Consultation Paper on Proposed Changes to Funding and Asset Allocation Rules Under a Future Agreement Respecting Multi-jurisdictional Pension Plans

July 2017

Introduction

The Canadian Association of Pension Supervisory Authorities (CAPSA) is a national inter-jurisdictional association of pension regulators whose mission is to facilitate an efficient and effective pension regulatory system in Canada. It develops practical solutions to further the coordination and harmonization of pension regulation across Canada.[1]

One of CAPSA's strategic priorities is to support the adoption and implementation of an agreement respecting the regulation of multi-jurisdictional pension plans by all Canadian jurisdictions with pension legislation.

A multi-jurisdictional pension plan is a pension plan that has members in more than one jurisdiction in Canada, resulting in the plan being subject to more than one jurisdiction's pension legislation. There are over 2,000 multi-jurisdictional pension plans in Canada with more than two million members across the country.

The regulation of multi-jurisdictional pension plans is currently subject to a patchwork of agreements between different jurisdictions in Canada, which results in complexity and legal uncertainty about how such plans are to be regulated in some areas.

In 2016, the governments of British Columbia, Nova Scotia, Ontario, Quebec and Saskatchewan signed the 2016 Agreement Respecting Multi-jurisdictional Pension Plans (2016 Agreement), which was prepared by CAPSA and clarifies how each participating government's pension legislation must be applied to the multi-jurisdictional pension plans that operate in their jurisdictions. The 2016 Agreement helps to streamline the rules that a multi-jurisdictional pension plan must follow by providing that only the requirements of the jurisdiction in which the plurality of active plan members are employed will be applied to key aspects of the plan's operations throughout the jurisdictions covered by the agreement,[2] and by establishing rules which could only be effectively implemented through an agreement between those jurisdictions.[3]

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[1] For more information about CAPSA, please visit CAPSA's website at www.capsa-acor.org.

[2] Under the 2016 Agreement (as with the other existing inter-governmental pension agreements in Canada), a multi-jurisdictional pension plan is registered solely with the pension regulator for the jurisdiction in which the plurality of active plan members are employed. That pension regulator becomes the "major authority" for the plan, and the 2016 Agreement provides that the major authority's pension legislation will apply to the plan and its members instead of any other applicable pension regulator's legislation in certain key areas, such as the funding rules applicable to the plan and the duties of the plan administrator (although some exceptions and modifications respecting the application of the major authority's pension legislation will apply in certain areas).

[3] For example, the assets of a multi-jurisdictional pension plan might have to be divided (at least notionally) between the jurisdictions that have members in the plan due to a major plan event (such as a plan split or the wind up of the plan). Such a division and allocation of plan assets allows the specific legislative requirements of each relevant jurisdiction to be applied to the plan assets and liabilities that relate to each jurisdiction (for example, differing legislative rules for funding a plan wind up deficit, different rules for reducing members' benefits where the employer is insolvent on plan wind up, etc.).

In particular, the 2016 Agreement sets out rules for determining which jurisdiction's pension legislation will govern the funding of an ongoing multi-jurisdictional pension plan's benefit liabilities, as well as rules for how the assets of such a plan are to be divided and allocated between jurisdictions upon the occurrence of major plan events (such as a plan split or the wind up of the plan).

Towards a Future Agreement Respecting Multi-jurisdictional Pension Plans

The 2016 Agreement was based on an earlier Agreement Respecting Multi-jurisdictional Pension Plans (2011 Agreement) that came into effect between Ontario and Quebec in 2011. While improving upon the previous inter-governmental agreements that they replaced, the requirements of the 2011 Agreement and 2016 Agreement were largely conceived at a time when the pension legislation of Canadian governments generally required that ongoing defined benefit pension plans[4] be funded on both a going concern basis and a solvency basis.[5]

Recently, however, Quebec amended its pension legislation to eliminate solvency funding requirements altogether for all defined benefit pension plans (while strengthening its going concern funding requirements), other jurisdictions have amended their legislation to take a similar approach for certain kinds of pension plans, and Ontario has announced that it will be amending its legislation to reduce solvency funding requirements for defined benefit plans that are at least 85% funded on a solvency basis (while also strengthening Ontario's going concern funding requirements).

