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Ontario Updates on Pension Plan Funding Rules

On May 19, 2017, the government of Ontario introduced their long-awaited changes to the framework for funding of defined benefit pension plans. The legislation will be introduced this fall with consultations planned before finalizing regulations. The announced changes apply to single employer defined benefit pension plans with valuation dates on and after December 31, 2016. Changes to funding rules for multi-employer pension plans and jointly sponsored pension plans are still to be announced.

In the short term, the government will enact measures to assist plan sponsors who are required to file a valuation report on or after December 31, 2016 and before December 31, 2017. These measures will help plan sponsors that would have otherwise faced new solvency funding requirements in 2017.

Background

In its 2015 Ontario Economic Outlook and Fiscal Review, the government announced its plan to review the current solvency funding framework for defined benefit pension plans under the Ontario Pension Benefits Act. The 2016 Ontario budget announced further details of the solvency funding review. A consultation paper entitled Review of Ontario's Solvency Funding Framework for Defined Benefit Pension Plans was subsequently released in the summer of 2016. Following feedback from pension stakeholders, the Ontario government announced the following changes to the funding framework for defined benefit plans.

Summary of Key Funding Changes

- Pension plan funding will be based on an enhanced going concern funding basis, unless the plan has a solvency ratio below 85%. Solvency funding will be required for plans with a solvency ratio below 85%.
- Unfunded going concern shortfalls will be consolidated into a single schedule and amortized over a 10-year period (vs. the current 15-year amortization period and layered funding schedules).

- The enhanced going concern funding basis will require a new funding reserve known as a Provision for Adverse Deviation (PFAD).
- To enhance member security, guarantees on member pensions in cases of plan bankruptcy will be increased to $1,500 per month from $1,000 by the Pension Benefits Guarantee Fund (PBGF).

What This Means for Plan Sponsors

Depending on the pension plan's current financial status, the new funding rules may represent a potential contribution savings for the plan sponsor. The focus on going concern funding would require plan sponsors to revisit some of their long-held approaches to pension plan funding and investing. For example, plan sponsors may need to review:

- Existing government and funding policies
- Actuarial assumptions for going concern funding
- Investment policies
- Results of any recent asset liability management study
- De-risking glide paths

If a plan sponsor's funding policy and the relevant investment policy were geared towards the plan becoming fully funded on solvency measure, the new funding rules may have some plan sponsors revisiting this approach. However, with increased PBGF pension coverage, this will mean higher PBGF premiums.

Other Changes

- The government has proposed to provide plan sponsors with the ability to discharge their pension obligations if annuities are purchased from an insurance company or other financial institution licensed to sell them. This change may encourage plan sponsors to consider more seriously the annuity purchase option as a full liability discharge is now available.
- The government is also introducing new rules on a plan sponsor's ability to take contribution holidays and fund benefit improvements.
- Similar to other jurisdictions, plan sponsors will also be required to create new funding and governance policies.
- The Ontario government indicated it will be reviewing the rules governing the wind-up of defined benefit plans and studying a proposal to establish an agency to administer pension benefits of wound-up plans on an ongoing basis.

In Closing

Detailed regulations are set to be published so we don't know the exact mechanics of the new funding framework. In the government's view, the proposed changes represent an important step in enhancing the long-term viability of defined benefit pension plans in Ontario and providing benefit security for members. In line with other Canadian jurisdictions, the government recognizes that the existing solvency funding rules required a significant update to make these plans sustainable in the long run.

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