New Year, New Pension Funding Rules in Québec: Passage of Bill 57

Bill 57, An Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans, was assented to on November 26, 2015, and will come into effect on January 1, 2016. The bill will implement major changes to the funding rules for private sector defined benefit (DB) pension plans, 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 some notable changes to other provisions of the Supplemental Pension Plans Act (SPPA), such as eliminating the additional pension benefit, and changing the rules for commuted value payments when members elect portability. Full details on the draft version of the bill can be found in Eckler’s June 19, 2015 Special Notice: New Québec Legislation Proposes Major Changes to Pension Funding Rules.

As Bill 57 was the product of a two-year consultation, and its main features were favourably received by stakeholders, there are only a small number of key changes between the draft and final versions. These changes impact the new stabilization provision, actuarial valuations, the employer’s reserve, use of surplus, use of annuity buy-outs and availability of variable payments for defined contribution (DC) pension plans.

This Special Notice provides an overview of the key changes between the draft and final versions of the bill, and discusses some of the administrative impacts of the new legislation.
Key changes

Stabilization provision

In exchange for the elimination of solvency funding, DB pension plans must now fund an additional amount determined by a stabilization provision. 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 requirements for plans with more aggressive policies. The current service stabilization contribution is payable until a contribution holiday is permitted. Stabilization amortization payments will be paid until the plan reaches the stabilization provision amount, minus 5%.

Update from draft: The final version of Bill 57 provides that the target funding level will not only depend on the investment policy but on other criteria that will be set out in forthcoming regulations.

Actuarial valuations

To prepare for the new funding regime, all DB 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 triennially going forward, with an annual notice of the plan’s financial position sent to the Régie des rentes du Québec within four months after the plan’s fiscal year-end. The upcoming regulations are expected to outline the content of this notice.

Update from draft: The final version of Bill 57 provides that annual valuations will be required if a plan’s going-concern funded ratio is less than 90%. The draft had originally mandated annual valuations if a plan’s solvency ratio was less than 85%. While an actuarial valuation will also be required in the event of an annuity purchase, it can be a partial valuation, as discussed below.

Employer’s reserve

Employer contributions to fund the plan’s deficit and stabilization provision are designated as 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.

Update from draft: The final version of Bill 57 provides that the employer’s reserve will be applicable at all times, including on wind-up. In addition, employee contributions used to help fund any deficit will also constitute a reserve, subject to the same special monitoring and usage rules.

Bill 57 requires annual valuations for plans with going concern funded ratios of less than 90% — the draft required annual valuations for plans with solvency ratios of less than 85%.
**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, regardless 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.

The draft of Bill 57 also required that administrators amend or confirm existing surplus plan provisions (while the plan is ongoing and on termination) through a consultation process. If no amendment or confirmation was made by January 1, 2017, the plan would be deemed to split any surplus 50/50 between the employer and members on termination. Furthermore, if the employer uses a portion of surplus in an ongoing plan, an equal portion must be used to provide additional benefits to plan members and beneficiaries proportionately to the value of their benefits.

**Annuity purchases**

Similar to provisions included in British Columbia’s new *Pension Benefits Standards Act*, Bill 57 will amend the SPPA to provide that plans with an annuity purchasing policy (which meet the requirements to be set out in regulations) can 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 after the annuity purchase.

**Update from draft:** In addition to requiring a valuation as of the date of the annuity purchase (as noted on page 2), the final version of Bill 57 also provides that employers may need to make a special contribution to address any deficiency revealed by the valuation before purchasing annuities, although details are not currently available. While insured retirees retain their rights to surplus for three years after the annuity purchase, they will still remain at risk in the event of the employer’s bankruptcy over the same period of time. Finally, the legislation now provides that the available discharge only applies to the purchase of annuities in respect of pensions currently in pay status.

**Variable benefits**

The final version of Bill 57 contains provisions that allow private sector DC plans to pay variable benefits directly from the pension plan. Before these amendments, the only option available to terminating or retiring DC members were an annuity purchase or transfer to a prescribed retirement savings vehicle. Additional details, such as the minimum and maximum payment amounts, and the default annual payment if an individual fails to select a payment amount, will need to be set out in the regulations.

**Update from draft:** Given that variable benefit provisions were not found in the draft, all of the above is new.
Implications for administrators and next steps

Plan sponsors will need to decide how to address the following changes, and prepare for 2016:

- **Portability:** With limited exceptions (e.g., mandated transfers at time of death or marriage breakdown and transfers subject to the small benefit rule), Bill 57 provides that members who elect to transfer their commuted value after termination will be paid based on the plan’s solvency ratio (up to one), with no requirement from the employer to make up any shortfall. Administrators of multi-jurisdictional plans may still decide to pay the full commuted value to ensure consistency and fairness among all members. It should also be noted that the new rules may lead more terminating members to keep their entitlements in the plan until its solvency ratio is greater than one, leading to more deferred pensions.

- **Additional benefit:** Bill 57 eliminates the additional pension benefit introduced in 2001 (providing partial indexing of deferred pensions for former members until age 55) and the requirement to fund it. Plan amendments to eliminate the additional benefit can be made retroactive to January 1, 2001 without constituting an adverse amendment. Plan sponsors will need to decide whether or not to eliminate the additional benefit by January 1, 2017 — the deadline for related amendments. The elimination of the additional benefit will require careful review for collectively bargained plans, and for multi-jurisdictional plans that offered this benefit to all members.

Multi-jurisdictional plans should also determine the scope of the application of Bill 57 to their membership, whether a plan is registered in Québec or not. Although plan funding is based on the province of registration (driven by the plurality of active members), members’ rights are generally established according to their province of employment.

While Bill 57 takes effect on January 1, 2016, related regulations must still be introduced and finalized. Eckler will provide information on these regulations as soon as they are available.