Amendments to the *Supplemental Pension Plans Act* effective 1 January 2016

This *Newsletter* provides information for plan administrators on the main amendments to the *Supplemental Pension Plans Act* that took effect on 1 January 2016.

It covers:

- the funding of pension plans;
- measures for risk management;
- the use of surplus assets;
- other measures.

The amendments were made under Bill 57, the *Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans* (2015, chapter 29).

With the exception of the section on variable benefits\(^1\), this edition of the *Newsletter* concerns defined benefit pension plans exclusively, including those with a defined contribution component.

**Excluded plans**

The new provisions of the Act do not apply to plans whose funding is subject to exemption via regulation\(^2\), particularly plans in the municipal and university sectors.

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1. For further details, refer to the section on variable benefits.
2. A regulation made pursuant to section 2 of the Act.
3. For further details, refer to the section on the funding policy.

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In the case of those plans, the Act as it read prior to 1 January 2016 continues to apply, adapted as required in accordance with the provisions of various exempting regulations. However, the new provisions regarding the funding policy\(^3\) do apply to these plans.

**Plan funding**

Requiring funding to be established solely on a going concern basis and the creation of a stabilization provision established on a going concern basis are among the major amendments to Chapter X of the Act.

**Frequency of actuarial valuations**

Going forward, a complete actuarial valuation is required every three years only. However, under the Act, an actuarial valuation is required each year where the financial position of the plan warrants.

Thus, where a complete actuarial valuation shows that the plan’s funding ratio is less than 90%, a complete actuarial valuation of the plan must be carried out each year until the funding ratio reaches at least that percentage.
An actuarial valuation is also required where

- final payment of the benefits of retired members and beneficiaries is made by purchasing an annuity from an insurer;
- an amendment having an impact on funding is valued; or
- surplus assets are allocated to the payment of employer contributions.

In such cases, a partial valuation can be carried out. However, in the latter two cases, the valuation can be partial provided that the actuarial valuation is produced at the end of the plan’s fiscal year and that no complete actuarial valuation is required under the Act or by Retraite Québec.

Legal reference: sections 118 and 119 of the Act

**Notice concerning the plan's financial situation**

Each year, the pension committee must send Retraite Québec an annual notice informing it of the plan’s financial situation. The notice must be sent no more than four months following the end of the plan’s fiscal year, except where an actuarial valuation is required every year in the case of a funding ratio of less than 90%, or every three years.

The information to be contained in the notice and the documents to be included with the notice are prescribed by regulation.

Legal reference: section 119.1 of the Act

**Actuarial valuation on a solvency basis**

An actuarial valuation on a solvency basis determines the pension plan’s capacity to meet its commitments if the plan were to be terminated on the valuation date.

All pension plans are now exempted from funding on a solvency basis. However, under the Supplemental Pension Plans Act, it is still necessary to present the plan’s financial situation on that basis in the actuarial valuation report.

**Stabilization provision**

To reduce risks related to economic and demographic fluctuations, defined benefit pension plans must provide for the establishment of a stabilization provision.

The target level of the provision is specific to each plan and is determined using a scale established by regulation.

Legal reference: section 125 of the Act

**Actuarial valuation on a going concern basis**

The terms used to designate the types of deficiencies on a going concern basis have also been changed. There are now three types: technical deficiency, improvement unfunded liability and stabilization deficiency.

A technical deficiency is the difference between results and predictions, as well as any changes to actuarial assumptions and methods. It can be amortized over a maximum period of 10 years and is consolidated at each actuarial valuation.

An improvement unfunded liability results from any amendment to the plan provisions that has an impact on the funding of the plan. It can be amortized over a maximum period of 5 years and cannot be consolidated. However, if the plan has a funding ratio of less than 90%, a special improvement payment must be paid into the pension fund instead.

A stabilization deficiency is established to fund the stabilization provision up to a certain level. It can be amortized over a maximum period of 10 years and is consolidated at each actuarial valuation.

