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Frequently Asked Questions Pertaining to the 2018 Funding Reform for Defined Benefit Pension Plans

New Ontario funding rules ([O. Regulation 250/18](#) ) for defined benefit pension plans came into effect on May 1, 2018. The Financial Services Commission of Ontario (FSCO) has developed frequently asked questions (FAQs) and other communication materials to address questions concerning the new funding requirements.

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FSCO has also developed a series of other communications on the new funding rules, which can be found on the general [2018 Funding Reform page](#).

[Provision for Adverse Deviation \(PfAD\)](#)

[Background](#)

On May 1, 2018, a new funding regime came into effect for Ontario single employer pension plans. This includes a change to the solvency funding rules and the introduction of a new funding provision for adverse deviations (PfAD). The PfAD is prescribed in section 11.2 of Regulation 909, and provides for an additional level of funding on top of existing normal cost and going concern funding requirements. The PfAD is based on a number of factors, including the asset allocation of the plan, the discount rate, and whether any portion of the plan is closed to new members.

The new regime also introduced a new disclosure requirement for the statement of investment policies and procedures (SIPP), set out in sections 78(7) and (8) of Regulation 909. It requires that the SIPP include the plan's target asset allocation for each of the investment categories listed in section 76(12) (see the list of categories attached in [Exhibit 1](#)).

FAQs on the new PfAD and SIPP regulations are provided below.

There are optional transition provisions regarding the calculation of component "B" of the PfAD, as prescribed under sections 11.2(11) and (12) of Regulation 909, that apply to valuation reports with a valuation date before December 31, 2019. See FAQ series 400 in this regard.

SIPP Content Provisions

Q100. What are the new requirements under sections 78(7) and (8) of Regulation 909 and what steps must I take to comply?

A100. Section 78(7) of Regulation 909 requires that the SIPP include the plan's target asset allocation for each of the investment categories listed in section 76(12) of Regulation 909. Section 78(8) describes the target asset allocation for an investment category as the target proportion of the plan's assets invested in a particular investment category in proportion to the total target investment in all investment categories, expressed as a percentage.

To comply with this requirement, the administrator can either amend the existing target asset allocation in the SIPP to reflect the investment categories in section 76(12) of Regulation 909, or create a second asset allocation table that provides the required target asset allocations.

Where a separate table is established to comply with sections 78(7) and (8), the plan's actual asset allocation is governed by both the original description of the target asset allocation already found in the SIPP and the description of the target asset allocation in the separate table.

FSCO recognizes that it may take time for the administrator to review and amend the SIPP to meet the requirements of sections 78(7) and (8) of Regulation 909. FSCO expects the administrator to bring the SIPP into compliance with sections 78(7) and (8) of Regulations 909 as soon as is practical.

In any event, the plan's SIPP must contain the required asset allocation information on or before the valuation date of a report based on that information (i.e., December 31, 2019 or earlier).


Q101. Do the new SIPP requirements in sections 78(7) and (8) of Regulation 909 require every investment category in section 76(12) of Regulation 909 to be listed in the SIPP, even if there are no investments in that category?

A101. For purposes of sections 78(7) and (8) of Regulation 909, a SIPP does not need to explicitly list an allocation to an investment category in which the plan does not invest. Investment categories will be deemed to have no allocation if not mentioned in the SIPP.

Q102. Is it acceptable for the target asset allocation to be listed as a range? Is there any restriction on the ranges that can be specified in a SIPP?

A102. Under section 11.2(8) of Regulation 909, the PfAD is to be based on the target asset allocation as documented in the plan's SIPP, and requires a single figure expressed as a percentage for each section 76(12) investment category in which the plan invests. A range would not work for purposes of the PfAD calculation, but can be included in the SIPP in addition to the target (as is commonly done).

With respect to the second part of this question, there is no specific restriction on the asset allocation ranges that can be specified in the SIPP. However, an overly wide asset allocation range may not provide necessary investment control and monitoring of that asset category.

We also make note of the *Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans* , published by the Office of Superintendent of Financial Institution, which provides useful guidance on developing investment policy, and advises that the range of possible allocations should be sufficiently narrow so that:

- the intentions of the administrator are clear;

- the activities of investment managers can be controlled; and
- third parties can assess the security of benefits.

Q103. Section 78(7) of Regulation 909 requires the SIPP to state target allocations for each of the asset categories in section 76 (12) of Regulation 909. For plans that invest entirely in pooled funds, how would the requirement in section 78(7) be applied?

A103. FSCO recognizes that a pooled fund is an investment vehicle, and not strictly speaking an asset class. There are two acceptable approaches to addressing pooled funds in the target asset allocation in the SIPP.