Rules for allocating a multi-jurisdictional pension plan's assets between jurisdictions in such cases could only be effectively implemented if the rules were set out in an agreement covering all of the affected jurisdictions, or if each affected jurisdiction had the same legislative rules for carrying out such an allocation.

[4] For the purposes of this Consultation Paper, a defined benefit pension plan is a pension plan that defines the ultimate pension benefit payable to a plan member at retirement age in accordance with a formula (usually based on years of service, earnings, on a flat rate, etc.). This includes plans where the pension benefit so defined can be reduced in future due to the funded status of the plan (as is permitted under some pension legislation for certain multi-employer pension plans and target benefit pension plans).

[5] Requiring a defined benefit pension plan to be funded on a going concern basis means that, when calculating the value of the assets and liabilities of the plan and the contribution amounts required to fund the plan, the actuary making those calculations must assume the plan continues indefinitely and never winds up. On the other hand, when calculating the plan's assets, liabilities and contribution requirements on a solvency basis, the actuary must assume the plan is wound up on the relevant calculation date. In recent years, economic conditions have meant that the solvency basis calculation has generally produced plan contribution requirements that are significantly higher (and often more volatile) than those calculated using a going concern basis. These higher and more volatile contribution requirements, while providing a degree of benefit security to pension plan members, have led many employers to view defined benefit plans as increasingly unaffordable.

When CAPSA announced the adoption of the 2016 Agreement, CAPSA noted that the agreement was negotiated as an interim measure while CAPSA completes a future agreement that is intended to be signed by all Canadian governments with pension legislation, and which will address the issue of changing pension plan funding regimes across jurisdictions. CAPSA also committed to holding a public consultation on any such future agreement.

Current Funding and Asset Allocation Rules Under the 2016 Agreement

The 2016 Agreement requires that an ongoing multi-jurisdictional pension plan be funded, for the most part, in accordance with the requirements of the pension legislation of the major authority[6] for the plan instead of the pension legislation of any minor authority[7] for the plan.[8] However, that agreement also provides for some modifications to this general approach. For example, if a particular kind of benefit is not required to be funded under the major authority's legislation, but is required to be funded under a minor authority's legislation, then that benefit must be funded for the plan members employed in that minor authority's jurisdiction (although the manner in which that benefit will be funded for the minor authority members must be consistent with the way in which other benefits are required to be funded under the major authority's legislation).[9]

With respect to the allocation of a multi-jurisdictional pension plan's assets between jurisdictions when a major plan event occurs, the 2016 Agreement applies a multi-tiered priority approach. Under this approach, plan assets are first allocated between jurisdictions to cover any defined contribution benefits owed to plan members. If the plan also has defined benefit liabilities, plan assets are next allocated to cover the value of certain kinds of defined benefits offered by the plan to all members across all jurisdictions, before any plan assets are allocated to cover other kinds of defined benefits that may only be offered to the members of some jurisdictions but not others. However, if a jurisdiction's pension legislation does not require certain kinds of defined benefits to be funded on a solvency basis, then plan assets will only be allocated to cover those defined benefits for that jurisdiction after plan assets have first been allocated to cover the defined benefits of all other jurisdictions whose legislation requires those benefits to be funded on a solvency basis.[10]

[6] The "major authority" for a multi-jurisdictional pension plan under the 2016 Agreement is the pension regulator with which the plan is registered – see note 2 above.
[7] A "minor authority" for a multi-jurisdictional pension plan under the 2016 Agreement is any pension regulator (other than the major authority for the plan) whose pension legislation applies to the plan due to the plan having members or other beneficiaries that are subject to the minor authority's pension legislation.
[8] This general approach is set out in section 6 of the 2016 Agreement and paragraph 6 of section 1 of Schedule B to that agreement.
[9] See section 6(2)(a) of the 2016 Agreement for this example. Other modifications to the general approach of applying only the major authority's pension legislation to the funding of an ongoing multi-jurisdictional pension plan can be found in section 6 of that agreement.
[10] See section 13 of the 2016 Agreement for the multi-tiered priority approach. Sections 10 to 17 of that

This tiered asset allocation approach was developed by CAPSA at a time when all jurisdictions generally required defined benefit pension plans to be funded on a solvency basis. Since some jurisdictions have eliminated solvency funding requirements for those plans, however, the asset allocation rules under the 2016 Agreement are no longer appropriate and require modification for the future agreement that will replace the 2016 Agreement.

