MERCER

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COMMUNIQUÉ

ONTARIO DRAFT REGULATION ON PENSION ASSET TRANSFERS

The Ontario Government has released the long-awaited draft regulations on the transfer of assets and liabilities between registered pension plans. The proposed regulations would complete the new pension plan merger rules under the enacted but not yet proclaimed new versions of section 80 (sale of business) and 81 (same employer mergers) of the *Pension Benefits Act* (PBA). The draft regulations have been released as a consultation draft to facilitate dialogue on the proposed changes. Comments are due by September 9, 2013.

These new asset transfer rules require the Superintendent of Financial Services to consent to the transfer if the prescribed requirements are met. Under the former rule, an asset transfer could be refused consent if, in the Superintendent's view, it failed to protect members' pension and other benefits.

Overall, the new rules are intended to facilitate transfers and as a result, make it easier to keep members' benefits whole and in one plan.

What the draft regulations do not cover

The draft regulations do not address requirements for transfers upon change of trade union (section 80.2), transfers from public sector to federal public sector (section 80.3) or reciprocal transfer agreements (section 21). Draft regulations have already been released addressing the temporary opportunity for certain public sector plans to offer individual transfers of past service benefits to a successor plan, for prior divestitures (section 80.1).

The government indicates in its explanatory notes that the draft regulation does not address its 2013 budget commitment to make amendments to permit assets to be transferred from certain single employer plans to jointly sponsored pension plans (JSPPs).

Effective date

There is no indication in the draft regulations or explanatory note of the intended effective date for bringing the amended PBA and new regulations into force. The draft regulations do define the effective date of an asset transfer – being the date of sale or the effective date of the original plan/successor plan amendments, as applicable. The draft regulation also states that it applies to every transfer of assets under sections 80 and 81. It does not exclude effective dates prior to the coming into force of the new rules. This allows the inference that the new rules will apply to old transactions, including those for which an application has already been made under the old rules. However, it is far from clear how pending applications for approval will be affected.

Defined benefit transfers

The PBA will provide that assets transferred from a defined benefit provision must be used to provide defined benefits in the successor plan. The rules for sale of business under section 80 and those for same employer mergers under section 81 are substantially the same, except as indicated below.

Protection of benefits

The PBA will provide that it is not necessary for a successor plan to duplicate the past service benefits of transferred members, if the commuted value of those benefits is the same. The draft regulation requires this value test to be done as of the effective date of the asset transfer using the transfer value basis (section 3500 of the Canadian Institute of Actuaries *Standards of Practice*, June 3, 2010) as if the member's employment terminated on the effective date. The termination of employment must be treated as an "activating event" so that the value of grow-in benefits is included.

Also, for transfers under section 81, a transferred member's accrued pension amount (calculated without ancillary benefits) cannot be reduced by more than 15%. This restriction is not applicable to sale of business transactions under section 80.

If a member is credited with less service in the successor plan than the member had in the original plan, the successor plan must allow the member to purchase the additional past service within a reasonable time after regulatory consent to the asset transfer is received.

Transfers from plans that cannot reduce accrued benefits into plans that can reduce accrued benefits are prohibited. For example, this would disallow transfers from a traditional single employer plan to a multi-employer pension plan.

Funding requirements

The regulations include a formula for determining the amount of assets to be transferred. The amount is a share of solvency assets (including letters of credit) proportionate to the solvency liabilities to be transferred, and includes a proportionate amount of solvency surplus. To that amount there is added a proportionate share of special payments (solvency and going concern) made between the effective date of the transfer and the date on which the transfer is made.

An asset transfer must satisfy at least one of two conditions:

1. After the transfer, the successor plan has a solvency ratio of 0.85 (for section 80 sale of business) or 1.00 (for section 81 successor plans); or
2. After the transfer, the solvency ratio of the successor plan is not reduced by more than 0.05 below the solvency ratio of each of the original plan and the successor plan before the transfer.

If an asset transfer results in a new going concern unfunded liability or a new solvency deficiency in the successor plan, special payments must be made following the normal funding rules.

If the original plan or the successor plan files a funding valuation with a review date after the effective date of an asset transfer but before the date consent is granted, the report must disclose the amount of assets and liabilities to be transferred on a going concern and a solvency basis.

