

COMMUNIQUÉ

NEW FEDERAL PENSION REGULATIONS RELEASED FOR COMMENT

On September 19, 2014 the federal Minister of State (Finance) released proposed regulations (Proposed Regulations) under the federal *Pension Benefits Standards Act, 1985* (PBSA). After publication in the Canada Gazette on September 27, 2014 there is a 30-day public comment period. The Proposed Regulations follow through on several measures that were included in Bill C-9 and Bill C-47 both of which were tabled in 2010, and also contain some new measures. All measures included in the Proposed Regulations are to come into force on a date to be fixed by proclamation. There is no indication in the government's explanatory materials of an intended in force date.

Permitted Investments

The 10% limit on investment of a plan's assets in a single entity and the restrictions on investment in a related party are significantly changed. In addition the defined term "public exchange" is replaced with the term "marketplace" so that the definition encompasses various trading systems. The term "investment fund" is created to replace "mutual fund" and "pooled fund".

The 10% Single Entity Rule

The current 10% concentration rule is based on book value. The Proposed Regulations will base this test on market value. It is made clear that the 10% limit applies to combined debt and equity with a single entity, and that the rule applies separately to each defined contribution (DC) account for which the member directs investment (a "member choice account").

The Related Party Rule

The current related party rules prohibit investment in a related party, including an employer who contributes to the plan, subject to specific exemptions. One of the current exemptions is that the plan can invest (subject to any other restrictions) in securities of a related party if the securities are purchased on a public exchange. Another is that nominal or immaterial transactions may be made. Both of these exemptions are removed.

The Proposed Regulations will only permit investment in a related party if the investment:

- Is an investment fund or a segregated fund in which other investors can and do invest, and that complies with the general investment rules and the rules applicable to member choice accounts;
- Is an unallocated general fund of an authorized life insurance business in Canada;
- Is a security issued or fully guaranteed by the Government of Canada, of a province or an agency of same;
- Is a fund comprised of mortgage-backed securities that are fully guaranteed by the Government of Canada, of a province or an agency of same; or
- Involves the purchase of a contract or agreement in respect of which the return is based on the performance of a widely recognized index of a broad class of securities traded at a marketplace.

The Proposed Regulations will allow an administrator to engage the services of a related party for plan administration by means of a transaction under market terms and conditions.

There will be a five year period for achieving compliance with the changes to the related party rules.

Measures for DC Provisions

Variable DC Benefits

Under the PBSA it will be possible to pay variable benefits directly from DC provisions to members who have terminated employment and reached retirement age, subject to the consent of a spouse or common-law partner. A member (or survivor receiving variable benefits) is entitled once each year, or more frequently if the plan permits, to transfer the account balance from the plan under standard portability options.

The variable benefit calculation is prescribed by the Proposed Regulations. The annual variable payment amount that can be withdrawn is subject to a minimum and a maximum, consistent with the rules that apply to a life income fund. If the member fails to elect, the minimum amount will apply by default. After age 90 there is no maximum.

Disclosure for Member Choice Accounts

Provisions of the PBSA will state explicitly that a pension plan can give investment choice to individuals who have DC accounts. Under the Proposed Regulations these DC accounts are called "member choice accounts".

Under the Proposed Regulations disclosure to members who hold a member choice account must include a description for each investment option that indicates:

- its investment objective;
- the type of investments and the degree of risk associated with it;
- its top 10 holdings by market value;
- its performance history;
- that its past performance is not necessarily an indication of its future performance;
- the fees, levies and other charges associated with it that reduce return on investments expressed as a percentage or a fixed amount; and
- its target asset allocation.

The statement must also describe how the person's funds are currently invested and indicate any timing requirements that apply to making an investment choice.

It will not be necessary to address member choice accounts in a pension plan's statement of investment policies and procedures.

Electronic Communications

The PBSA will provide a set of rules to allow administrators to use electronic methods in order to provide required information to plan members and others. Items such as annual statements and benefit option forms will be eligible. Under the PBSA the use of electronic means is subject to the revocable consent of the recipient. The recipient will designate an "information system" for receipt of the information, to which the electronic document must be provided. The information must be capable of being retained by the recipient.

The Proposed Regulations outline the requirements for valid electronic delivery of documents. A recipient's consent may be given in writing (on paper or electronically) or orally. When asking for a recipient's consent a plan administrator must notify the recipient of the right to revoke consent at any time, of the recipient's responsibility to provide updated information relating to the information system and of the date when consent takes effect. When a document is posted on a generally accessible information system, the administrator must provide written notice (on paper or electronically) of the document's availability and location. Delivery is considered to have occurred when entered into or made available on the information system. However, if the administrator has reason to believe that an intended recipient has not received the document or notice, a paper copy shall be mailed (but will still be considered to have been provided when entered or made available).

