This would allow the plan to go into a form of insolvency restructuring regime whereby stakeholders would be drawn to the table, and be allowed to make compromises and agreements that don't fit within the usual provisions of the PBSA.

10. Defined Contribution Plans: The changes will give greater guidance to employers, members, administrators and investment providers in respect of defined contribution plans, and will formally recognize the CAP Guidelines as best practices. Members of a defined contribution plan will have the right to a Life Income Fund type benefit from the plan. Further, defined contribution plans will no longer need to have a Statement of Investment Policies and Procedures.

11. Negotiated Cost Plan Rules: The changes will clarify the rules for negotiated cost defined benefit plans, will allow such plans to reduce benefits even if the plan text says benefits can't be reduced, and will set out the information disclosure requirements for such plans.

12. Investment Rules: The changes will remove the quantitative limits in respect of resource and real property investments, limit pension funds to investing a maximum of 10% of the market value (rather than book value) of assets of the pension fund in any one entity. Finally, the changes will prohibit self-investment meaning that an employer will no longer be permitted to invest *any* amount of the pension fund in its own debt or shares. Currently, such investments are permitted provided the employer's shares are sold on a designated stock exchange.

For a more comprehensive discussion of the proposal or to discuss how these changes may affect your plan specifically, please contact Murray Campbell or Ken Burns of our Pension and Employee Benefits Group.

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