Guideline

BCFSA
BC FINANCIAL SERVICES AUTHORITY

TITLE: Use of Letters of Credit for Meeting Solvency Deficiencies

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LEGISLATION: *Pension Benefits Standards Act* and Regulation

DISTRIBUTION: Pension Plan Administrators and Plan Sponsors

TABLE OF CONTENTS

INTRODUCTION

This document is prepared to assist administrators of plans with a defined benefit component who wish to use a letter of credit to meet a portion or all of the component's solvency deficiency instead of making some or all of the payments required in respect to a solvency deficiency.

Please note that this is not a legal document. This document replaces and supersedes our information bulletin of PENS-10-003.

BACKGROUND INFORMATION

All section references are to the British Columbia ("BC") *Pension Benefits Standards Act* (the "PBSA") and Pension Benefits Standards Regulation (the "PBSR") unless otherwise indicated. Specifically, please refer to section 55 of the PBSA and section 63 of the PBSR which outline the legislative requirements (including required filings) for the use of a letter of credit for pension plans registered in BC.

QUESTIONS AND ANSWERS ON LETTERS OF CREDIT

Q1: **Can any pension plan that provides a defined benefit provision make use of a letter of credit relating to a solvency deficiency?**

A1: No. The use of a letter of credit does not apply to participating employers in a collectively bargained multi-employer plan [section 55(1) of the PBSA].

Q2: **What is a prescribed letter of credit?**

A2: A prescribed letter of credit is an irrevocable and unconditional standby letter of credit issued by a bank or credit union that has an acceptable rating and that is a member of the Canadian Payments Association.

Please refer to section 63(1) of the PBSR for the full definition of a prescribed letter of credit as well as terminology used in relation to the use of a letter of credit.

Q3: **What are the steps involved to initiate the use of a letter of credit?**

A3: **Step 1:** The administrator must**, at least 30 days** before the date on which the next solvency deficiency payment falls due, file both of the following with the Superintendent of Pensions (Superintendent) [section 63(4) of the PBSR]:

a) the executed letter of credit or a certified copy of it;
b) a written statement from the administrator that the letter of credit is a prescribed letter of credit.

Step 2: As soon as practicable, the Superintendent will provide the administrator a notice of receipt in relation to the letter of credit [section 63(8) of the PBSR].

Step 3: The administrator must forward the original of the executed letter of credit to the holder, together with a copy of the Superintendent's acknowledgement of receipt, **on or before the day** when the first of the solvency deficiency payments to which the letter of credit relates falls due [section 63(10)(a) of the PBSR].

Q4: **What are the steps involved to renew or replace a letter of credit?**

A4: **Step 1:** The administrator must, **at least 30 days** before the expiry of the letter of credit to be renewed or replaced [Sections 63(5) and (6) of the PBSR],

a) file <u>both</u> of the following:
   i. the executed renewal or replacement letter of credit or a certified copy of it;
   ii. a written statement from the administrator that the renewal or replacement letter of credit is a prescribed letter of credit.
b) notify the holder (fundholder to whom the letter of credit is made out for the benefit of the plan) that the renewal or replacement letter of credit was filed, and

c) if the amount covered by the letter of credit is to be reduced by the renewal or replacement letter of credit, file proof that the amount covered by the renewal or replacement letter of credit will continue to be sufficient to meet the funding requirements of the plan based on the current actuarial valuation report.

Step 2: As soon as practicable, the Superintendent will provide the administrator a notice of receipt in relation to the renewal or replacement letter of credit [section 63(8) of the PBSR].

Step 3: The administrator must forward the original of the executed letter of credit to the holder, together with a copy of the Superintendent's acknowledgement of receipt, **at least 15 days** before the expiry of the letter of credit being renewed or replaced [section 63(10)(b) of the PBSR].

Q5: What are the steps involved to allow a letter of credit to expire?

A5: The administrator must, **at least 30 days** before the letter of credit expires [section 63(7) of the PBSR],

a) notify the superintendent and the holder that the letter of credit will be allowed to expire without being renewed or replaced, and
b) at the same time that the notification is provided to the Superintendent, file
   i. the current actuarial valuation report showing that the funding requirements of the plan will continue to be met, or
   ii. proof that the participating employers have remitted to the plan all of the amount covered by the letter of credit.

Q6: What is the holder's obligation?

A6: If, **14 days** before the expiry of a letter of credit, the holder has not received the records as required under section 63(5)(b), (7)(a) or (10) of the PBSR, and has not been notified that the plan is or is about to be terminated, the holder must, **on the next business day**, demand payment from the obligated issuer of the full amount of the letter of credit.

