National Report
for
CANADA

In the past two years, many of the issues that were raised in the previous National Report in respect of pension reform and changes in the income tax system in respect of retirement savings have moved towards a final determination. Ontario, with the largest number of pension plans subject to regulation, has passed its pension reform legislation as has the province of Nova Scotia. The federal government has finally issued draft legislation on the taxation of retirement savings, almost three years after the original proposals were made. In Ontario, a Task Force has issued a report on the Inflation Protection for Pension Plans. The government has indicated that it intends to proceed with legislation in the fall of 1988. The pension reform legislation and income tax changes, have created enormous activity for actuaries engaged in pension work.

One unfortunate result of this activity has been an significant increase in the regulation of pension plans in Canada, added complexity in administrative and reporting requirements for pension plans and a decrease in the flexibility of design of pension plans. Because of this, there has been a trend towards money purchase arrangements from defined benefit plans in order to avoid some of these complexities.

Pension Reform

Pension regulation in Canada is primarily the responsibility of the provinces. The federal government regulates pension plans for a few industries that are subject to federal regulation such as broadcasting, transportation, etc. The federal government also indirectly regulates pension plans through the Income Tax Act which sets out standards for registration of a pension plan in order for contributions to be tax deductible and the pension fund investment earnings tax sheltered. In its new draft legislation, the federal government has tried to avoid conflicts with the various provincial pension benefit acts. Unfortunately, the provinces, with Ontario in the lead, have broken the consensus that had been reached on pension reform among the provinces. Thus many years of work of provincial pension authorities, business groups and pension consultants to arrive at a consensus for relatively uniform legislation among the provinces have been frustrated. Plan sponsors operating nationally will have to cope with different provisions in respect of employees in each province.

The most serious break with the consensus that had previously been achieved, was the Ontario decision to enforce some form of mandatory indexation of

pensions. The original consensus was that there would be no mandatory indexation of pension.

The Ontario Task Force on Inflation Protection for Employment Pension Plans recommended mandatory indexing of future benefit accruals. The recommended formula is (75% of the increase in the Consumers Price Index) less 1%. Indexation would start from the later of age 55 or retirement. Deferred vested benefits would also be indexed.

While the Task Force did not recommend mandatory indexation of pensions already payable or the accrued benefits of active employees, they did recommend that "incentives" be offered to induce plan sponsors to index benefits retroactively. These include a phase-in period for the indexation formula, indexing benefits from age 65 instead of age 55 and greater access to pension plan surplus.

Ontario has also implemented very stringent and costly rules in respect of pension benefits on a partial or complete plan windup. Ontario rules state that the closure of any physical location of a company or the termination of a significant number of employees will trigger a partial plan windup for the affected employees. On a partial or complete plan windup, all employees must be vested. In addition, all employees whose age and service equal at least 55, must be allowed the option of retiring, if they are eligible for retirement, or receiving an early or normal retirement benefit at the point of time they would have been eligible to do so if the plan and their active membership in the plan had continued. Employer consent cannot be a eligibility requirement to receive the early retirement benefits. These requirements can cause significantly increased liabilities over the liabilities under an on-going actuarial valuation of the plan, if there are generous early retirement benefits. If the pension fund does not have sufficient assets to provide the plan windup benefits, the plan sponsor must continue to fund the shortfall.

In conjunction with the plan windup provisions, Ontario also requires a solvency valuation taking into account the special benefits payable on a plan windup. If there is a deficiency under the solvency valuation, the deficiency must be funded over 5 years. This can significantly increase the funding requirements, particularly for flat benefit plans with generous early retirement benefits. Moreover, as time goes by and a plan is not wound up, surpluses will develop because of the solvency funding that will become a matter of dispute between the plan sponsor and the employees.

Ownership of Pension Plan Surpluses

Over the past few years, there have been a number of court cases revolving around the issue of ownership of pension plan surpluses, the right of the plan sponsor to withdraw surpluses and the right of the plan sponsor to use surpluses to meet funding requirements. These issues have not been settled. However, because of the publicity surrounding these cases and because of union pressures, the provincial pension authorities have made the reversion of surplus much more difficult.

In most provinces, in order to withdraw surplus, you must first notify all plan members and give them an opportunity to comment to the pension authorities. The pension authorities will only approve a surplus reversion to the plan sponsor if the plan legal documents (both current and past) clearly show that the surplus belongs to the plan sponsor. If there is any question about this, including any contrary indication in booklets or employee announcement material, the pension authorities will require a judicial interpretation of the plan sponsor's right to withdraw surplus. If the pension authorities feel that the employer does not have the right to the surplus, they will not allow a reversion.

Ontario has gone further than the other provinces by putting a moratorium on all surplus reversions from ongoing plans and on plan terminations. The Task Force Report on Inflation Protection has recommended that the employer can only withdraw surplus if the plan provides inflation protection for all existing benefits.