Under the first approach, the SIPP does not have to specify an allocation to pooled funds (investment category 2), even if the plan ultimately employs these vehicles. The SIPP can instead set out its target asset allocations using the other investment categories listed in section 76(12). In doing so, the administrator is indicating that it does not allocate any assets to pooled funds as an asset class, although it may use pooled funds to achieve its allocation to the investment categories that are indicated.

Under the second approach, the administrator may decide to indicate that it has allocated all (or a stated portion) of its assets to the “pooled fund” investment category. If it takes this approach, then the SIPP must also indicate what the underlying allocation is to the various investment categories listed in subsection 76(12) in order to permit the calculation of the PfAD in accordance with the look-through rules set out in section 11.2(8) of the Regulation. (The definitions of “N”, “P” and “Q” in section 11.2(8) of Regulation 909 require the administrator to “look through” assets invested in pooled funds, and determine the proportion of those assets that are invested in investment categories “L” and “M”, as defined in section 11.2(8)).

Where applicable, the SIPP should specify that the fund is permitted (or required) to invest plan assets using pooled funds.

Q104. Section 11.2(10) of Regulation 909 requires the use of the target asset allocation in the SIPP that “is in effect at the time at which the determination is made”. What does “in effect at the time” and “at which the determination is made” mean?

A104. For the purpose of determining the PfAD, a SIPP is normally “in effect” either on the date it is approved or the date it is amended by the administrator. Where a SIPP specifically states a future effective date, the previous SIPP would still be considered to be “in effect” until that future date.

The phrase “at which the determination is made” is a reference to the valuation date of the report, and not the date the report was filed or signed.

Q105. If the SIPP calls for changes in the asset mix after the valuation date, should those future changes be reflected in the calculation of the PfAD?

A105. No. For the purpose of section 11.2(10) of Regulation 909, it is FSCO’s position that “the time at which the determination is made” refers to the valuation date of the valuation report. Future changes to the asset allocation noted in the SIPP, such as those in a de-risking glide path, that would occur after the valuation date of the report are not to be considered in calculating the PfAD.

This differs from the practice of setting the discount rate for purposes of the valuation report. In that case, the actuary needs to exercise professional judgement in reflecting any pending changes to the plan’s investments.

Actuarial Issues

Q200. For plans that have an explicit normal cost for expenses, should the PfAD be applied to this portion of the normal cost?

A200. For the purpose of the going concern valuation, the PfAD should be applied to any provisions for plan expenses payable from the pension fund.

Q201. Does the new provision for adverse deviations (PfAD) satisfy any margin requirement in the going concern discount rate noted in section 1 of FSCO’s Actuarial Guidance Note AGN-001?

A201. Effective May 1, 2018, the PfAD is a legislated additional funding target requirement under Regulation 909. In preparing a going concern actuarial valuation, the actuary needs to exercise professional judgement to determine whether an additional margin for conservatism is warranted; this includes, but is not limited to, taking into account the terms of engagement and relevant funding policy of the pension plan. For example, consideration should be given to whether there is a need or desire to build a funding buffer via additional margin for conservatism to enable plan stakeholders to better manage the volatility of funding obligations

or sustainability of the plan's benefits in a going-concern context. Also, the actuary is expected to provide a rationale in the valuation report for any changes in assumptions, including any changes in margins. FSCO will undertake a review of our Actuarial Guidance Notes and revise as appropriate to reflect the requirements of the new funding regime.

Q202. When is a plan considered to be a "closed plan" for purposes of section 11.2 of Regulation 909?

A202. A "closed plan" is defined in section 11.2(1) of Regulation 909 as follows:

"closed plan" means a pension plan at least one portion of which, according to the terms of the plan, does not permit new members to join and accrue defined benefits;"

Determining if a plan is "closed" requires analysis of the particular facts of that plan. Ultimately, it is the administrator who is responsible for making that determination and directing the actuary in that regard.

FSCO does not expect administrators or their advisors to request FSCO's determination of whether a particular plan is a closed plan; administrators are expected to make this determination, and to obtain any advice they may need to do so. If FSCO has reason to question a statement in an actuarial valuation report that a plan is not a closed plan, we may ask the signing actuary to provide the facts and analysis that support the administrator's determination in this regard.

Refer to the FSCO position paper *The determination of whether a plan is a "Closed Plan"*, which provides some examples of whether a plan is "closed" or not in accordance with the definition in section 11.2(1).

Investment Classification

The questions below address the classification of certain investments for the purposes of calculating the provision for adverse deviations (PfAD). FSCO expects that the administrator, in consultation with its agent(s), will determine the appropriate classification of the investment or asset class. Both the administrator and, where applicable, its agent(s) should be prepared to justify any classification.

