



Research Advisory

Hewitt

Canadian Research Group

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Highlights

While some funding relief was announced in the 2009 Ontario Budget, broader measures will have to await the government's much-anticipated pension reform initiative. Questions are also raised by plans to implement a harmonized sales tax.

The Hewitt Research Advisory is a regular Hewitt newsletter designed to provide a detailed overview of specific legislative and regulatory developments in Canada relating to human resources.

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Funding Relief, Pension Reform and Sales Tax Harmonization Represent Important Budget Initiatives in Ontario

Introduction

On March 26, 2009, the Ontario government released its 2009 provincial Budget, which contains important initiatives to combat the global recession in various areas, including: pensions; investments; health care; and the provincial workforce.

Unrelated to the Budget, but of great importance to pension plan sponsors and administrators, the government has also filed regulations authorizing use of the new Canadian Institute of Actuaries (CIA) Commuted Value Standard for administrative purposes effective April 1, 2009.

Pension Measures

Solvency Relief

In its 2009 Budget, the government reiterated its previously announced intention to introduce amendments to the *Pension Benefits Act*, retroactive to September 30, 2008, allowing sponsors to:

- consolidate existing solvency payment schedules;
- defer for one year the start of new going-concern contributions and solvency special payments; and
- extend solvency payment schedules to a maximum of 10 years.

In addition:

- the amendments will permit early use of the revised CIA Standard of Practice for Pension Commuted Values for solvency valuations as of December 12, 2008;

- workers and retirees will be entitled to receive clearer information about the financial health of their pension plans
- and the ability of plan sponsors to take contribution holidays between 2010 and 2012 will be limited.

Absent from the Budget proposals was any movement to allow the use of letters of credit to assist with solvency funding, as has been adopted in various other jurisdictions.

Hewitt Comment: *The Budget's solvency relief measures are roughly in line with the proposals made in December 2008 and, taken as a whole, should provide plan sponsors with meaningful relief, particularly if considered in conjunction with existing provisions permitted under the Act and regulations.*

The ability to consolidate existing solvency amortization payments into a new five-year payment schedule will be beneficial to sponsors who already have an onerous solvency special payment schedule, but will prove less helpful for sponsors whose solvency special payments are the result of recent market conditions.

In addition, granting the ability to defer by one year the start of both new going concern contributions and solvency special payments could allow for one more year of cash flow relief, and time to plan for future large increases in special payments. Of note is the fact that the government's initial deferral proposal applied to solvency payments only.

Allowing use of the new CIA Transfer Value Standard for valuations with effective dates of December 12, 2008 or later will help reduce liabilities which must be funded to a small extent. This is also consistent with other provincial initiatives already announced or legislated. While letters of credit were not introduced in this Budget, we hope they will become a longer-term funding initiative.

Problematic is the decision to require consent for plan sponsors to extend the solvency amortization period from five years to 10 years, since it could delay unnecessarily the ability to fund on a modified basis or, if consent is withheld, severely limit the usefulness of this initiative. Yet, instead of requiring the positive consent of two-thirds of each class of membership (actives, deferreds and retirees), as originally contemplated, consent will now be deemed granted if no more than one third of total aggregate membership objects. Groups that have a large proportion of inactives could still find it difficult to obtain the necessary consent.

Requiring any future benefit enhancements during the period of solvency relief to be funded over five years on both the going concern and solvency bases is more restrictive than under current regulations, where the enhanced benefits are only required to be funded over 15 years on the going concern side. The practical impact of this additional restriction will be slight for most plans since solvency liabilities are typically greater than going concern liabilities in plans where there are regular benefit improvements.

Finally, limiting the ability of plan sponsors to take contribution holidays between 2010 and 2012, will be based on a cost certificate that contains an approximation of the funded

position. Whether this methodology will be satisfactory to the Canada Revenue Agency in situations where there is excess surplus based on the last filed report remains to be seen.

Pension Reform

In response to the Ontario Expert Commission on Pensions (OECF) final report, the government announced the creation of a Pension Reform Advisory Council to help secure pension reform. In addition:

- plans will be allowed to offer phased retirement;
- the pension rules regarding marriage breakdown will be simplified;
- the amount of unlocking permitted from Ontario Life Income Funds (LIFs) will be increased from 25 to 50 per cent;
- a two-year waiver of fees for financial-hardship unlocking applications will be introduced;
- the Superintendent will also be empowered to review certain pension arrangements in restructuring proceedings, and;
- the Financial Services Commission of Ontario (FSCO) will be directed to hire 25 additional full-time positions to support better regulatory efficiency and oversight.

Hewitt Comment: *On the heels of the OECF final report, establishing a Pension Reform Advisory Council reinforces the government's commitment to reforming pensions in Ontario.*

In 2007, the federal Income Tax Act was amended to allow payment of a partial pension to employees 60 years of age and older, or 55 years of age and older with an unreduced early pension. With the implementation of phased retirement in Ontario, plan sponsors will have the option of allowing eligible members to commence a pension, while earning further credited service at the same time. While the proposed changes will not require employers to offer phased retirement, it may be an attractive option for many who are looking for ways of encouraging a reduction in hours worked, or encouraging mature, experienced workers to stay in the workforce longer on a part-time basis for their needed expertise, mentoring and management capabilities.

