Special Notice

October 26, 2020

Quebec introduces Bill 68 allowing for the establishment of target benefit plans

On October 7, 2020, the government of Quebec introduced Bill 68, *An Act mainly to allow the establishment of target benefit pension plans* (Bill 68). Bill 68 amends the *Supplemental Pension Plans Act* (SPPA) to allow for the establishment of target benefit pension plans (TBPs) in the province, which were previously only permitted for certain companies in the pulp and paper industry. This *Special Notice* provides an overview of Bill 68 and its potential impact for Quebec pension plan sponsors.

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Background: Target benefit plans

TBPs combine features of both defined benefit (DB) and defined contribution (DC) pension plans. As with a DB plan, they provide participants with the payment of a pension at retirement, based on a pre-set formula and payable for their lifetimes. However, TBPs differ from DB plans in that benefits can be modified (increased or decreased) according to the evolving financial situation of the plan. Such modifications may include adjusting benefits if the plan's assets and contributions are not sufficient to fund the target benefits.

As with a DC plan, employer contributions to a TBP are limited to those stipulated in the plan, and plan members bear the risks linked to longevity and return on investments. However, unlike a DC plan, where members bear those risks individually, these risks are borne collectively in a TBP. This sharing of risk, along with the potential for better investment performance and lower investment management fees as a result of a larger pooling of assets, offers a key advantage for TBP participants: higher expected pension amounts than can typically be generated in a DC plan with the same fixed contributions.

Key measures for target benefit plans

Bill 68 establishes the requirements for TBPs, including:

- Establishing the limits for employer contributions;
- Allowing benefits to be reduced due to insufficient contributions;
- Requiring TBPs to determine benefit targets, recovery measures for insufficient contributions and procedures for restoring benefits that have been reduced;
- Establishing the rules for converting DC plans and certain multi-employer pension plans into TBPs; and
- Introducing requirements for existing TBPs in the pulp and paper industry to comply with the new TBP regulations by December 31, 2023.

Bill 68 also allows DB plans or TBPs to provide that the measurement of a plan's solvency, for the purposes of a member's lump sum benefit payment, can be established at intervals shorter than the plan's fiscal year.

Characteristics of target benefit plans under Bill 68

Bill 68 establishes the characteristics and requirements for TBPs in the province, including limiting employer contributions to those stipulated in the plan, establishing contributions to be paid by employers and employees, and establishing that benefits, including pension benefits in payment, may be reduced due to insufficient contributions.

TBPs must set out the benefit target and the recovery measures to be taken in the event there are insufficient contributions, as well as the procedure for restoring benefits that have previously been reduced.

Bill 68 also contains several measures governing the management of TBPs, including restrictions on benefits to be offered. In particular, TBPs cannot provide:

- Pensions based on the plan member's average salary over their last remunerated years or an average of their highest salaries over a specified number of years;
- Increases in the member's pension during retirement based on an index or rate specified in the plan;

- Conditional benefits to be granted on plan termination; and
- Early retirement conditions based on the plan member's years of service or membership in the plan.

Funding rules

Bill 68 introduces several measures regarding funding and management of TBPs assets. It requires TBPs to include provisions outlining funding and management that leave no discretion to the pension committee when considering their enforcement.

Contributions must be established according to the benefit target. Plan liabilities are determined in a similar manner to that which is typical for DB plans, but it is also necessary to reflect benefit adjustments resulting from a recovery plan, a restoration plan or the use of any surplus assets. Actuarial valuations must be made on the date of the end of the fiscal year of the plan.

Detailed provisions related to the recovery of the plan's financial situation, the restoration of target benefits (if reductions have previously been made), and the use of surplus assets must be explicitly stated in the plan documents to provide guidance to the pension committee. Barring exceptions, only plan participants and beneficiaries are entitled to benefit from surplus assets.

Sufficiency of contributions must be determined separately for service after and prior to the valuation date. The following recovery measures may be used:

- Increase in member contributions;
- Increase in employer contributions, subject to the maximum employer contribution provided for in the plan text;
- Reduction in the benefit target; and
- Reduction in the accrued benefit related to service credited at the valuation date, which is only possible up until the valuation date.

A combination of the above measures is possible.

Any changes to the plan provisions governing recovery measures are only permissible if less than 30% of plan members and beneficiaries object.

Other measures of interest

Amendments related to established plans

Bill 68 introduces amendments regarding established TBPs in the pulp and paper industry in Quebec that will require existing TBPs to amend their current plan structure to comply with the new TBP framework no later than December 31, 2023. It also introduces special rules governing TBPs and member-funded pension plans in the municipal and university sectors, such as restricting employer contributions to no more than 55% of the total of employer and member contributions provided for in the plan for any class of members.

Bill 68 also establishes rules to support the conversion of DC plans and certain multi-employer pension plans into TBPs. However, DB plans will not be allowed to be converted into a TBP. Additionally, no pension plan may contain both DB provisions and target benefit provisions.

Bill 68 will allow pension plans that include DC provisions and voluntary retirement savings plans to offer variable payment life pensions to be paid out of all or part of the sums that the plan member or plan member's spouse holds in a DC or voluntary retirement savings plan.

Impact

Bill 68 offers employers and employees in Quebec an additional option for retirement savings that allows for a sharing of financial and longevity risks, and the potential advantages that arise from that risk pooling, while providing for greater cost certainty for employers similar to that of a DC plan. TBPs offer several benefits of DB pension plans, such as a target retirement benefit that will simplify members' retirement income projections and planning, potential for the provision of increased retirement income through increased retirement savings as a result of longevity and investment risk poolings, access to additional investment options and investment management professionals and, potentially, lower investment management fees. By design, TBP benefits will be kept simple to minimize volatility in the financial situation of the plan. Moreover, the establishment of TBPs will allow for a fresh start and TBPs will include specific recovery and restoration measures, as well as provisions for the use of surplus assets, which will be triggered by pre-determined funding levels. The combination of the plan provisions and corrective measures will maximize chances that TBPs remain sustainable in the long term.

These features may prove to be an attractive option for employees and employers, particularly when compared to DC plans. While DC plan members have, in general, experienced advantageous investment returns over the last two decades, many members lacking investment knowledge may have made poor investment decisions that resulted in lower savings for their retirement. Also, for retirees living significantly past their life expectancy, the longevity risk pooling under a TBP is a very important feature. In this context, TBPs offer a lifetime payment, which is highly desirable for a significant number of retirees, and the added benefit that favourable experience under a TBP translates into benefit improvements for members, both active and inactive.

A number of other Canadian jurisdictions, including Ontario, Nova Scotia, Saskatchewan, British Columbia and Alberta, have introduced legislation allowing for TBPs, but some have yet to establish regulatory measures outlining the specific rules governing these plans. As regulations in other jurisdictions come into effect, the potential for multi-jurisdictional TBPs could be explored for employers.

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