Q300. How would an investment in a real estate investment trust (REIT) be classified for purposes of determining the PfAD?

A300. The classification of an investment in a REIT will depend on the nature of the investment. For example, an interest in a REIT which is held through shares in a corporation would be classified as either investment category 13 or 14 of section 76(12) of Regulation 909, depending on whether it is a domestic or foreign corporation, and assuming none of the investment categories in paragraphs 1 to 12 apply. However, an interest in a REIT which is held through some other legal structure, such as a partnership or trust agreement, would be classified as investment category 17 (assuming none of the categories in paragraphs 1 to 16 of section 76(12) apply). As an investment in a REIT is not a direct investment in real estate, it would not be classified as investment category 7.

Q301. What is a real estate debenture as referred to in investment category 8?

A301. For purposes of section 76(12), "real estate debenture" (investment category 8) can be defined as a debt obligation backed by the credit of the real estate property owner, not by the collateral of the real estate property itself. Investment category 8 is classified as an "M" item under section 11.2(8) of Regulation 909.

Q302. Is private equity a "stock" and hence a non-fixed income asset under the PfAD rules, or is it not a stock, and hence falls under investment category 17 and is categorized as an "M" investment?

A302. The classification of a private equity investment will depend on the nature of the investment. For example, private equity that is accurately characterized as venture capital should be classified as investment category 10 (venture capital). Private equity that is in the form of Canadian or foreign "stock" (and is not venture capital) should be classified as either investment category 13 or 14 (Canadian or foreign stocks), depending on whether it is a domestic or foreign corporation and assuming none of the categories in paragraphs 1 to 12 of section 76(12) apply.

Q303. What is meant by the term "insured contracts" in section 76(12) of Regulation 909 and the term "benefits for which an annuity contract has been purchased from an insurance company" as used in sections 11.1 and 11.2 of Regulation 909?

A303. It is FSCO's view that "insured contracts" referred to in section 76(12) of Regulation 909 and the term "benefits for which an annuity contract has been purchased from an insurance

company” which is used in sections 11.1 and 11.2 of Regulation 909 both refer to the same thing: buy-in annuities and buy-out annuities that are not subject to a discharge under section 43.1 of the PBA.

Buy-out annuities that are subject to a discharge under section 43.1 of the PBA, however, should no longer be included in the assets or liabilities of the plan, and therefore would not need to be included in the PfAD calculations.

Q304. How should infrastructure investments be treated under the PfAD rules?

A304. The classification of an investment in infrastructure will depend on the nature of the investment. For example, an investment in the shares of a Canadian infrastructure enterprise would be classified as either investment category 13 or 14 (Canadian or foreign stocks), depending on whether it is a domestic or foreign corporation, and assuming none of the categories in paragraphs 1 to 12 of section 76(12) apply. However, an interest in infrastructure which is held through some other legal structure, such as a partnership or joint venture, would be classified as investment category 17, assuming none of the categories in paragraphs 1 to 16 of section 76(12) apply.

Q305. How are commodities treated under the PfAD rules?

A305. The classification of an investment in commodities will depend on the nature of the investment. For example, the purchase of actual gold, or of gold futures, for example, would be classified as investment category 17 (other investments). Alternatively, the investment may take the form of an investment in the shares of a company that produces the commodity (e.g., mining company), in which case the investment would be classified as investment category 13 or 14 (Canadian or foreign stocks), depending on whether it is a domestic or foreign corporation, and assuming none of the categories in paragraphs 1 to 12 of section 76(12) apply.

Q306. Derivatives and leverage strategies can have an impact on the overall return/risk profile for the pension fund. However, the methodology for calculating the PfAD does not explicitly address their use. Are derivatives and leverage strategies to be considered in the PfAD calculations, and if so, how?

A306. Under sections 11.2(9) and (10) of Regulation 909, the PfAD is calculated using the plan’s target asset allocation as set out in the plan’s SIPP. Accordingly, the treatment of derivatives and leverage strategy will depend on how they are reflected in the target asset allocation, if at all.

Q307. If a bond held by a pension fund does not meet the minimum credit rating requirements, how is it treated under the PfAD rules?

A307. Under sections 11.2(9) to (10) of Regulation 909, the determination of the level of fixed income assets is not affected by any specific bond that is actually held in the portfolio. Instead, it depends on the target asset allocations to investment categories 15 and 16 (Canadian bonds and Foreign bonds), and whether the SIPP sets out a minimum rating for such category given by a credit rating agency recognized by a competent authority that is not less than the levels set out in the tables to section 11.2.