Taxation

There have been significant changes in the proposals for changes in the tax system for retirement savings that were reported in the last National Report. The federal government has just issued draft legislation of the proposed changes.

Generally the new rules provide an overall tax deductible contribution limit to all types of retirement savings plans, both company and individual, of 18% of earned income up to a dollar maximum which will increase from $8,500 in 1989 to $15,500 in 1995. After 1995, the maximum dollar limit will be indexed to increases in wages. Defined benefits in pension plans are converted to a contribution equivalent by multiplying the amount of benefit by $9. For instance, a pension plan that had a benefit formula of 1.5% of earnings per year of service would be considered to use up 13.5% (ie - 9 X 1.5%) of the 18% limit. The new rules will require an enormous amount of additional reporting to the government and will significantly increase the

amount the record keeping and the complexity of pension plan administration.

The federal government has also implemented "tax reform" measures starting in 1988 under which rates of taxation have been reduced, the number of tax brackets have been reduced from 15 to 3 and many deductions from taxable income have been converted to tax credits. In order to make up the loss in revenue from personal and corporate income taxes, the government intends to increase indirect taxes either through a national sales tax, through changes in the existing federal sales tax or through a VAT. This will not be done until 1989 at the earliest.

Social Security Benefits

There have been no changes to the provisions of the Canada Pension Plan, the Quebec Pension Plan or Old Age Security Act since the last National Report. The federal government has been studying the possibility of a national disability income program but there is no indication of when or whether they will proceed with it.

The most serious problem facing Canada's social security system is the escalating cost of the medicare system. Medicare is run by the provinces but is partially financed by the federal government. For the past four years, the federal government's contribution to the cost of the medicare system has not been increasing as fast as the cost, thus putting a strain on the financial resources of the provincial governments. Some of the provinces have responded to this problem by increasing provincial taxes thus negating some of the tax reductions as a result of the federal government's tax reform package.

Insurance Companies

The Canadian Institute of Chartered Accountants has adopted specific standards for the preparation of financial statements for life insurance companies, health insurance companies and fraternal societies. The accountants have mandated the new standards from January 1, 1989, with encouragement for earlier adoption for 1988. The CICA has adopted the policy premium method for measuring actuarial liabilities and recognizing profit. This method tends to recognize profit much earlier than the statutory reserving basis. The Canadian and British Insurance Companies Act requires that a federally incorporated life insurance company report the statutory reserves required under the Act in all financial statement published by the company for presentation to policyholders, shareholders or the public. This will require significantly increased actuarial activity for life company

valuations and financial reporting and the reconciliation of the reserves under the new accounting standards with the statutory reserves.

The Canadian and British Insurance Companies Act has also been revised to require that property and casualty loss reserves be certified by a Fellow of the Canadian Institute of Actuaries after an initial phase-in period. Currently, loss reserves are not required to be certified by an FCIA.

Professional Matters

The number of Fellows of the Canadian Institute of Actuaries resident in Canada has increased form about 1,150 to 1,410 since the last National Report. Nearly one-third are engaged in consulting work. The Canadian Institute of Actuaries continues to be very active, holding regular meetings, preparing studies on various professional matters and submitting briefs to governments on many matters of importance to the profession. Much of the Institute's work is done through committees. At the present time there are 48 active committees of which 21 are chaired by a consulting actuary.

Economics

While it is disappointing that after five years of real growth in the economy, the federal deficit continues to hover around $30 billion, there has been an improvement in the deficit as a percentage of the Gross Domestic Product from 6.9% of GDP in 1984 to a predicted 4% of GDP for 1988. Unemployment has dropped from 11.3% in 1984 to a forecast rate of 8.2% in 1988. The Canadian dollar has risen over 17% against the U.S. dollar since 1986 and is currently worth 0.81U.S.$. The Toronto stock market achieved a return of 5.9% in 1987 in spite of the October crash. Currently the stock markets remain volatile and uncertain. Long term government bond yields have decreased from a range of 12 1/2% to 13 1/2% in 1984 to a range a 9 1/2% to 10 1/2% during the past year.

While the Canadian economy has done well as a whole since 1984, most of the growth has been in Central Canada with much slower growth in both the western provinces and the Maritimes.

Most economists predict modest growth and modest inflation in 1988 with some increase in interest rates. Canada is now in the 6th year of sustained real growth and many economists forecast a recession in 1989.

Conclusion

There has been a tremendous explosion in the amount of actuarial valuations being performed by consulting actuaries. 1987 was the first year when most pension plans required actuarial valuations for accounting purposes in order to determine pension expense under the guidelines of the Canadian Institute of Chartered Accountants. The assumptions used in the valuations for accounting purposes are almost always different from the assumptions used for funding. For accounting purposes the actuarial assumptions to be used are management's best estimates not the actuary's. In addition, all Ontario plans will require a solvency valuation.

The additional valuation work that is now required along with changes in pension legislation and taxation of retirement benefits, will strain the resources of most actuarial consulting firms required to meet the needs of their pension fund clients.