Legal reference: sections 38.2, 131, 132, 134, 138 and 139 of the Act

**Letters of credit**

An employer may, on providing the pension committee with a letter of credit, be relieved of paying all or part of the portion of the employer contribution in respect of the stabilization amortization payment.
The total amount of such letters of credit is taken into consideration as part of the assets on a going concern and a solvency basis, and may not exceed 15% of the liabilities established for each of these bases. In addition, under section 42.1 of the Act, the total amount of the letters of credit cannot exceed 15% of the plan’s liabilities on a going concern basis.

This rule also applies to letters of credit provided in accordance with the Act as it read prior to 1 January 2016.

Legal reference: sections 42.1, 122.2 and 288.2 of the Act

**Special monitoring under section 42.2 of the Act**

Under the Act, employer or member contributions that are technical amortization payments or stabilization amortization payments are subject to special monitoring, commonly called a banker’s clause. The same is true for employer contributions paid in excess of the contributions required under the Act.

Such contributions must be recorded separately for the employer and members, and are subject to interest at the net rate of return derived from the investment of the plan assets. However, the employer contributions paid by means of a letter of credit are not subject to special monitoring.

A person or body who has made amortization payments to the pension fund for certain deficiencies can recover those amounts first, in particular by taking a contribution holiday when the plan’s financial situation so allows. All amounts appropriated for that purpose must be deducted from the contributions subject to special monitoring.

If contributions paid before 1 January 2016 were, in accordance with the plan text, the subject of special monitoring (or banker’s clause), those contributions must be recognized and shown in the actuarial valuation of the plan as at 31 December 2015.

Legal reference: sections 42.2 and 288.3 of the Act

**Transitional rules**

All defined benefit pension plans must be the subject of a complete actuarial valuation at 31 December 2015. For the purposes of the valuation, the amortization payments required for an unfunded actuarial liability determined in a prior actuarial valuation are eliminated.

In addition, certain rules apply to the funding of deficiencies determined as at 31 December 2015. For pension plans whose employers will incur an increase in amortization payments and current service stabilization contributions, there is a three-year transition period. The employer contributions that would be required for 2016 under the provisions in effect on 31 December 2015 (maximum funding between a going concern basis and solvency basis, and the use of relief measures, if any) must be compared with those required for the same period under the new funding rules.

The Act provides that the increase is only applicable at a rate of one-third per year as of 1 January 2017, with no increase being applied for 2016.

To summarize, for

- 2016, there is no increase in employer contributions;
- 2017, one-third of the increase must be paid into the pension fund by the employer;
- 2018, two-thirds of the increase must be paid into the pension fund by the employer;
- 2019, the employer must pay the contributions required under the new provisions of the Act.

Legal reference: sections 318.2 through 318.4 of the Act
Measures for risk management

Funding policy

The person or body empowered to amend the pension plan must establish a written funding policy that meets the requirements prescribed by regulation, review it regularly and send it to the pension committee without delay.

All defined benefit pension plans must meet that requirement, even those to which exemption rules apply.

Legal reference: section 142.5 of the Act

Internal by-laws

For several years, pension committees have been required to adopt internal by-laws establishing their rules of operation and governance. The committee ensures that they are complied with and reviews them regularly. The internal by-laws must now also set out how the risks that face the plan are quantified.

Legal reference: section 151.2 of the Act

Investment policy

The pension committee must establish and adopt a written investment policy, giving particular consideration to the type of pension plan, its characteristics, and its financial obligations. Under the Act, the investment policy must now take into account the funding policy.

Legal reference: sections 169, 170 and 171.1 of the Act

Annuity purchasing policy

A pension plan can now contain an annuity purchasing policy allowing for, during the life of the plan, partial or full payment of pensions of members and beneficiaries. The content of the policy is set out by regulation.