Options for Funding and Asset Allocation Rules Under the Future Agreement

CAPSA is currently developing a future agreement respecting multi-jurisdictional pension plans (Future Agreement) to respond to the changes in pension plan funding rules noted above. The Future Agreement is intended to replace the 2016 Agreement and be signed by all governments in Canada that have pension legislation.

The two most significant elements of the Future Agreement that could differ from the 2016 Agreement are the rules for how a multi-jurisdictional defined benefit pension plan must be funded while it is ongoing, and the rules for allocating the assets of the defined benefit plan between jurisdictions when a major plan event occurs. These two elements are linked and CAPSA has developed the following two broad options for addressing them.

Option 1 – Major Authority Focus

Funding Rules – The approach to pension plan funding under Option 1 is broadly similar to the 2016 Agreement. For the funding of a multi-jurisdictional defined benefit plan while it is ongoing, Option 1 would, as a starting point, apply the requirements of the pension legislation of the major authority for the plan instead of the pension legislation of any minor authority. However, if a particular kind of benefit would not be required to be funded under the major authority's legislation, but would be under a minor authority's legislation, then that benefit would have to be funded for the plan members employed in that minor authority's jurisdiction (although the manner in which that benefit would be funded for the minor authority members would have to be consistent with the way in which other benefits are required to be funded under the major authority's legislation).

agreement also contain many additional rules that affect the asset allocation. For example, section 14(4) of the agreement provides that if a jurisdiction's pension legislation is amended after January 1, 2014, to permanently remove a defined benefit solvency funding requirement (such as occurred for Quebec effective January 1, 2016), the defined benefit liabilities for that jurisdiction which have been accrued up to the effective date of the jurisdiction's legislative amendment will be deemed, for the purposes of the asset allocation rules under the 2016 Agreement, to be subject to a solvency funding requirement in that jurisdiction.

Asset Allocation Rules – For the allocation of a multi-jurisdictional defined benefit plan's assets when a major plan event occurs, Option 1 would allocate the plan's assets pro-rata to the plan's defined benefit liabilities related to each applicable jurisdiction. A jurisdiction's defined benefit liabilities would be those related to the jurisdiction that are required to be funded in any way (whether on a solvency, going concern or other basis) under the pension legislation of the major authority or the requirements of the Future Agreement.[11]

Option 2 – Potential Minor Authority Recognition

Funding Rules – Option 2 for the funding of a multi-jurisdictional defined benefit plan while it is ongoing would, like Option 1, apply the requirements of the pension legislation of the major authority for the plan instead of the pension legislation of any minor authority for the plan as a starting point, but would also require additional funding under certain circumstances. Like Option 1, if a particular kind of benefit would not be required to be funded under the major authority's legislation, but would be under a minor authority's legislation, then that benefit would have to be funded for the plan members employed in that minor authority's jurisdiction (although the manner in which that benefit would be funded for the minor authority members would have to be consistent with the way in which other benefits are required to be funded under the major authority's legislation).

Option 2 differs from Option 1 (and the 2016 Agreement) in that it would include an additional funding requirement in situations where the major authority's pension legislation would not require the pension plan's defined benefits to be funded on a solvency basis, but a minor authority's pension legislation would require such funding if the plan were registered with that minor authority. In such circumstances, an additional liability would have to be calculated under Option 2 and funded based on the plan's defined benefit liabilities related to that minor authority. The purpose of calculating this additional liability would be to generate additional plan funding in relation to those minor authority liabilities, in recognition of the fact that additional solvency funding would have occurred (at least in current economic conditions) for those minor authority liabilities had the plan been registered with that minor authority.

