New Québec Legislation Proposes Major Changes to Pension Funding Rules

Bill 57: An Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans.

Bill 57 was introduced on June 11, 2015, and is the product of a two-year consultation process stemming from the D’Amours Report (Innovating for a Sustainable Retirement System). The bill introduces major changes to the funding rules for private sector defined benefit pension plans effective January 1, 2016, including:

- Eliminating solvency funding;
- Requiring that going concern funding be augmented by funding towards a stabilization provision, the amount of which will be specific to each plan’s investment policy; and
- Changing the rules for use of surplus in ongoing plans and on termination.

The bill also makes a number of changes to the benefit provisions of the Supplemental Pension Plans Act (SPPA), including elimination of the additional pension benefit introduced in 2001, and rule changes for commuted value payments when members elect portability.

The bill should be subject to a parliamentary commission later this year. The main features of the bill have been favourably received by various stakeholders, so it is not expected to change significantly before its January 1, 2016 effective date.

This Special Notice provides an overview of the funding and benefit changes contained in Bill 57.
Funding changes

Solvency and Going Concern Funding

While Bill 57 eliminates solvency funding, a plan’s solvency must still be determined and used for specific purposes, such as the new limits on the use of surplus in an ongoing plan, funding rules for plan amendments, termination of a plan, filing frequency for actuarial valuations, and transfers of commuted values out of the plan (discussed below).

Effective January 1, 2016, plans must be funded on a going concern basis. Asset smoothing may still be used, with a maximum averaging period of five years. Letters of credit (LOCs) may be used for funding the new stabilization provision discussed below. Any LOCs may not be used to fund more than 15% of a plan’s going concern liability, and the value of the LOCs must now be included in the plan’s assets on a going concern basis (including existing LOCs at the time the measure becomes effective).

The new funding rules require that technical and stabilization amortization payments be amortized over a 10-year period. However, for valuations prior to December 31, 2016, a 15-year amortization period may be used, which will be reduced gradually to 10 years by December 31, 2020.

In addition, transition rules provide that if the total annual employer contributions determined for the years 2016, 2017 or 2018 are greater than those that would have been payable in 2016 under the provisions in force on December 31, 2015, only one-third of the difference is payable in 2017 and the remaining two-thirds in 2018. Regular employer current service contributions are excluded from this transition rule.

Stabilization Provision

In exchange for the elimination of solvency funding, plans must now fund an additional amount determined by a stabilization provision (essentially, a reserve account). The account will be funded through actuarial gains, current service contributions, and separate amortization payments. The target funding level for each plan will be based on a scale to be specified in forthcoming regulations. It is expected that the funding level will vary depending on the plan’s investment policy, with higher funding for plans with more aggressive policies.

The current service stabilization contribution is payable until the plan reaches the stabilization provision amount plus 5%, while stabilization amortization payments will be paid until the plan reaches the stabilization provision amount minus 5%.

Actuarial Valuations

To prepare for the new funding regime, all plans must prepare an actuarial valuation as of December 31, 2015. For the purposes of this valuation, amortization payments required for previously established deficits are eliminated. Valuations will be done every three years, with an annual notice of the plan’s financial position to be sent to the Régie des rentes du Québec within four months of the plan’s fiscal year-end. The upcoming regulations are expected to outline the content of this notice. If an annual notice indicates that a plan’s solvency ratio is less than 85%, annual valuations will be required.

Employer contributions to fund the plan’s deficit and to fund the stabilization provision are designated the “employer’s reserve” and are subject to special monitoring. The value of this reserve will increase annually with interest calculated at the rate of return on plan assets, net of administration and investment fees. Any contribution holiday or surplus withdrawal by the employer will reduce the amount of the reserve.
Use of Surplus

Bill 57 changes the rules governing the use of surplus in an ongoing plan and on termination. It provides that surplus assets can only be used in an ongoing plan if:

- the plan is fully funded (on a going concern basis);
- the target funding level under the stabilization provision has been exceeded by 5%; and
- the plan’s solvency ratio is at least 105%.