The PBA will provide that the Superintendent can waive funding requirements in prescribed circumstances. However, the draft regulation does not include a provision for the prescribed circumstances, therefore they do not allow for any waiver.

When applying for consent, the original plan and the successor plan must both file valuation reports, as of the effective date of the asset transfer, that contain the information normally required in a funding valuation. Additional required information includes:

- Going concern liabilities and assets, solvency liabilities and assets, solvency ratio and transfer ratio before and after the asset transfer;
- The amount of assets to be transferred;
- Required contributions before and after the asset transfer; and
- A statement by each plan administrator certifying that certain requirements are satisfied.

Process

The timeframes for completion of each stage of the transfer of assets are as follows:

- Notice to members, former members, retirees, unions and advisory committee is due within 90 days after the effective date;
- If the information changes, an updated notice to a union or advisory committee must be provided within a reasonable time;
- Where special notice is given to members for purposes of obtaining individual consent for a sale of business asset transfer under section 80 (see below), their response is due within no less than 90 days after the special notice date for a defined benefit asset transfer and within no less than 60 days after the special notice date for a defined contribution asset transfer;
- Application for the Superintendent's consent is due within 180 days after the effective date;
- The asset transfer must be effected within 60 days after the Superintendent's consent is granted; and
- Notice to the Superintendent of the completion of the asset transfer, together with a certificate of compliance and a cost certificate indicating the amount transferred, is due within 60 days after completion.

For sale of business transactions, the PBA will provide an option for plan administrators to make the transfer subject to individual member consent. If that approach is used, then the notice to members must provide information that allows them to compare their options. The PBA will provide that where the transfer is made with individual member consent, and where the prescribed requirements are met, the plan administrator of the original plan is entitled to a discharge on completion of the asset transfer. It is not clear what, if anything, this discharge adds to the general provision that after an asset transfer, members have no further claim against the original pension plan.

The transaction must comply with detailed requirements for notice to members and for information to be provided to the Superintendent with the application for approval. For example, notices to members must contain information that is similar to the information provided to them in annual statements. Members would receive notice from the original plan administrator and from the successor plan administrator, or the notices can be combined in certain circumstances. Documents to be provided to the Superintendent with the application include copies of notices, related plan amendments and the agreement between the plan administrators.

Defined contribution transfers

The rules for merger of defined contribution entitlements are simple, as expected. The amount in each individual account under the successor plan must be no less than the amount in each individual account under the original plan.

Trust rules

The PBA will provide that after the transfer, members have no further claim against the original pension plan and that the transferred assets cease to be identified as assets of the original plan. The PBA will also continue to provide that a successor plan is deemed to be a continuation of the original plan.

The new PBA and regulation establish a process in which the Superintendent will not consider trust issues. However, the PBA and regulation do not directly override member or employer rights and obligations that may be created by trust terms. It remains to be seen what effect the new provisions have on trust issues.

It will be important for parties to an asset transfer to know that the PBA was amended in 2010 to provide that on wind up of a successor plan, unless the successor plan and the original plan both provided for employer entitlement to surplus, the successor plan is deemed to provide for member entitlement.

Comment

Concerning details, the draft regulation requires refinement, and the consultation process can be expected to identify flaws and omissions. For example, the calculation of the asset transfer amount should provide for adjustments for fund return and benefit payments made after the effective date. The provisions for the Superintendent’s waiver of funding rules should be completed.

Concerning the big picture, it will facilitate transactions to have trust issues set aside for purposes of regulatory consent. It was reasonable to expect the funding rules to protect benefit security, and the ability to merge plans with a 0.05 change in solvency ratio adds a modest level of flexibility. Whether the prescribed level of change provides adequate protection or adequate flexibility should be considered by stakeholders during the consultation period. The alternate test that requires 100% solvency in the successor plan for same employer mergers but 85% for sale of business mergers seems inequitable toward members. Whatever the right level of protection is, it should be the same for all affected members.

The big innovation is the ability to change past service benefits, subject to protection of the commuted value. This is not a simplifying measure. It is doubtful that this will serve to facilitate transactions given the complexity of the individual calculations that would be necessary. On the other hand, there will be transactions in which this is a valuable option despite the effort required.

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