In the event that annuities are purchased under the policy, an actuarial valuation must be completed within four months of the agreement with the insurer. Payment of the benefits in accordance with the policy must meet the funding requirements prescribed by regulation. A special annuity purchasing payment, calculated in the manner determined by regulation, may be required.

The payment made in accordance with annuity purchasing policy constitutes final payment of the benefits of the members and beneficiaries covered by the agreement with the insurer. The Act provides that members and beneficiaries whose benefits have been paid retain, for three years, their status as a member or beneficiary under the plan for the purposes of the provisions relating to the allocation of surplus assets in the event of termination of the plan. They also retain their status, for the same period, in the event of the employer's bankruptcy or insolvency which, following the employer's withdrawal from the plan or the termination of the plan, results in a reduction of their benefits.

Legal reference: sections 14, 33, 142.4, 182.1 and 182.2 of the Act

Use of surplus assets

Amendments to the plan text with regard to the use of surplus assets

All plan texts, regardless of their type or effective date, must now contain a special section that is easily recognizable and includes all provisions related to the use of surplus assets during the life of the plan. The provisions related to the allocation of surplus assets in the event of plan termination must also be in a special section. These provisions can be presented separately or together, but the rules that apply in the two situations must be separate from the rest of the plan text and clearly identified.

A pension committee that proposes to apply for the registration of an amendment to such a plan provision concerning surplus assets must inform the plan members and beneficiaries in

4. This requirement will come into effect once the regulation has been made.
5. As of April 2016, the regulatory provisions had not been set out.
writing and consult them. If more than 30% of the members and beneficiaries oppose the proposed amendment, it is deemed rejected and cannot be made.

Legal reference:
sections 14, 26, 146.1 through 146.5 of the Act

Use of surplus assets during the life of the plan

For a defined benefit pension plan, the use of surplus assets during the life of the plan is allowed only if the following conditions are met:

1. On a going concern basis:

\[
\text{Plan assets} > \text{Plan liabilities} + \text{Value of the target level of the stabilization provision plus 5%}
\]

2. On a solvency basis:

\[
\text{Plan assets} > 105 \% \times \text{Plan liabilities}
\]

The Act also introduces new limits regarding the use of surplus assets. All surplus assets must first be appropriated to the payment of the employer and member current service contributions, up to the amount subject to special monitoring, as outlined under section 42.2 of the Act. If there is a balance of surplus assets, up to 20% of the balance may be appropriated per fiscal year of the plan and in accordance with its provisions.

The new limits could prevent the plan from taking a contribution holiday, even if the plan has considerable surplus assets. However, under section 146.9 of the Act, it is permitted to amend a plan text to authorize a contribution holiday greater than the amounts subject to special monitoring, providing the conditions regarding the use of surplus assets are met.

Even though actuarial valuations are carried out every three years, the appropriation of surplus assets to a contribution holiday must stop at the end of any fiscal year for which an actuarial valuation or a notice concerning the plan’s financial situation shows that one of the conditions concerning the use of surplus assets is not met.

Legal reference:
sections 146.6 through 146.9.1 of the Act

Distribution of surplus assets in the event of termination

Any surplus assets of a terminated pension plan are first allocated concurrently to the employer and to the members and beneficiaries with benefits under defined benefit provisions, up to the amount of the contributions subject to special monitoring.

Any remaining surplus assets must be allocated in accordance with the conditions and procedure set out in the plan. The portion allocated to the members and beneficiaries is apportioned among them in proportion to the value of their accrued benefits, unless another method has been set out in the plan.

The arbitration procedure for the allocation of surplus assets in the event of termination no longer applies.

Legal reference: section 230.2 of the Act

Other measures

Repeal of section 60.1 of the Act (additional pension benefit)

Section 60.1 of the Act, concerning the additional pension benefit, was repealed on 1 January 2016. Since that date, it is no longer an obligation for pension plans to contain the minimal test that the section required. If the plan retains the test, the applicable methods for doing so are those provided for in the plan text since the Act and its regulation no longer contain provisions to that effect. In addition, since section 60.1 no longer applies, the additional pension benefit provided for under the plan can no longer be paid in a lump-sum as it would violate section 67.1 of the Act, which provides that no pension plan may provide for refunds contrary to the provisions of the Act.

