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Pension and Benefit Highlights from Ontario's Budget 2019

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On April 11, 2019, Ontario's Progressive Conservative government released its first budget after winning a majority of seats in the Ontario Legislature in the 2018 Ontario general election. Titled "*Protecting What Matters Most*", Budget 2019 is accompanied by Bill 100, *An Act to implement Budget measures and to enact, amend and repeal various statutes* (Bill 100).

This Sidebar summarizes the aspects of Budget 2019 and Bill 100 that will be of interest to employers and pension plan administrators. It also summarizes two sets of draft regulations relating to ongoing pension reform initiatives – discharges for buy-out annuity transactions and defined contribution (DC) variable benefit provisions – which were also released for consultation on April 11, 2019.

Pension Initiatives

1. *Pension Plan Contribution Holidays*

Effective May 1, 2018, new section 55.1 of the *Pension Benefits Act* (Ontario) (PBA) regarding contribution holidays came into effect in conjunction with the introduction of new PBA funding rules. New section 55.1 explicitly allows employers to reduce or suspend normal cost contributions, including the PfAD on such contributions, if a plan has "available actuarial surplus" and provided that other prescribed requirements are met. Generally, available actuarial surplus is the lesser of (i) the excess of a plan's assets over the sum of its going concern liabilities and PfAD going concern cushion, and any prior year credit balance (PYCB),[1] and (ii) the amount by which the transfer ratio of a plan is greater than 1.05 (or the amount by which the solvency ratio of a plan is greater than 1.05 for a public sector pension plan).

New section 55.1 of the PBA raised a number of interpretation issues. By way of example, subsection 4(3) of Regulation 909 (the PBA General Reg) specifically contemplates that a PYCB may be applied to reduce future contributions otherwise

[1] A PYCB is an employer "overpayment" that arises if past contributions to a plan were in excess of the minimum contributions required under the governing actuarial valuation report.

required to be made to a plan by an employer under the PBA General Reg, including contributions for normal costs and PfADs.

The Financial Services Commission of Ontario (FSCO) interpreted section 55.1 of the PBA as an override to the ability to use a PYCB or, for plans subject to actuarial valuations filed prior to May 1, 2018 under the funding rules then in place, to permit contribution holidays if the plan would have otherwise qualified. This interpretation prohibited employers from applying a PYCB or from taking a contribution holiday to reduce normal cost contributions unless the plan also had available actuarial surplus.

Bill 100 includes amendments to the PBA to clarify that the new section 55.1 contribution holidays rules do **not** prevent the reduction or suspension of employer normal cost contributions, including the PfAD on such contributions, if the reduction or suspension is otherwise authorized by the PBA or the PBA General Reg. The Bill 100 amendment to section 55.1 is an important clarification for employers who have PYCBs and, in some other cases, who have otherwise been impacted by the transition to the new PBA funding rules.

2. *Expanding the Target Benefit Framework*

"Target benefit pension plan" (TBP) is a term generally used to describe a pension plan that combines the features of defined benefit (DB) and defined contribution (DC) pension plans. Under a TBP, the contributions made by participating employers are fixed, as under a DC pension plan. The amount of monthly pension provided by a TBP is determined by reference to a formula, like a typical DB pension plan. However, unlike a traditional DB pension plan, in certain circumstances (and depending upon the TBP's governing legislation) funding deficits in a TBP can be remedied by reducing past service benefits, including by reducing monthly pensions being paid to retirees. While some Canadian jurisdictions have introduced legislative frameworks to govern TBPs, others have yet to do so.

While unionized multi-employer pension plans (MEPPs) in Ontario resemble TBPs in many respects, the current PBA provisions governing such plans are limited. Beginning in 2010, the prior government took a number of preliminary steps toward the establishment of a comprehensive framework under the PBA for the establishment and regulation of TBPs. Specifically, in 2010, the Legislature passed, but did not proclaim into force, legislation to introduce TBPs as a distinct type of arrangement under the PBA.

In June 2017, the government announced a framework for the establishment of TBPs for collectively-bargained MEPPs. As reported in a prior Sidebar, in November 2017, Ontario enacted legislation that made technical changes to the unproclaimed PBA provisions pertaining to TBPs, and enacted new provisions governing the conversion of certain MEPPs to TBPs. In April 2018, the prior government released for public comment draft regulations setting out a proposed funding framework for target benefits provided under collectively-bargained MEPPs. To date, the focus of Ontario's efforts toward the establishment of TBPs had been MEPPs for unionized workforces.

Budget 2019 announces the government's intention to expand Ontario's TBP framework to allow MEPPs to provide target benefits beyond collectively bargained arrangements, including in the non-unionized not-for-profit sector. Bill 100 does not go so far as to authorize single employer TBPs. Budget 2019 also announces the government's intention to continue to work with stakeholders to further develop the TBP framework under the PBA, including related funding requirements.