Q308. How is private debt treated under the PfAD rules?

A308. Private debt would fall into either investment category 15 or 16 (Canadian or non-Canadian bonds and debentures) assuming that none of the categories in paragraphs 1 to 12 of section 76(12) apply, but its treatment is subject to the credit rating requirement in section 11.2(9) of Regulation 909.

A target asset allocation in a plan's SIPP for investment category 15 or 16 is not considered fixed income unless the SIPP sets out a minimum rating for investments in that category that is given by a credit rating agency recognized by a competent authority that is not less than the levels set out in the tables to section 11.2.

Q309. What is meant by a "competent authority" in the phrase "by another credit rating agency recognized by a competent authority" as set out in sections 11.2(9) and (12) of Regulation 909?

A309. We understand that "competent authority" generally refers to a financial regulatory or supervisory authority recognized by legislation.

Q310. For private debt, can an internally developed credit rating from a third party investment manager be considered sufficient for the purpose of section 11.2(9) and (12) of Regulation 909?

A310. No.

Q311. If an investment grade bond was downgraded below the minimum credit rating as set out in the SIPP, would this impact the remaining investment grade bonds in the same investment category, so that they are no longer treated as 100% fixed income?

A311. No. A downgrading in the bond would not adversely affect the classification of the remaining investment grade bonds. However, the administrator would have to dispose of the bond within a reasonable period of time, in order to remain in compliance with its own SIPP.

Transition Rules

The following questions address the transition rules relating to component B of the PfAD formula, as prescribed under sections 11.2(11) and (12) of Regulation 909. These transition rules may be applied to valuation reports with a valuation date before December 31, 2019.

Q400. How do the transition rules work under sections 11.2(11) and (12) of Regulation 909?

A400. Under the transition rules, a plan's actual asset allocations to the section 76(12) investment categories on the valuation date of the report, as set out in the plan's financial statements, may be used instead of the plan's target asset allocations in determining the values of "L", "M", "N", "P", "Q" and "R" in section 11.2(8).

The transition rules may be used to calculate the PfAD in a valuation report with a valuation date before December 31, 2019.

Q401. Under the transition rules, how is a bond treated that does not meet the minimum credit rating requirements set out in section 11.2(12)? Does it impact other investment grade bonds in the same investment category?

A401. The bond would be classified as investment category 15 or 16 (Canadian or foreign bonds and debentures), depending on whether it is issued by a Canadian or foreign company, but would not be a fixed income asset for purposes of the PfAD calculation and would not be classified as an "L" or "M" investment (assuming that it does not fall under categories 1 to 12). The bond would not adversely affect the classification of the investment grade bonds held in the same investment category.

Q402. If a pooled fund has a small target allocation to high yield bonds (which would not meet the minimum credit rating referred to in section 11.2 of Regulation 909), how is the pooled fund treated for purposes of the PfAD under the transition rules?

A402. The definitions of “N”, “P” and “Q” in section 11.2(8) of Regulation 909 require the administrator to “look-through” assets invested in pooled funds, and determine the proportion of those assets that are invested in investment categories “L” and “M”, as defined in section 11.2(8).

Where the PfAD is calculated based on the actual asset allocation under the transition rules, the administrator, in consultation with its agent(s), can classify bonds individually.

Under this approach, if a pooled fund had 85% invested in investment grade bonds which meet the credit rating described in the regulations, and 15% high yield bonds that do not meet the credit rating, for purposes of calculating the PfAD, the actual bonds held in the pooled fund that meet the credit rating (i.e., 85%) would be treated as fixed income assets (i.e., included in “P”), and the bonds that do not meet the credit rating (i.e., 15%) would be treated as non-fixed income assets.

Q403. How is private debt treated under the transition rules?

A403. Under the transition rules, an investment in private debt that does not meet the minimum credit rating requirements in section 11.2(12) would not be considered a fixed income asset, and would not be classified as an “L” or “M” investment (assuming that it does not fall under categories 1 to 12). However, the private debt investment would not adversely affect the classification of the investment grade bonds held in the same investment category.

Q404. How are derivatives and leverage strategies considered in the PfAD, under the transition rules?

A404. Under the transition rules, the PfAD is calculated using the plan’s actual asset allocation as set out in the plan’s financial statements. Accordingly, the treatment of derivatives or a leverage strategy will depend on how they are reflected in the actual asset allocation in the financial statements, if at all.

Funding Related Disclosures

Q500. In any plan year where the employer is taking a contribution holiday, is the plan administrator required to notify the plan membership?