The additional pension benefit test must be made as at the date a member ceases to be an active member. Therefore, section 60.1 of the Act and sections 15.0.1 through 15.0.3 of the Regulation respecting supplemental pension plans continue to apply to members who ceased to be active before 1 January 2016.
Amendment to the plan text regarding the additional pension benefit

The Act, in general, provides for minimum benefits. A plan text may contain more advantageous provisions, which would take precedence. Therefore, plan provisions concerning the additional pension benefit continue to apply as long as the plan has not been amended, in accordance with the Act and the plan provisions, to remove them. The decision to make such an amendment must be made by the person or body authorized to do so.

Section 288.4 of the Act provides that the conditions set out in section 20 do not apply to an amendment to a pension plan made before 1 January 2017 to remove the additional pension benefit referred to in section 60.1. Therefore, if it is decided before that date to remove the benefit, the amendment can take effect from 1 January 2016 or after, and apply to all service regardless of the effective date of the collective agreement or the date on which a notice is sent to the members. The consent of the members is not required. As of 2017, it will still be possible to remove the additional pension benefit, but only in accordance with the rules set out in section 20.

If, in 2016, it is decided to remove the additional pension benefit retroactively, caution should be exercised in order to avoid administrative complications related to the recovery of any overpayments. For example, the person or body empowered to amend the plan could choose an effective date for the amendment that is after the date on which the notice is sent to the members. It would also be possible to indicate in the text related to the amendment that the members who requested a refund or transfer of their benefits before the decision to amend the plan are not affected.

For certain plans, the test required under section 60.1 of the Act had no effect because the plan text provided for the indexation of a deferred pension. Section 288.4 of the Act also provides for the removal of the portion of the indexation that is equal to the additional pension benefit under section 60.1 of the Act, and under the same conditions.

Minimum employer contribution

The minimum employer contribution test now makes it possible to distinguish amortization payments (if a portion is assumed by members) from current service contributions.

The test now has two parts.

1. Determine a member’s current service contributions accumulated with interest, which cannot be used to fund more than 50% of the value of his or her benefits.

2. If a member contributes to amortization payments, determine the amount of the member contributions, accumulated with interest, reduced by the amount of surplus contributions calculated during the first part of the test, which cannot be used to fund more than 100% of the value of benefits.

In order for a member contribution to be deemed an amortization payment, the plan text must provide for it.

For example

Value of the pension = $10 000

<table>
<thead>
<tr>
<th>Member contributions cumulated with interest</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current service contribution for current service</td>
<td>$5 000</td>
</tr>
<tr>
<td>Amortization payment</td>
<td>$3 000</td>
</tr>
<tr>
<td>Current service stabilization contribution</td>
<td>$2 000</td>
</tr>
<tr>
<td>Stabilization amortization payment</td>
<td>$1 000</td>
</tr>
</tbody>
</table>

First test: calculation of excess current service contribution

Member’s current service contributions:

$5000 + $2000 = $7000

50% of the value of the pension:

50% of $10 000 = $5000

The refund according to the first test is therefore $2000 ($7000 - $5000).

6. Includes current service contribution for current service and the stabilization provision.
Second test: calculation of excess amortization payment

Member’s current service contributions:
$5000 + $2000 = $7000

Member’s amortization payments:
$3000 + $1000 = $4000

Total member contributions = $11 000

To calculate the amount to refund to the member according to the second test, it is necessary to compare the member contributions paid ($11 000) minus the refund calculated in the first test ($2000) with the total value of the pension ($10 000).

In this example, the member would not be entitled to an additional refund because the member contributions minus the refund calculated in the first test, which equals $9000, is less than the total amount of the pension ($10 000).