3. *Electronic Communication of Pension Information*

Currently, electronic communication of plan information requires individual member consent, which creates a barrier to less costly electronic communication. Budget 2019 announces the government's intention to consider changes to the PBA that would permit pension plans to use electronic means as the default method of communicating plan information to members, subject to appropriate safeguards. Budget 2019 confirmed that pension plan members would be given the option to continue to receive paper documents, if desired.

4. *Financial Services Regulatory Authority (FSRA)*

In 2016, the *Financial Services Regulatory Authority of Ontario Act, 2016* (FSRA Act), was introduced to establish FSRA as the new Ontario pension regulator. The transition from FSCO to FSRA is currently scheduled to occur in June 2019. Bill 100 includes amendments to the FSRA Act in advance of the transition setting out specific powers and responsibilities of FSRA.

<u>Other Budget Initiatives</u>

1. *Changes to the Broader Public Sector Executive Compensation Act, 2014 (the BPSECA)*

Shortly after its election in 2018, the Government implemented Ontario Regulation 406/18 under the BPSECA (the New Compensation Framework). The New Compensation Framework repealed and replaced Ontario Regulation 304/16 under the BPSECA (the Prior Compensation Framework). The New Compensation Framework placed a hard freeze on salaries, performance pay, and all other elements of compensation payable to designated executives governed by the BPSECA. The New Compensation Framework affected compensation plans developed, implemented, and/or approved under the Prior Compensation Framework. At the time, the

Government committed to review the New Compensation Framework before June 7, 2019.

Budget 2019 announces that the new approach will involve performance-based assessments for salary increases and bonus pay which will be based on priorities set for each sector after consultation.

Bill 100 proposes changes to the BPSECA to allow amendments to the Compensation Framework Regulation to, among other things:

- authorize the Management Board of Cabinet to establish rules governing an employer’s use of performance factors to ensure alignment with established priorities when determining an executive’s salary and performance pay;
- authorize the Minister to limit increases in salary or performance pay that may be granted to executives including by limiting the number of executives to whom an employer may give salary or performance pay increases or by limiting the time periods for which an employer may give performance-related increases in salary or performance pay; and
- authorize the Minister to exempt particular employers and executives from certain requirements in the regulations.

Bill 100 also contemplates grandparenting. The general proposal is that grandparenting applies to all covered employers and executives until August 13, 2021 (i.e., three years from the effective date of the hard freeze on compensation under the New Compensation Framework) and the proposed amendments allow this timeline to be shortened and for particular employers and executives to be exempted altogether. Bill 100 also proposes transitional rules to govern the compensation plans of newly-created entities that qualify as designated employers.

2. Post-Secondary Education Sector Compensation

Bill 100 amends the *Ministry of Training, Colleges and Universities Act* to allow new regulations to be made governing the reduction, limitation and alteration of compensation of individuals who are employed or otherwise engaged by a post-secondary institution if the individual (i) has started to receive a pension from a plan where the individual’s benefits relate to service with a post-secondary institution, or (ii) has received a commuted value transfer from such a plan. The regulations are proposed to apply in the event of a conflict with collective agreements or other legislation. Budget 2019 announces the Government’s intention to engage in consultations with post-secondary education stakeholders to develop the new regulations.

3. Electronic Designation of Insurance Beneficiaries

As discussed in a prior Sidebar, in December 2018 the government passed legislation amending the PBA to permit Ontario-based members to designate a pension beneficiary electronically, despite any contrary requirements under the *Succession Law Reform Act*, provided prescribed requirements are met. The prescribed requirements have not yet been published.

Budget 2019 proposes similar amendments to the *Insurance Act* that, if passed, would clarify that insurers may accept electronic beneficiary designations, subject to any requirements that may be prescribed in a rule issued by FSRA. Such rules would facilitate electronic beneficiary designation in relation to insured programs, such as life insurance and insured long-term disability benefits.

4. Continued Review of Ontario's Publicly-Funded Benefit Programs

In our January 21, 2019 Sidebar, we discussed changes to the OHIP+ program, a publicly-funded program which provides Ontario children and youth access to free prescription drugs. Effective April 1, 2019, those changes restrict access to OHIP+ to children and youth under age 25 who are not covered by a private plan.

The Ontario Drug Benefit (ODB) program covers most of the cost of more than 4,400 prescription drug products for eligible seniors age 65 and over. Budget 2019 announces the government's intention to explore efficiencies in the ODB program, including providing timely access to new clinically-proven medicines while continuing efforts to lower prescription drug costs, and reducing red tape for clinicians and industry, where possible.

The Government also announced its intention to provide publicly funded dental care for low-income Ontarians over age 65 under a new specialized dental program.