A500. If a plan administrator is taking a contribution holiday pursuant to section 7.0.3 of Regulation 909, section 8(4) of Regulation 909 requires the plan administrator to give notice to plan members, former members, retired members and trade unions and the advisory committee, if any, within the first six months of the fiscal year in which a planned contribution holiday is to occur. A separate notice to a member, former member or retired member is not required if the administrator includes the information required under section 8(3) in the annual or biennial statement provided to such member, former member or retired member in the same fiscal year.

Q501. Is section 4(1.3) of Regulation 909 only applicable to a report filed under the new rules?

A501. No. Section 4(1.3) provides that any amendment that is required for purposes of complying with 4(1.1) shall be made within 12 months after the date the first report with a valuation date on or after December 31, 2017, is filed. The regulation does not make a distinction as to whether the report was prepared under the old or new rules.

Q502. Under the new funding regime, new sections 40(1)(p)(v.1), 40.1(1)(m)(i.1) and 40.2(1)(l)(i.1) were added to the disclosure requirements and come into effect on January 1, 2019. What does this mean for plan administrators issuing statements to the plan membership on and after this date?

A502. The new disclosure provisions require the disclosure of the plan's estimated transfer ratio as at the end of the statement period and this requirement is to come into effect on January 1, 2019. This means that plan administrators must include these new disclosure requirements in statements (whether annual or biennial) issued on and after January 1, 2019.

Exhibit 1

Investment Categories for Purposes of Calculating the PfAD

The following table lists the categories in section 76(12) along with their classification under section 11.2(8) of Regulation 909 for purposes of calculating component B of the PfAD formula

(as set out in section 11.2(2)). "L", "M", "N" and "R" are defined in section 11.2(8) (see also the following page). Assets in the "L" category are treated as fixed income, 50% of the assets in the "M" category are treated as fixed income. There are special "look-through" rules for assets in the "N" category. "R" assets are effectively excluded from the PfAD calculations.

Investment Category	Classification under 11.2(8)
1. Insured contracts.	R
2. Mutual or pooled funds or segregated funds.	N
3. Demand deposits and cash on hand.	L
4. Short-term notes and treasury bills.	L1
5. Term deposits and guaranteed investment certificates.	L
6. Mortgage loans.	M
7. Real estate.	M
8. Real estate debentures.	M
9. Resource properties.	M
10. Venture capital.	M
11. Corporations referred to in subsection 11 (2) of Schedule III to the federal investment regulations.	M
12. Employer issued securities.	No classification – treated as non-fixed income
13. Canadian stocks other than investments referred to in paragraphs 1 to 12.	No classification – treated as non-fixed income

14. Non-Canadian stocks other than investments referred to in paragraphs 1 to 12.	No classification – treated as non-fixed income
15. Canadian bonds and debentures other than investments referred to in paragraphs 1 to 12.	L ¹
16. Non-Canadian bonds and debentures other than investments referred to in paragraphs 1 to 12.	L ¹
17. Investments other than investments referred to in paragraphs 1 to 16.	M

¹ Subject to the minimum credit rating requirements in sections 11.2(9) and (12) of Regulation 909.

Section 11.2(8) of Regulation 909 contains component B of the PfAD Formula. It states as follows:

(8) Subject to subsections (9) to (11), for the purposes of the value of “J” in subsections (4) and (7), the plan’s combined target asset allocation for fixed income assets shall be determined in accordance with the formula,

$$L + (0.5 \times M) + (N \times P) + (0.5 \times N \times Q) / (100\% - R)$$

in which,

“L” is the sum of the plan’s target asset allocations for each of the investment categories listed in paragraphs 1, 3, 4, 5, 15 and 16 of subsection 76 (12), excluding any portions of the target asset allocations that are allocated to the assets described in “R”, expressed as a percentage,

“M” is the sum of the plan’s target asset allocations for each of the investment categories listed in paragraphs 6 to 11 and 17 of subsection 76 (12), excluding any portions of the target asset allocations that are allocated to the assets described in “R”, expressed as a percentage,

"N" is the plan's target asset allocation for the investment category listed in paragraph 2 of subsection 76 (12), expressed as a percentage,

"P" is the proportion of "N" that is allocated to the investment categories listed in paragraphs 1, 3, 4, 5, 15 and 16 of subsection 76 (12), expressed as a percentage,

"Q" is the proportion of "N" that is allocated to the investment categories listed in paragraphs 6 to 11 and 17 of subsection 76 (12), expressed as a percentage, and

"R" is the portion of the plan's target asset allocation for each investment category listed in paragraphs 1, 3 to 11 and 15 to 17 of subsection 76 (12), expressed as a percentage, that is allocated to annuity contracts that have been purchased from an insurance company in respect of benefits.