Questions and Answers on Letters of Credit

Q1. What are the prescribed requirements for a financial institution to be an issuer of a letter of credit provided under section 55.2 of the Pension Benefits Act (PBA)?

A1. The issuer must meet the following three criteria:

a) be a member of the Canadian Payments Association;
b) be a bank, credit union, caisse populaire, or a cooperative credit society; and
c) have a credit rating that meets the prescribed level, when the letter of credit is issued or renewed.

In addition, the issuer cannot be the employer, or an affiliate of the employer, who is required to make payments into the pension fund with respect to a solvency deficiency. -12/12

Q2. Can any pension plan that provides defined benefits make use of a letter of credit relating to a solvency deficiency?

A2. No, the PBA prohibits jointly sponsored pension plans (JSPPs) or multi-employer pension plans (MEPPs) from using letters of credit for solvency deficiencies. The PBA also prohibits public sector pension plans from using letters of credit for solvency deficiencies, unless they are specified in a regulation made under the PBA. Six public sector plans specified in **Regulation 118/14** made under the PBA, have been authorized to use Letters of Credit. In addition, Regulation 909 prohibits Abibow Canada Pension Plans, Algoma Steel Inc. Pension Plans, General Motors Pension Plans, and Stelco Inc. Pension Plans from using letters of credit for solvency deficiencies. - 05/14

Q3. Does the definition for "going concern assets" in section 1(2) of Regulation 909 include the amount of any letter of credit that is held in trust for the pension plan?

A3. No, the definition for "going concern assets" in section 1(2) of Regulation 909 excludes the amount of any letter of credit that is held in trust for the pension plan. -12/12

Q4. Does the definition for "solvency assets" in section 1(2) of Regulation 909 include the amount of any letter of credit that is held in trust for the pension plan?

A4. No, the definition for "solvency assets" in section 1(2) of Regulation 909 excludes the amount of any letter of credit that is held in trust for the pension plan. -12/12

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Q5. Are interest payments required on the portion of the solvency deficiency that is covered by a letter of credit?

A5. Yes, 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. -12/12

Q6. Regulation 909 allows a letter of credit to be renewed for an amount that is greater than the amount of the original letter of credit. What is this greater amount?

A6. The total amount of the new letter of credit, plus the total of all other letters of credit held in trust for the pension fund, cannot exceed 15 per cent of the pension plan's solvency liabilities (as set out in section 5.3.1 of Regulation 909) as of the date of the most recently filed valuation report. -12/12

Q7. Under what circumstances may a letter of credit be reduced?

A7. A letter of credit may be reduced in any one of the following circumstances:

a) if the employer has paid into the pension fund the amount by which the letter of credit is to be reduced; or

b) if the most recently filed valuation report indicates that the solvency liabilities minus the solvency assets (both after smoothing) is less than or equal to the present value of the total amounts of all letters of credit, then the letter of credit may be reduced to the level by which the solvency liabilities exceed the solvency assets (both after smoothing).

The administrator must notify the trustee that the letter of credit is reduced and the trustee must have received notice that a) or b) above has been satisfied. - 3/14

Q8. If an application has been filed under the Companies' Creditors Arrangements Act (CCAA) is the trustee required to demand payment of the letter of credit?

A8. Regulation 909 does not speak to an application under the CCAA. Once the trustee is made aware of an application under the CCAA, the trustee's course of action should be dictated by the terms of the trust agreement, and the fiduciary responsibilities that are placed on the trustee by the Pension Benefits Act. -12/12

Q9. Under Regulation 909, is the trustee required to take any action before the letter of credit expires?

A9. Fourteen days before the letter of credit expires, the trustee is required to demand payment for the amount of the letter of credit, unless one or more of the following events has occurred:

1. The employer has paid into the pension fund an amount that is equal to the amount of the letter of credit.
2. The letter of credit has been renewed for an amount that is at least equal to the amount of the original letter of credit, and the trustee has received notice of the renewal.
3. The letter of credit is being replaced for an amount that is at least equal to the amount of the original letter of credit, and the trustee has received the replacement letter of credit.

4. The plan administrator has notified the trustee that the amount of the letter of credit has been reduced, and the trustee has received the following documents:

   a) The replacement letter of credit for the reduced amount, or notice of the renewal of the current letter of credit in the reduced amount.

   b) Notice that the employer has paid into the pension fund the amount by which the letter of credit is reduced, or notice that no such payment is required because the most recently filed valuation report indicates that the solvency deficiency has fallen by at least the amount by which the letter of credit will be reduced. -12/12

Q10. Can a letter of credit be applied towards existing solvency special payments or can it only be applied towards special payments resulting from a new solvency deficiency revealed in a valuation report?

A10. Yes, a letter of credit can be applied towards future scheduled solvency special payments that are set out in valuation reports already filed with FSCO. However, it can only be applied towards special payments that are not yet due; it cannot be used to fund existing special payments that are in arrears. -03/13

Q11. Can the terms of a letter of credit provide for the automatic renewal of the letter of credit?

A11. Yes, the terms of a letter of credit can provide for the automatic renewal of the letter of credit, but the notification and other requirements as set out in the Regulation must be met including filing a certificate of compliance with the Superintendent with respect to the renewed letter of credit. The issuer's credit rating must meet the requirements in the Regulation at the time of each renewal. -03/13

Q12. Can the terms of a letter of credit provide for automatic increases in the amount of the letter of credit?

A12. Yes, a letter of credit may provide for automatic increases in the amount of the letter of credit. The amount of the increase and the resulting total amount must be set out in the letter of credit. -03/13

Q13. Does interest have to be paid on the total outstanding amount of the special payments covered by the letter of credit?

A13. Yes, interest must be paid in cash to the pension fund on the special payments covered by the letter of credit, unless the interest payments are already included in the amount of the letter of credit. An Actuarial Guidance Note on this matter is forthcoming. -03/13

Q14. We plan to acquire a letter of credit to be used to cover a portion of the special payments which are due. Can we begin to use the letter of credit to cover the special payments as soon as the letter of credit is issued?

A14. No, a letter of credit can be used to cover special payments only if it has been provided to the trustee at least 15 days before the due date of the special payments that are to be secured by the letter of credit. -03/13

Q15. When must the interest on special payments that is not covered by a letter of credit be paid?

A15. Interest on special payments that is not covered by a letter of credit must be paid by the expiry date of the letter of credit to which those special payments relate. Such interest cannot be covered by a subsequent letter of credit. – 01/14