Surplus assets in excess of the lesser of the above surplus amounts must first be used — up to the employer’s reserve — to pay any employer current service contributions, irrespective of plan provisions. Any remaining excess surplus (up to 20% per year) must be dealt with in accordance with plan provisions, and can serve to pay for the costs of a plan amendment, or be returned to the employer, depending on plan provisions.

Bill 57 states that administrators must amend or confirm existing plan provisions on the appropriation and allocation of surplus assets in an ongoing plan or on termination. The process requires that notices be sent to all plan members and beneficiaries, and the provisions are deemed to be confirmed if less than 30% of members file an objection.

If no amendment or confirmation is made by January 1, 2017, the plan will be deemed to split surplus 50/50 between the employer and members on termination. The use of a portion of surplus by an employer in an ongoing plan will require that an equal portion be used to provide additional benefits to plan members and beneficiaries proportionately to the value of their benefits. Note that the use of the employer reserve to pay employer current service contributions on an ongoing basis is governed by legislation and is not subject to the consultation process.

As a result, new rules will apply to surplus distribution on plan termination, in lieu of the current surplus sharing proposal and arbitration rules.
Benefit Changes

Additional Pension Benefit

The requirement to fund the additional pension benefit introduced in 2001 will be eliminated. This benefit currently provides partial indexing of deferred pensions for former members until age 55. If the plan is amended on that point prior to January 1, 2017, the elimination may be retroactive to January 1, 2001 regardless of the rules for adverse amendments.

Portability

Bill 57 provides that members who elect portability after termination will have their commuted value calculated based on the plan’s solvency ratio, with no requirement to make up the shortfall. Note that this provision will not apply in cases where terminating members are required by administrators to transfer their benefits that are below the small pension limits.

Annuity Purchases

Similar British Columbia’s new Pension Benefits Standards Act, Bill 57 will amend the SPPA to provide that plans with an annuity purchasing policy meeting the requirements to be set out in regulations will be able to discharge their obligations to members following an annuity purchase. Unlike British Columbia, the SPPA will provide that affected individuals still have rights to share in any surplus if the plan is terminated within three years of the annuity purchase.

Other Provisions

Bill 57 also contains the following notable provisions:

- Every plan must have a written funding policy, with content to be set out in regulations.
- A plan may be amended to allow members to contribute to the funding of the plan’s deficit. Any such contributions will not be subject to the 50% rule.

While the bill refers to the funding of additional obligations arising from a plan amendment, those rules have not changed, except for the funding of the stabilization provision. The amendment deficiency must still be paid over a maximum of five years; however, if the plan is less than 90% funded, the total cost of the amendment must be paid in full, in addition to the stabilization provision in respect of those obligations.

Implications and Next Steps

Bill 57 will take effect on January 1, 2016, although related regulations must still be introduced and finalized. It is hoped that the regulations will address:

- Whether the employer’s reserve will be subject to the new surplus rules on termination;
- How surplus will be treated if more than 30% of members object to a surplus confirmation/amendment proposal;
- What elements will constitute an acceptable annuity purchasing policy for a plan to discharge its benefit obligations; and
- Whether the going concern discount rate must include a margin for adverse deviation.

While Bill 57 does not state how the new portability rules will apply to members of multi-jurisdictional plans, it is expected that the...
new rules will apply to all Québec plan members, regardless of where a plan is registered. Members of Québec-registered pension plans who are employed in another jurisdiction are expected to have their portability funding determined based on the rules for their jurisdiction of employment. Administrators of multi-jurisdictional plans will need to carefully communicate the different portability rules to their members.

The financial impact of stabilization payments will depend on a plan’s investment policy, and any cost increase may be offset by the elimination of solvency payments. However, it should be noted that some plans may have to make contributions to the stabilization provision under the new rules if their stabilization provision is not fully funded, even if the plan’s funded ratio is greater than 100%.

In light of the changes made by Bill 57, plans should also review and/or revise their investment policies, particularly any de-risking strategies.

Please contact your Eckler pension, investment or communication consultant for assistance in complying with the Regulations.