ATTACHMENT 1

ASSOCIATION OF CANADIAN PENSION MANAGEMENT

PROPOSAL FOR USE OF LETTERS OF CREDIT TO MEET SOLVENCY DEFICIT CONTRIBUTION REQUIREMENTS FOR REGISTERED PENSION PLANS

Overview

In today's environment of 45-year low interest rates, current five-year solvency deficit funding requirements are causing significant increases in pension contribution requirements for many Canadian pension plan sponsors. Furthermore, when long-term interest rates rise and/or equity markets perform favourably over a sustained period, as will inevitably occur, many mature plans with a solvency deficit today will subsequently find themselves with surpluses that are too large to be effectively utilized over the foreseeable future.

This attachment describes proposed changes to pension funding regulations to permit the use of letters of credit to cover all or a portion of the current solvency deficit funding requirements. This proposal is a viable means of providing alternative solvency funding that will assist financially sound employers in addressing the issues identified above.

As is the case when letters of credit are utilized for supplemental pension arrangements, the letters of credit would be held by the plan's trustee. If the plan sponsor failed to renew the letters of credit, the trustee would call the existing letters of credit and the financial institutions that issued the letters of credit would be required to deposit the face amount of the letters of credit in the pension fund. Consequently, the issuance of letters of credit will have the same favourable impact on a less-than-fully-solvent plan's benefit security as the remittance of additional contributions to the plan.

Detailed Proposal

It is proposed that plan sponsors be able to elect to meet all or a part of their required solvency special payments (but not going concern special payments) by arranging for a letter of credit for the solvency special payments. The intent is that the sum of the plan's assets and the face amount of the letters of credit at any point in time will equal the expected assets at that time as if the solvency special payments had been made in cash. The proposed amendment to pension regulations would specify the following:

1. The sponsor may arrange a letter of credit in lieu of some or all of its required solvency special payments.

2. Once a letter of credit has been arranged for a specified amount of foregone contributions, it must remain in effect in such amount as long as the

contributions remain unpaid or, if earlier, until the plan has a solvency surplus (with plan assets valued at market value and taking into account the value of the letters of credit in place).

3. The letters of credit must be held by the pension fund trustee, and exercisable by the pension fund trustee independently of action, inaction or incapacity of the sponsor. Failure to renew a letter of credit will result in the letter of credit being called by the trustee, unless the letter of credit is no longer required (either as a result of the employer remitting the previously-foregone contributions or the plan reverting to a solvency surplus as per paragraph 2). Failure by the plan sponsor to remit any statutory minimum required contributions to the plan year in which they are due will result in all outstanding letters of credit being called by the trustee. (There may be circumstances where it is appropriate to call only a portion of the letters of credit.)

4. The letters of credit must be issued by financial institutions whose credit is rated by DBRS as "A-" or higher (or equivalent rating from another major credit rating agency), and who deal at arm's length with the plan sponsor.

5. In addition to the contribution requirements under existing regulations, additional contributions are required in the amount of the deemed interest on the accumulated balance of foregone solvency contributions, computed using the solvency liability discount rate used in the previous actuarial valuation.

6. To simplify the plan trustee's monitoring requirements, it is proposed that the plan sponsor be required to arrange, at the beginning of each year, the necessary letter of credit for the portion of that year's contribution requirements that will be met via letter of credit. The trustee would then be provided with the appropriate schedule setting out the statutory minimum contribution amounts for that year, including the portion being met by letter of credit. Any increase in contribution requirements for such year must be contributed to the pension fund in cash. Less restrictive requirements may be appropriate if the corporate trustee community deems that the monitoring is manageable.

7. In determining the solvency position of the plan, the face amount of the letters of credit is included in the plan assets.

8. In determining the going concern financial position of the plan (and hence the going concern special payments), any letters of credit in place would not be taken into account.

9. The face amount of any letters of credit in place can be reduced by the amount of any solvency special payments for a fiscal year that are in excess of the minimum requirement for such fiscal year.

10. The face amount of any letters of credit in place can be reduced if, at the effective date of the actuarial valuation, the sum of the market value of the plan assets and the face amount of the letters of credit exceeds the plan's solvency liabilities, in which case the face amount of the letters of credit can be reduced so that the sum of the market value of the plan assets and the adjusted face amount of the letters of credit equals the plan's solvency liabilities.

11. Normal (current service) cost contributions may be reduced to the extent that there is a going concern surplus, subject to there also being a solvency surplus. If the normal cost "contribution holiday" exceeds the solvency surplus, then such excess must be treated like unpaid solvency contributions (i.e., it is added to the minimum letter of credit face amount). In computing such surplus amounts, the face amount of any letters of credit in place is excluded in the calculation of the going concern surplus, and included in the calculation of the solvency surplus. Normal cost contributions may not be reduced if solvency liabilities exceed the sum of the plan's assets and the face amount of any letters of credit in place.

12. The plan sponsor is responsible for paying any fees for securing the letters of credit. If it is required that the fee for a letter of credit be paid from the pension fund, then the sponsor must first contribute the amount of the fee to the fund, in addition to any other required contributions.

13. Annual actuarial valuations would be required while any letters of credit remain in place.

14. A letter of credit would have to be in place as at the date at which a solvency contribution is due in order for the letter of credit to be utilized in lieu of contributing this amount.

15. In determining the plan's solvency ratio (i.e., the ratio used to compute any transfer deficiency contributions required when lump sum benefit payments are made from the plan), the face amount of any letters of credit would be included in the plan assets.