Q7: What happens if the administrator receives a notice from the Superintendent that the executed letter of credit is not a prescribed letter of credit?

A7: The following must occur **within 30 days after** that notification [section 63(9) of the PBSR]:

a) the administrator must notify the participating employers who provided the letter of credit that the Superintendent has notified it that the executed letter of credit is not a prescribed letter of credit;
b) the participating employers who provided the letter of credit must
   i. provide to the administrator an executed letter of credit that is a prescribed letter of credit, or
   ii. remit the required solvency deficiency payments;

c) the administrator must, if a letter of credit is provided to the administrator under paragraph (b)(i) above, file that executed letter of credit with the Superintendent, or a certified copy of it, together with a written statement that the letter of credit is a prescribed letter of credit.

Q8: Can the amount covered by a letter of credit be used to determine the defined benefit component's solvency assets value, going concern assets value, or be used to calculate the solvency ratio and/or going concern funded ratio of the plan?

A8: No. A letter of credit is not an asset of a pension plan for purposes of determining the defined benefit component's solvency assets value, going concern assets value, nor can it be included in the calculation of a solvency ratio and/or going concern funded ratio of the plan.

However, the calculation of solvency asset adjustment shall include the face amount of any prescribed letter of credit in relation to the defined benefit component.

Q9: If a plan is using a letter of credit to meet the solvency funding requirements and the solvency position of the plan has improved on a subsequent review date, can the letter of credit be reduced or allowed to expire?

A9: Yes. A plan may reduce or allow any existing letters of credit to expire, as applicable, provided that the current actuarial valuation report certifies that 85% of the plan's solvency liabilities does not exceed the sum of the plan's solvency assets value and the solvency asset adjustment (which factors in any letters of credit, if applicable).

Q10: Can a plan acquire a letter of credit to cover a portion of the special payments?

A10: Yes, provided that the total of the amount covered by the letter of credit and the contributions made to the plan are sufficient to cover the plan's solvency deficiency payments for the period covered by the letter of credit.

Q11: Is it acceptable to remit the payment of the amount of a letter of credit into the plan's solvency reserve account (SRA)?

A11: Yes. The amount of the letter of credit can be paid into the SRA portion of the plan fund as such payments are in respect of solvency deficiencies.

Q12: Can fees related to the letter of credit be charged to the pension plan?

A12: No. The fees related to the issue and maintenance of the letter of credit must not be included in the letter of credit or charged as a cost to the plan [section 63(16)(a) of the PBSR].

Q13: Are interest payments required on the amount of the solvency deficiency that is covered by the letter of credit, given that solvency deficiency payments are calculated without interest?

A13: Yes. Despite that the calculation of solvency special payments does not take into account an interest component over the valuation period, section 63(16)(b) of the PBSR requires that interest which would have accrued on the amount of the solvency deficiency be included. For clarity, interest must be paid on the portion of the solvency deficiency that is covered by a letter of credit, unless the interest payments are included in the amount of the letter of credit.

Q14: The existing letter of credit contains an 'automatic renewal' clause, and therefore the issuer of the letter of credit does not issue an amendment or renewal as a result. Would it be acceptable if the plan administrator does not file a renewal or amendment to the letter of credit as it expires?

A14: No. A prescribed letter of credit must specify the date on which it becomes effective and the date on which it expires; and it expires no later than one year after the date on which it becomes effective.

The auto-renewal clause on the letter of credit as provided by the issuer (bank) does not satisfy the requirements under subsections 63(5) and 63(6) of PBSR. If the required filings are not received by the Superintendent within the prescribed timeline, the holder of the letter of credit must demand payment from the obligated issuer of the full amount of the letter of credit as per subsection 63(11) of PBSR.

Q15: Can a plan with a letter of credit restrict commuted value transfers if the solvency ratio is less than one?

A15: No. The full commuted value must be transferred when a person becomes entitled to that lump sum. The participating employer must [Section 63(17) of PBSR]:

a) make a lump-sum payment to the plan, in an amount equal to the transfer deficiency, before the administrator may make a transfer, or
b) include an amount equal to the transfer deficiency in the participating employer's next remittance of contributions.

Q16: Can the terms of a letter of credit provide for automatic increases in the amount covered?

A16: Yes, a letter of credit may provide for automatic increases in the amount covered by the letter of credit during the one-year period. The amount of the increase and the resulting total amount must be set out in the letter of credit.

ADDITIONAL INFORMATION

If you have any questions, please contact the BC Financial Services Authority (the BCFSA) at Pensions@bcfsa.ca or by phone at 604-660-3555.