While proposals allowing the Superintendent to review certain pension arrangements in restructuring proceedings could prove helpful in protecting member benefits in such circumstances, there remains a concern that the Superintendent could extend the interpretation of "member benefits" to include surplus entitlements.

The Pension Benefits Guarantee Fund (PBGF) will be reconstituted as a self-sustaining fund, independent of the government, which will be given added flexibility to make grants to the PBGF if it chooses to do so. The PBGF's liability to guarantee pensions will also remain limited to the amount of its assets. The review of pension taxation and investment rules is identified as a key provincial priority.

Hewitt Comment: *The Budget proposals concerning the PBGF are interesting in that they exhibit the same ambivalence expressed in the OECF final report. Tellingly, the government also declined to increase maximum PBGF benefits, as recommended in the report, from \$1,000 to \$2,500. As such an increase would almost certainly have been accompanied by*

premium hikes, this is a welcome stance from the government and represents a form of indirect support for plan sponsors amidst the current economic and market turmoil. However, members will enjoy less benefit security.

Investment Related Measures

In addition, the government will introduce legislation expanding the mandate of the Ontario Teachers' Pension Plan (OTPP) Board to permit the Board to provide pension administration and investment services to other pension plans and institutional investors in the public sector. The benefits of doing so are described as higher revenues for the OTPP Board, lower administrative costs, and enhanced investment opportunities for future OTPP clients.

The government also reiterated its support for the federal Expert Panel on Securities Regulation's recommendation that Canadian jurisdictions adopt a single Securities Act. The government also supports headquartering any new national securities regulator in Toronto.

***Hewitt Comment:** With respect to the OTPP proposal, the basic premise that larger plan assets can lead to greater efficiencies is sound, especially with regard to asset management fees and increased access to certain illiquid and "lumpy" assets, such as infrastructure. As such, there is a strong rationale supporting expanded mandates. In addition, OTPP enjoys a strong reputation in the industry for innovation and performance. However, the appropriateness of selecting OTPP as the single beneficiary of public plan consolidation could be questioned. As noted in the OECP final report, there is little reliable, standardized data within the industry to perform retrospective and prospective performance assessments. As well, further study could be needed to determine what constitutes "ideal" size in this context.*

Harmonization

The government also announced its intention to eliminate the Retail Sales Tax (RST) and move to a single federally administered value added sales tax, set at the rate of 13 per cent (with the provincial portion at a rate of 8 per cent and the federal portion at a rate of 5 per cent). Despite exempting prescription drugs, Ontario will retain a tax on insurance at 8 per cent after the transition to the single sales tax, on the same types of insurance currently subject to RST, such as group insurance.

***Hewitt Comment:** It remains to be seen whether an 8 per cent provincial tax component will be imposed on all group insurance products. Hewitt Associates will continue monitoring developments in this area and keep clients informed as we approach July 1, 2010.*

In addition, while harmonization will result in an additional 8 per cent being applied to the accounts of all professional service providers, legal or accounting advice should be sought with respect to perhaps offsetting such costs even in part through the possible use of input tax credits.

To harmonize provincial policy with recently announced federal taxation measures, the government will: increase the Home Buyers' Plan withdrawal limit from \$20,000 to \$25,000; and allow deductions for the loss of value in Registered Retirement Savings Plan (RRSP) or

Registered Retirement Income Fund (RRIF) investments after death. As well, the Succession Law Reform Act will be amended to allow for beneficiary designation of Tax-free Savings Accounts (TFSA's).

Labour Force Initiatives

Labour force initiatives announced in the Budget include: increased funding over two years for literacy and basic skills training such as community projects, distance learning and workplace literacy; new funding over two years to expand support for new Canadians, including bridge training and mentorship opportunities; and new funding over two years to develop a Green Jobs Skills Strategy that responds to labour demand in the emerging green energy sector, including electricity.

In addition, the government of Ontario called on the federal government to ensure Ontarians have equitable access to the Employment Insurance (EI) program, especially during these difficult economic times, and to review and change the current EI funding formula for training programs to reflect current labour market conditions.

The Co-operative Education Tax Credit will be enhanced to increase, effective for eligible expenditures incurred after March 26, 2009, the 10 per cent CETC rate to 25 per cent, and the enhanced 15 per cent rate for small businesses to 30 per cent. As well, the maximum available tax credit will be increased from \$1,000 to \$3,000 per work placement.

As well, the Apprenticeship Training Tax Credit (ATTC) will be enhanced, effective for expenditures incurred after March 26, 2009, by: increasing the 25 per cent ATTC rate to 35 per cent, and the enhanced 30 per cent rate for small businesses to 45 per cent; increasing the \$5,000 annual maximum tax credit to \$10,000; extending the ATTC to salaries and wages paid during the first 48 months of an apprenticeship program; and making the ATTC a permanent tax incentive

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