The amount of the additional liability related to a minor authority's defined benefits would be calculated by using a factor to gross up the value of the minor authority's benefit liabilities as they have been calculated under the major authority's pension legislation. This factor would be designed to account for the difference in funding that would be generated in relation to those benefits while the plan is ongoing under the minor authority's solvency funding requirements compared to the major authority's

[11] Additional rules affecting the asset allocation, like those found in the 2016 Agreement, would apply as well (for example, situations where a full asset allocation can be avoided by a plan, where new plan liabilities are not (or not fully) counted for purposes of the asset allocation, where there are insufficient assets to cover all plan liabilities, etc.).

funding requirements. The grossed up amount related to the minor authority's defined benefit liabilities would then be funded in accordance with the major authority's legislation.

As part of Option 2, CAPSA is considering whether the requirement to calculate the additional liability should only be applied in certain circumstances, such as only when both of the following conditions apply:

- the defined benefit plan's assets at market value equal less than 95% of the plan's total defined benefit liabilities calculated on a solvency basis, and
- the combined defined benefit liabilities of the plan members related to all of those minor authorities that would require the plan to be funded on a solvency basis (if the plan were registered with such a minor authority) equal at least 10% of the plan's total defined benefit liabilities calculated on a solvency basis (all without regard to any additional liability that could be calculated for the plan under Option 2).

Asset Allocation Rules – For the allocation of a multi-jurisdictional defined benefit plan's assets when a major plan event occurs, Option 2 would allocate the plan's assets pro-rata to the plan's defined benefit liabilities related to each applicable jurisdiction. A jurisdiction's defined benefit liabilities would be those related to the jurisdiction that are required to be funded in any way (whether on a solvency, going concern or other basis) under the pension legislation of the major authority or the requirements of the Future Agreement. So far, this approach to asset allocation rules is similar to that under Option 1.

However, Option 2 would also adjust a jurisdiction's defined benefit liabilities upward for the purposes of the asset allocation if any additional funding was required in relation to that jurisdiction's defined benefit liabilities in the last 10 years, roughly in proportion to the amount of additional funding required by the approach to funding rules under Option 2.[12]

[12] Additional rules affecting the asset allocation, like those found in the 2016 Agreement, would apply as well (for example, situations where a full asset allocation can be avoided by a plan, where new plan liabilities are not (or not fully) counted for purposes of the asset allocation, where there are insufficient assets to cover all plan liabilities, etc.).

Additional Issue Under Consideration for Both Option 1 and Option 2

Since the pension legislation in some Canadian jurisdictions has been amended to eliminate or modify solvency funding requirements for defined benefit pension plans, an issue arises with respect to certain kinds of defined benefits that can generate significant funding costs when valued and funded on a solvency basis, but that potentially result in lower funding costs when valued and funded on solely a going concern basis. For example, consent benefits[13], plant closure benefits[14] and some subsidized early retirement benefits (including grow-in[15] benefits) can result in significant solvency funding costs while a pension plan is ongoing if the plan is required to fund such benefits on a solvency basis. However, the potential cost of these benefits if the plan were to wind up may not be recognized and funded while the plan is ongoing if the plan is only subject to going concern funding requirements.

For both Option 1 and Option 2 described above, CAPSA is considering how these kinds of benefits should be addressed in the funding and asset allocation rules under those options. Two methods for addressing these benefits include:

- Modifying the proposed funding rules under both Option 1 and Option 2 to require additional funding for these kinds of benefits in situations where the major authority's pension legislation would not require these benefits to be funded on a solvency basis. In doing so, no modifications to the proposed asset allocation rules under either Option 1 or Option 2 would be required since the asset allocation would, under both options, be based on higher benefit liability amounts that include these kinds of benefits.
- Modifying the proposed asset allocation rules under both Option 1 and Option 2 to introduce priority asset allocation tiers in situations where the major authority's pension legislation would not require certain benefits to be funded on a solvency basis. Under such tiers, plan assets would only be allocated to cover the costs of these benefits after assets have first been allocated to cover other higher priority

[13] A consent benefit is a benefit that is only payable to a pension plan member if the employer or plan administrator consents to grant the benefit.

[14] Plant closure benefits are benefits that are only payable to pension plan members if all or a significant portion of the business carried on at a specific location by the employer that sponsors the plan is discontinued.

