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Ontario Pension Benefits Act Amended to Provide a Discharge for Buy-out Annuity Purchases Effective July 1, 2018

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De-risking of defined benefit ("DB") pension plans has been an important topic for Canadian employers and pension plan administrators in recent years. The use of "buy-out annuities" is one of the de-risking strategies available while a pension plan is ongoing. Very generally, a buy-out annuity purchase is a transaction pursuant to which a licenced insurance company assumes the obligation of an ongoing DB pension plan to provide pensions to particular retirees, former members and/or surviving spouses.

Although the Ontario *Pension Benefits Act* (the "PBA") has permitted plan administrators to purchase buy-out annuities for ongoing plans for many years, interest in such transactions may have been dampened due to the fact that the PBA does not discharge the pension plan administrator from liability for the annuitized benefit payments in the event the insurance company fails to make those payments. The "problem" has been that, in the absence of a discharge, the relationship between the plan, on the one hand, and retirees, former members and/or surviving spouses for whom annuities were purchased, on the other, was not severed. Plan administrators were required to continue to treat the underlying pension obligations as a continuing plan liability for actuarial valuation and Pension Benefits Guarantee Fund assessment purposes. Similarly, plan administrators have had to treat annuitants like other former members and retired members who have rights to biennial statements and access to Ontario's family law pension valuation system. In some cases, the possibility – however remote – that the insurance company could fail, with the result that liability for the annuitized benefits would "boomerang" back to the plan and, as a result, the sponsoring employer, impacted the accounting treatment for buy-out annuities.

After significant advocacy efforts by the pension industry to address these issues, the Ontario PBA was recently amended to provide a statutory discharge for administrators of single employer plans that purchase buy-out annuities to satisfy DB pension obligations. The discharge will apply if the conditions set out in section 43.1 of the PBA and O.Reg. 193/18 (the "Annuity Regulation") are satisfied. Notably, no discharge is available under the PBA in respect of annuity purchases for active plan members.

Ontario will become the third Canadian province to provide a statutory discharge for annuity purchases made in connection with ongoing pension plans. In this Sidebar, we review the new Ontario discharge that will apply to Ontario registered plans and buy-out transactions covering Ontario former members, retirees, and surviving spouses. There are differences between the new Ontario rules and those in effect in British Columbia and Québec.[1]

Discharge for Buy-Out Annuity Purchases Made After July 1, 2018

The PBA and Annuity Regulation set out specific detailed criteria that must be met in order for a plan administrator to obtain a discharge for a buy-out annuity purchase that is made after July 1, 2018, the date on which the new regime becomes effective.

Notice. The administrator must provide affected former members, retired members and spouses[2] with notice of the annuity purchase in accordance with the requirements of the Annuity Regulation. Advance notice prior to completing the annuity purchase is not required, but the new rules require more fulsome notice after the purchase than what is typically now provided to affected individuals.

The content of the notice varies depending on whether the annuity purchase is in respect of a former member, retired member or a spouse. Notice requirements include, among other things:

- a statement that the administrator has purchased the individual's pension and ancillary benefits, if applicable, from an insurance company and that benefits will remain the same;

- basic information about the insurance company from which the annuity was purchased, including contact information, the policy number, the date of the purchase, and the annuitant's individual certificate number;

- for former members, the amount of the pension and ancillary benefits a former member is entitled to receive upon early, normal and postponed retirement dates;

[1] This Sidebar does not address multi- jurisdictional issues, i.e., buy-out transactions involving retirees, former members and spouses who were employed in provinces other than Ontario. Please feel free to contact us directly if you have questions about such issues.

[2] i.e., Surviving spouses in receipt of a pension for whom annuities are purchased, and spouses entitled to a payment from a plan due to a division of property on a marriage breakdown for whom annuities are purchased.

- a statement that the administrator intends to file a certificate prepared by an actuary pursuant to the PBA to seek a discharge in respect of the buy-out annuity purchase (discussed below);

- a statement that, if the administrator is discharged, the annuitant will no longer be former member or retiree under the plan, as applicable, except in certain circumstances where the plan is would up and has a surplus; and

- a statement regarding the rights of the retiree or former member to surplus in the event that the plan is wound up.

Same Benefit. The annuity purchased from the insurance company must provide the same benefit as the former member, retired member, or spouse, as applicable, would have received from the pension plan had the annuity purchase not been made.