If implemented, changes to the ODB program and dental care for seniors could impact employer-sponsored group benefit plans that include prescription drug and dental coverage for employees and retirees age 65 and over.

Draft Pension Regulations Released on Budget Day

1. Regulation 193/18 (Purchase of Pension Benefits from an Insurance Company – Section 43.1 of the Act) (the Annuity Discharge Reg)

Effective July 1, 2018 the PBA was amended to provide a statutory discharge when an administrator settles retiree and former member benefits through the purchase of an buy out annuity, provided that the prescribed requirements of the PBA and the Annuity

Discharge Reg were met. An outline of the discharge regime is set out in this Sidebar. The PBA was amended effective December 6, 2018 to extend discharges to annuities purchased for surviving spouses and former spouses (where a member's pension has been divided following a marriage breakdown). Proposed regulatory changes to the Annuity Discharge Reg released on April 11, 2019 include conforming changes such as the content of the notices that must be provided to surviving spouses and former spouses in order to obtain a discharge, and administrator record retention requirements relating to surviving spouses and former spouses.

The December 6, 2018 amendments to the PBA annuity discharge rules permit an administrator to obtain a discharge for annuity buy-out purchases made after December 6, 2018, even if the discharge rules are not followed in the first instance. The proposed changes to the Annuity Discharge Reg specify the requirements that must be met for annuity purchases made after December 6, 2018 including statements to annuitants and filing requirements that are similar to other circumstances in which a discharge is available. Based on the proposed changes to the Annuity Discharge Reg, the funding requirement for an annuity purchase made after December 6, 2018 is that the pension plan must have had an 85% solvency ratio at the time of the purchase in order for a discharge to be available to the administrator at a later date.

2. *Regulations Regarding the Payment of Variable Benefits from Defined Contribution Pension Plans*

Although not yet in force, the PBA was amended in 2015 to permit variable benefit payments, i.e., periodic pension payments to retired members and surviving spouses directly from a DC pension plan. Variable benefits will not be a required form of payment from a DC pension plan but will become an option that employers may make available to members as an alternative to the traditional options (transfer of the DC account balance to an insurer to purchase an annuity, or to a financial institution to establish a retirement income fund (RIF) for the member).

On April 11, 2019, three sets of draft regulations were released for consultation relating to the PBA variable benefit provisions: a new draft Variable Benefit Regulation under the PBA, and complimentary amendments to the PBA General Reg and Ontario Regulation 287/11 under the PBA (Family Law Matters) (the PBA Family Law Reg).

The new draft Variable Benefit Regulation (the Variable Benefit Reg) sets out a number of requirements relating to the administration of variable benefit provisions, including basic rules about variable benefit accounts and administrator obligations:

- retired members and specified beneficiaries (i.e., spouses or common law partners with entitlements) must advise the administrator of the pension plan how frequently their payments are to be made and the method of payment;

- retired members and specified beneficiaries are entitled to change the amount, frequency and method of payment no more than two times each calendar year;
- the default payment for retired members and specified beneficiaries who fail to provide the administrator with such instructions will be an annual payment of the minimum benefits prescribed under the *Income Tax Act* (Canada) (ITA);
- a retired member's entire DC plan account must be transferred to the variable benefit account (after the transfer, 50% of the variable benefit account may be "unlocked" similar to a life income fund);
- the administrator has an obligation to provide initial statements, annual statements, death benefit statements and cessation of variable benefits statements to retired members and specified beneficiaries, as applicable, containing the prescribed content; and
- detailed restrictions on permissible transfers in and out of variable benefit accounts to other retirement savings and retirement income vehicles.

Amendments to the PBA General Reg and PBA Family Law Reg include consequential technical amendments relating to, among other things, additional information to be included in the termination statement provided to members if a plan includes variable benefit provisions, an expansion of the shortened life expectancy rules to variable benefit accounts, and the valuation and division of a retired member's variable benefit account on marriage breakdown.

In our 2019 Federal Budget Sidebar, we outlined proposed changes to the ITA that will permit a new form of annuity, a variable payment life annuity (VPLA), to be provided to members directly from a DC pension plan. VPLAs are still in the concept phase and, as a result, are not addressed in the draft Variable Benefit Reg.

Interested parties may provide comments on all of these draft regulations prior to May 3, 2019, here.

With the release of these draft regulations, we anticipate that the variable benefit regime under the PBA will come into effect shortly.

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Bill 100 and the draft regulations build up, and expand the breadth of, ongoing Ontario pension reform initiatives. A number of other ongoing reform initiatives remain pending. By way of example, in 2017, the PBA was amended to require pension plan administrators to file governance policies and funding policies with the Superintendent. The PBA provisions containing these requirements have not been proclaimed into force pending the issuance of supporting regulations. Budget 2019 did not provide any update on the proposed timing for the introduction of governance and funding policy requirements.

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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