Process, Forms and Annual Statement Content

Annual Statements for Inactive Members

The PBSA will require plan administrators to provide an annual statement to former members and their spouse or common-law partner.

Under the Proposed Regulations this annual statement for inactive members must show the former member's name, the period covered by the statement, the name of the spouse or common-law partner on record and the name of the designated beneficiary on record. No other information specific to the individual is required. For a defined benefit (DB) plan with a solvency ratio less than one, the statement must provide the plan's solvency ratio with an explanation, as is already required for active member statements.

New Annual Statement Content Requirements

There are new content requirements for annual statements provided to active and inactive members and their spouse or common-law partner.

Annual statements for all DB plans must include the plan's solvency ratio (whether above or below one) and:

- The valuation date for the solvency ratio and the date of the next valuation;
- The total employer payments made to the plan for the plan year; and

- The total value of solvency assets and solvency liabilities of the plan on the valuation date.

With respect to DB or DC assets that are not held in DC member choice accounts, annual statements must include:

- A list of the top 10 largest asset holdings based on market value, each expressed as a percentage of the total assets; and
- The asset allocation expressed as a percentage of the total assets.

(Holders of member choice accounts receive this information along with other disclosure specific to them.)

If a member is receiving DC variable benefits, details must be provided including the date of birth used to determine the minimum benefit, the minimum and maximum benefit, the amount the member is receiving and the payment frequency, information about changing elections and a list of portability transfer options.

Spouse Consent for Portability Transfers and Variable DC

The PBSA requires the consent of a member's spouse or common-law partner if a member elects portability. (The regulator has indicated that compliance will not be required until the prescribed form becomes available.) The PBSA will also require the consent of a member's spouse or common-law partner if a member elects to receive variable DC benefits.

The Proposed Regulations create new forms for this purpose. The new forms explain to the spouse or common-law partner that the member will be able to withdraw funds and that there is no requirement that the funds be used to purchase a life annuity. A consenting spouse or common law partner acknowledges that the amount available to him or her may be significantly reduced if the maximum is withdrawn each year or investment performance is poor. A consent form cannot be signed in the presence of the member and must be witnessed.

Standard Portability Options Include Transfer to a PRPP

Transfer to a pooled registered pension plan (PRPP) is added to the list of prescribed retirement savings arrangements to which a member who is eligible to take a portability option may transfer his or her entitlement.

Revised Prescribed Forms

The option to transfer to a PRPP is added to the prescribed application form for portability transfers. The forms for termination of employment, retirement, death and plan termination will show the solvency ratio whether or not it is below one (currently it is shown only if below one). There are also various housekeeping changes in some of the prescribed forms.

New forms are created for pension plan termination. One is a notice to be provided to members within 30 days after plan termination and the other is a benefit statement, very similar to a termination or retirement statement, that is to be provided within 120 days after plan termination. The PBSA provides that these deadlines can be varied by the Superintendent.

Negotiated Contribution Plans

The PBSA establishes a definition for a negotiated contribution pension plan (NCP). An NCP is a DB plan where the employer contribution is fixed by agreement, statute or regulation. These plans may reduce benefits with the Superintendent's consent despite plan terms to the contrary. The Proposed Regulations require the information booklet for an NCP to describe the funding arrangement including an indication that benefits may need to be reduced if contributions are insufficient to meet solvency standards. Annual statements must also include this information.

Pooled Registered Pension Plan

Regulations under the *Pooled Registered Pension Plans Act* (PRPPA) will be changed for harmonization with the regulations under the PBSA. The maximum benefit payment for variable DC and life income funds under the PBSA will be replicated under the PRPPA.

The member option to transfer funds from a PRPP to a restricted locked-in savings plan will be removed, consistent with the PBSA rules. This will ensure that the member retains the potential to unlock up to 50% of their holdings from a restricted life income fund.

Measures Not Included

Only a few measures from the 2010 pension reform bills remain unaddressed. These include:

- Designation of an entity to hold assets related to the pension entitlements of persons who cannot be located;
- DC investment rules that, if followed, are intended to protect a plan administrator (known as the safe harbour rules);
- A framework for use of electronic signatures by plan members.

Comment

Changes to the investment rules will have broad application, as the pension standards legislation of Alberta, British Columbia, Manitoba, Ontario and Saskatchewan will incorporate the federal rules automatically, as amended. Two issues stand out. First, the removal of an employer's ability to invest in a related party if the securities are purchased on a public exchange will not be welcomed by employers who are using that exemption, notwithstanding the five year grace period for compliance. Second, the move to market value for the 10% limit on investment in one entity is understandable in principle but is incomplete. Market value provides a more accurate view of the actual level of investment at a given point in time than book value provides. However, rules will be needed to address the frequency of monitoring, and what must happen, and when, if the value of the investment increases above 10%. Affected parties should make good use of the opportunity to comment to ensure that something workable is achieved.

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