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

Revised to reflect changes in [Reg. 105/19](#) (in effect on May 21, 2019)

Note: Where this document conflicts with the Financial Services Regulatory Authority of Ontario Act, 2016 (FSRA Act), Pension Benefits Act, R.S.O. 1990, c. P.8 (PBA) or any regulation made under the PBA (Regulations), the FSRA Act, PBA or Regulations govern.

Frequently Asked Questions Pertaining to the 2018 & 2019 Funding Reform for Defined Benefit Pension Plans

On May 1, 2018, a new funding regime ([O. Regulation 250/18](#) ) came into effect for pension plans that provide defined benefits. The new regime included a change to the solvency funding rules and the introduction of a new funding provision for adverse deviations (PfAD). The 2018 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 the Regulation 909 (Regulation).

After the release of the 2018 funding regime, the Financial Services Commission of Ontario (FSCO) developed frequently asked questions (FAQs) and other communication materials to address questions concerning the new funding requirements. These can be found on the general [2018 Funding Reform for Defined Benefit Pension Plans](#) page.

On May 21, 2019, the government filed [O. Regulation 105/19](#) to amend various provisions of the 2018 funding regime, with immediate effect. Among the amendments were a revised “closed plan” definition for purposes of the PfAD calculation, new provisions relating to excess contributions, changes to the determination of prior year credit balance, clarifying rules for contribution holidays and clarification of the treatment of an investment allocation to bonds that does not meet the minimum credit rating.

The Financial Services Regulatory Authority of Ontario (FSRA) has now updated these FAQs and other communication materials to reflect the changes in [Regulation 105/19](#) . Updated communications can be found here [insert link].

The FAQs are organized as follows:



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**Provision for Adverse Deviation (PfAD)**

The PfAD is prescribed in section 11.2 of the Regulation 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 a significant portion of the plan is closed to new members

**SIPP Content Provisions**

**Revised 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) requires that the SIPP for a plan (other than a jointly sponsored pension plan listed in section 1.3.1(3) of the Regulation or a specified Ontario multi-employer pension plan as provided in section 6.0.4(2.0.1) of the Regulation) include the plan’s target asset allocation for assets in respect of defined benefits for each investment category listed in section 76(12) of the Regulation. 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), 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.

FSRA 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). FSRA expects the administrator to bring the SIPP into compliance with these sections as soon as is practical, but no later than December 31, 2019. We note that an amendment to a SIPP must be filed with FSRA within 60 days after the date the amendment is made, pursuant to section 78(6) of the Regulation.

In any event, the plan’s SIPP must contain the required asset allocation information on or before the

valuation date of a report that calculates the PfAD based on that information.

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

**A101.** For purposes of sections 78(7) and (8), 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.

**Revised 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 the Regulation, 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) (of the Regulation) 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).

The SIPP should identify any portion of the target asset allocation into categories 4, 15 and 16 that are not required to meet the minimum credit rating for the applicable investment category.

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.

**Revised Q103. Section 78(7) of the Regulation requires the SIPP to state the plan's target asset allocation for assets in respect of defined benefits for each investment category in section 76(12) of the Regulation. For plans that invest entirely in pooled funds, how would the requirement in section 78(7) be applied?**

**A103.** FSRA 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 section 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) 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.

**Revised Q104. Section 11.2(10) of the Regulation requires the use of the target asset allocation in the SIPP that “is in effect as of the valuation date”. What does this mean?**

**A104.** 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. For the purpose of determining the PfAD, the target asset allocation in the SIPP in effect as of the valuation date must be used and referenced. 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 PfAD satisfy any margin requirement in the going concern discount rate noted in section 1 of Actuarial Guidance Note AGN-001?**

**A201.** Effective May 1, 2018, the PfAD is a legislated additional funding target requirement under the Regulation. 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. FSRA will undertake a review of our Actuarial Guidance Notes and revise as appropriate to reflect the requirements of the new funding regime.

**Revised Q202. When is a plan considered to be a “closed plan” for purposes of section 11.2 of the Regulation?**

**A202.** Effective May 21, 2019, the definition of a “closed plan” has been revised and is defined in section 11.2(1) of the Regulation as follows:

“closed plan” means a pension plan:

- a. that has no members who are entitled to defined benefits; or
- b. in which at least 25 per cent of the members of the plan who are entitled to defined benefits are in a class or classes of employees from which new members are not permitted, according to the terms of the plan, to join the plan and accrue defined benefits.

Determining if a plan is “closed” requires analysis of the particular facts of that plan. Ultimately, the administrator is responsible for making that determination and directing the actuary in that regard. It is important to remember that whether a plan is “closed” or not must be re-determined at every valuation since it is possible that a plan’s status may change due to a change of facts since the last valuation.

For more information, refer to the revised position paper [\*The determination of whether a plan is a “Closed Plan”\*](#).

## Investment Classification

The questions below address the classification of certain investments for the purposes of calculating the PfAD. FSRA 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.

**Revised 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 the investment category described in either paragraph 13 or 14 of section 76(12) of the Regulation, 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 the investment category described in paragraph 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 the investment category described in paragraph 7.