Content of the Annuity Contract. Under section 43.1 of the PBA and the Annuity Regulation, the annuity contract must, among other things, incorporate provisions of the PBA in respect of non-alienation of benefits, spousal priorities, division of pensions on marriage breakdown and death benefits. The annuity contract must also require the insurer to issue to each annuitant a certificate of insurance confirming the annuity purchase.

Most, if not all, of these Annuity Regulation requirements are already included in most insurers' standard form annuity buy-out insurance policies. Administrators will nevertheless need to closely review insurance contracts in the future to ensure that all of these requirements are met.

Funding Requirements. The Annuity Regulation imposes minimum funding requirements which are designed to ensure that a buy-out annuity purchase does not erode the security of benefits for the pension plan members, retirees and spouses for whom no annuity purchase is made.

- If, under the most recently filed actuarial valuation report before the buy-out annuity purchase, the plan's solvency ratio[3] is at least 1.0, then it must be at least 1.0 after the annuity purchase; and

- If the most recently filed actuarial valuation report shows a solvency ratio less than 1.0, then after the annuity purchase the solvency ratio must be the greater of 0.85 or the solvency ratio in the report.

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[3] To determine the solvency ratio for the purpose of the funding threshold, solvency assets include letters of credit held in trust for the pension plan.

If the solvency ratio of the pension plan on the day after the date of the buy-out annuity purchase is less than the required solvency ratio, the employer has 90 days to top up the pension fund to meet the requisite funding status.

Maintenance of Records. The Annuity Regulation also imposes record retention requirements relating to the purchase. The administrator must retain certain information including: the date of the purchase, details about the insurance company, the name and address of all annuitants, and all records necessary to determine the pension, deferred pension and ancillary benefits, if any, that would have been payable to each annuitant under the pension plan.

There is no formal approval process for obtaining a discharge after complying with the new rules. Instead, the PBA provides an administrator with a discharge under the PBA upon filing with the Superintendent of Financial Services (the "Superintendent") a certificate prepared and signed by an actuary certifying that the administrator has complied with the requirements of PBA. The administrator must also file a copy of the annuity contract, and a listing of the affected former members, retired members and spouses, as applicable.

Once the discharge is obtained, the individuals for whom the purchase was made are no longer considered former members, retired members or spouses, as applicable, for any purpose under the PBA, except in respect of surplus entitlement. If the pension plan is later wound up and has a surplus, the individuals for whom the annuity purchase was made will have the same rights to payment of surplus as they would have had if the pension plan was wound up on the date the purchase was made.

Discharge for Buy-Out Annuity Purchases Made Prior To July 1, 2018

Buy-out annuity contracts that were entered into prior to July 1, 2018 will also qualify for a discharge under section 43.1 of the PBA provided that the requirements of PBA and Annuity Regulation are met.

In relation to such past transactions, the PBA and Annuity Regulation generally require that the old transaction be brought into compliance with the new rules in order for the administrator to benefit from a statutory discharge. Annuities must provide the same benefits that were provided for under the plan, notices that meet prescribed requirements must be distributed to affected retirees, former members and spouses, and specified funding criteria must be met. However, the annuity contract is not required to satisfy all of the same content requirements that apply to buy-out annuities purchased after July 1, 2018. If an annuity contract is amended to meet the requirements of the Annuity Regulation and requires an additional premium, the funding requirements outlined above must be met at the date of the amendment; if no amendments to the annuity contract are required, the solvency ratio of the plan must be at least equal to 0.85 at the date of the actuarial valuation last filed with the Superintendent when the annuity certification from the actuary is filed.

Similar to the process that applies to annuity buy-out purchases made after July 1, 2018, an administrator is provided a discharge under the PBA upon filing a certificate prepared and signed by an actuary certifying that the administrator has complied with the requirements of PBA. The administrator must also file with the Superintendent a copy of the annuity contract, and a listing of the affected former members, retired members and spouses, as applicable.

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While the focus of this Sidebar is on compliance with the PBA requirements for a buy-out annuity discharge, pension plan administrators also need to ensure that the requirements of the *Income Tax Act* are satisfied and that the administrator's general fiduciary obligations are met through the annuity purchase process.

If you have any questions regarding this update please do not hesitate to call a sidebar with any of us – we're here to help.

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