[15] In Ontario, "grow-in" benefits arise under the application of section 74 of the Ontario Pension Benefits Act and can apply when the employment of an Ontario member of a defined benefit pension plan is terminated involuntarily in certain situations or if the member's plan is wound up. In such circumstances, if the member's age plus years of service equals at least 55, the member's service will be deemed to continue, for the purposes of any age-related or service-related eligibility requirements that must be satisfied to receive early retirement benefits under the plan, until the age or service requirements have been met in relation to the member. This "grow-in" requirement can increase the value of the terminated member's benefits beyond that which the plan terms otherwise would have provided, since the member would not necessarily have obtained the actual years of service or age necessary to become eligible for those early retirement benefits in the absence of the grow-in requirement.

benefit liabilities. In doing so, no modifications to the proposed funding rules under either Option 1 or Option 2 would be required.

Discussion of the Options

Option 1 would be simpler for multi-jurisdictional pension plans in Canada to implement and administer compared to Option 2. Option 1 also appears more consistent with the overall approach of the 2016 Agreement, which is intended to clarify and simplify the regulation of multi-jurisdictional pension plans by applying the pension legislation of the major authority to the entire multi-jurisdictional plan and its members for certain key aspects of the operation of such plans.

Option 1 would mean, however, that where a pension plan is registered with a major authority that does not require defined benefits to be solvency funded, plan members outside the major authority’s jurisdiction would have their defined benefits funded at a potentially much different level (either higher or lower depending on a variety of factors) than would occur if the plan were subject to their own jurisdictions’ funding rules. Under current economic conditions, if the major authority’s pension legislation does not require solvency funding for the defined benefits provided by the plan, any plan members in jurisdictions that do require solvency funding for defined benefits would likely have their benefits funded to a lesser degree than if their own jurisdictions’ solvency funding rules had applied to their plan. Such a result could be seen as lowering the benefit security of these members outside of the major authority’s jurisdiction, since the general goal of solvency funding requirements is to generate sufficient funding to pay for all of the plan’s defined benefit liabilities if the plan has to be wound up (whereas a defined benefit plan that has been funded solely on a going concern basis would be unlikely, in current economic conditions, to have sufficient assets to cover all of its benefit liabilities if the plan were to wind up with an insolvent employer that could not provide any further funding to the plan). On the other hand, some observers might suggest that it is appropriate in such unfortunate circumstances to treat all members of the same plan the same way regarding the security of their benefits, which is the result that Option 1 would produce.

Option 2, meanwhile, would potentially require additional funding in relation to members outside the major authority’s jurisdiction if the major authority did not require solvency funding of defined benefits, but the members’ own jurisdictions did require such funding. Such additional funding while the plan is ongoing, and an appropriate corresponding recognition of such additional funding in the Future Agreement’s rules for allocating plan assets among jurisdictions, would provide additional benefit security to members outside the major authority’s jurisdiction in the event that their pension plan must be wound up with a funding deficit that cannot be paid by the employer.

However, it would be reasonable to expect that any method that is chosen under Option 2 for calculating and funding an additional liability amount related to defined benefit liabilities outside of the major authority's jurisdiction will involve added complexity, and would therefore be more difficult than Option 1 for pension plan administrators and actuaries to implement. Finally, should the pension plan be wound up with an insolvent employer that cannot provide further funding, Option 2 would result in members of the same plan being treated differently based on the jurisdiction of their employment.

Questions for Consideration

1. Is one option described in this Consultation Paper preferable to the other? If so, which one and why?

2. Are there advantages and disadvantages to either option that have not been described in this Consultation Paper? If so, what are they?

3. Is one method described in this Consultation Paper for addressing defined benefits that generate significant funding costs when valued and funded on a solvency basis, but lower funding costs when valued and funded on a going concern basis, preferable to the other? If so, which one and why?

4. Are there other options and methods that CAPSA should consider for the multi-jurisdictional pension plan funding and asset allocation rules under the Future Agreement?

How to Participate in this Consultation

Submissions (electronic are preferred) on this Consultation Paper may be directed to the CAPSA Secretariat:

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Submissions must be received by **August 31, 2017**.

All submissions received will be publicly released on the CAPSA website at the end of the consultation period. Any questions regarding this Consultation Paper may be directed to the CAPSA Secretariat at the contact information noted above.

Please note that this Consultation Paper does not reflect the official position of any provincial or federal government or agency.