**Revised Q301. What is a real estate debenture as referred to in paragraph 8 of section 76(12) of the Regulation?**

**A301.** For purposes of section 76(12), “real estate debenture” can be defined as a debt obligation backed by the credit of the real estate property owner, and not by the collateral of the real estate property

itself. A real estate debenture is classified as an “M” item for purposes of determining the combined target asset allocation for fixed income assets under section 11.2(8) of the Regulation.

**Revised 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 the investment category under paragraph 17 of section 76(12) of the Regulation and categorized as “M” for purposes of determining the combined target asset allocation for fixed income assets under section 11.2(8) of the Regulation?**

**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 the investment category described in paragraph 10 (venture capital) of section 76(12). Private equity that is in the form of Canadian or foreign “stock” (and is not venture capital) should be classified as the category of investment described in either paragraph 13 or 14 (Canadian or foreign stocks), depending on whether it is a domestic or foreign corporation and assuming none of the investment categories in paragraphs 1 to 12 of section 76(12) apply.

**Revised Q303. What is meant by the term "insured contracts" in paragraph 1 of section 76(12) of the Regulation 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 the Regulation?**

**A303.** It is FSRA’s view that both of these terms refer to 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.

**Revised 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 the category of investment described in either paragraph 13 or 14 (Canadian or foreign stocks) of section 76(12) of the Regulation, 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 the investment category described in paragraph 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?**

**Revised 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, would be classified as the investment category described in paragraph 17 (other investments) of section 76(12) of the Regulation. 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 the investment category described in either paragraph 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) applies.

**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 the Regulation, 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.

**Revised 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 the Regulation, 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 (or the portion thereof), as set out in the SIPP, to the investment categories described in paragraphs 15 and 16 (Canadian bonds and Foreign bonds) of section 76(12) of the Regulation, that meets the minimum rating for such category (as set out in the tables under section 11.2) given by a credit rating agency recognized by a competent authority. Any portion of a target allocation for an investment category listed in paragraph 15 or 16 of section 76(12) that is not required to meet the minimum credit rating will be in a 50% fixed income category (i.e., included in "M" or "Q").

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

**A308.** Private debt would fall into the investment category described in either paragraph 15 or 16 (Canadian or non-Canadian bonds and debentures) of section 76(12) of the Regulation, 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 the Regulation.

A target asset allocation in a plan's SIPP for the investment category described in either paragraph 15 or 16, or a portion thereof, is only considered to be fully fixed income if the allocation, or portion thereof, meets the minimum rating for investments in that category (as set out in the tables under section 11.2) given by a credit rating agency recognized by a competent authority. Any portion of a target asset allocation for an investment category listed in paragraph 15 or 16 of section 76(12) that is not required to meet the minimum credit rating will be in a 50% fixed income category (i.e., included in "M" or "Q").

**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 the Regulation?**

**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 the Regulation?**

**A310.** No.

**New** **Q311. If an investment-grade bond was downgraded below the minimum credit rating as set out in the SIPP, would this impact the calculation of a PfAD?**

**A311.** The calculation of a PfAD is based on the target asset allocation set out in the plan's SIPP. As a result, the downgrading of a bond that is actually held by the plan would not affect the calculation of a PfAD. However, the administrator may have to dispose of the bond within a reasonable period of time, in order to remain in compliance with its 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 the Regulation. 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 the Regulation?**

**A400.** Under the transition rules, a plan's actual asset allocations to the section 76(12) (of the Regulation) 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) of the Regulation.

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

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

**A401.** The bond would be classified as the investment category described in paragraph 15 or 16 (Canadian or foreign bonds and debentures) of section 76(12) of the Regulation, depending on whether it is issued by a Canadian or foreign company. For purposes of the PfAD calculation, the bond would be classified as "M" (i.e., treated as 50% fixed income). The bond would not adversely affect the classification of other investment-grade bonds held in the same investment category.

**Revised** **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 the Regulation), 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 the Regulation 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 Regulation, 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 50% fixed income assets (i.e., included in "Q").

Revised

**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) of the Regulation would not be considered a 100% fixed income asset, and would be classified as an "M" investment (i.e., 50% fixed income asset). However, the private debt investment would not adversely affect the classification of other 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

Revised

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

**A500.** Yes, the plan administrator is required to notify the plan membership of a contribution holiday and this notice must be given to plan members, former members, retired members, trade unions and the plan advisory committee, if any. The timing for providing this notice, however, depends on when the contribution holiday occurs. In general, notice about a contribution holiday must be given within the first six months of the fiscal year in which the contribution holiday is taken as required in section 8(4) of the Regulation. However, if a contribution holiday is commenced during the first year following the valuation date of a newly-filed report but more than six months after the start of that fiscal year, notice with respect to the contribution holiday taken in that fiscal year must be given within the first six months of the next fiscal year, as required under section 8(5) of the Regulation.

It should be noted that 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) of the Regulation 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 the Regulation 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 section 4(1.1) of the Regulation 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 funding 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) of the Regulation 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. These provisions came into effect on January 1, 2019. This means that plan administrators must comply with these new disclosure requirements in statements (whether annual or biennial) issued on and after January 1, 2019.

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