Legal reference: section 60 of the Act

Payment of benefits

Since actuarial valuations are now carried out every three years, except in some cases, the degree of solvency to be used for payment of defined benefits that are payable other than in periodic payments has changed. Previously, it was necessary to use the degree of solvency established in the most recent actuarial valuation report sent to Retraite Québec. If it is more recent, the degree of solvency indicated in the notice concerning the financial situation of the plan must now be used.

Section 146 has been amended so that, with a few exceptions, it is no longer required to fund and pay the benefits that could not be paid in accordance with sections 143 through 145.1.

The following exceptions apply:

- The member or beneficiary is unable to request that his or her benefits remain in the pension plan (for example, where a pension committee decides to force payment of small amounts in accordance with section 66 of the Act).

- The plan contains more advantageous provisions and provides for payment of the value of benefits in a higher proportion than its degree of solvency. In such case, the amounts must be funded before payment, in order to protect the plan’s financial health.

The pension committee must inform members, in their statement of termination, of the potential consequences of having their benefits transferred. The statement of termination must also clearly indicate that the degree of solvency used to carry out payment of the value of the benefits will be that established as at the date of payment.

With regard to the test concerning 20% of the maximum pensionable earnings (MPE) provided for in section 66 of the Act, it must be carried out on the total value of a member’s benefits, regardless of the degree of solvency applicable to the payment of the member’s benefits.

For members who requested payment of their benefits before 1 January 2016, the provisions of the Act as it read prior to that date apply. They are therefore entitled to 100% of the value of their benefits, even if no payment had been made by 1 January 2016.

Legal reference: section 146 of the Act

Amendments to the plan text concerning the payment of benefits

If the plan provides that the benefits of members are to be paid in full when they leave the plan, payment must be made in accordance with the plan text, provided it has not been amended and given that it is more advantageous than the provisions provided for in the Act.
Administration of the pensions by Retraite Québec

The Act now provides for a permanent measure allowing members and beneficiaries to have their pensions administered by Retraite Québec, where the pension is reduced due to the insolvency of the employer upon the employer’s withdrawal or on termination of the plan. However, the following amendments have been made:

- This option is no longer offered to members and beneficiaries who would have been entitled to payment of a pension if they had filed an application on the date of withdrawal or termination. Only members and beneficiaries whose pension was already being paid on the date of withdrawal or termination can take advantage of this option.

- Those beneficiaries can no longer choose to have the value of their pension transferred to a life income fund (LIF). They are only offered the possibility of purchasing an annuity from an insurer or having their pension administered by Retraite Québec.

The government can no longer guarantee pension amounts. The amount of a pension initially paid depends on the pension fund’s assets and no longer takes into account any relief measures taken by the employer. Therefore, in the event of insufficient assets, the pension amount could be reduced.

Legal reference: sections 230.0.0.1 through 230.0.0.11 of the Act

Variable benefits

A pension plan that includes defined contribution provisions may allow a member who has ceased to be active or, on the death of such a member, the member’s spouse, to elect to receive variable benefits from the fund on the conditions and within the time prescribed by regulation.

Legal reference: section 90.1 of the Act

Divisions

The provisions of the Act concerning the right to appropriate the surplus assets during the life of the plan have been repealed. As a result, in the event of plan division, the requirement to contain provisions having the same effect now applies in all cases, and not only where the initial plan provisions were confirmed.

Legal reference: section 195 of the Act

Mergers

The effect of provisions regarding the allocation of surplus assets during the life of an absorbing plan must now be identical to those of the absorbed plan.

With regard to plan provisions in the event of termination, the rules have not changed. The provisions regarding the allocation of surplus assets must have identical effect to those of the absorbed plan or be more advantageous. Otherwise, the merger may be authorized if the members and beneficiaries of the absorbed plan who are affected by the merger are informed of the merger in writing by the pension committee by means of a notice, and less than 30% of them voice their opposition.

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7 As of April 2016, the regulatory provisions had not been set out.
Furthermore, Retraite Québec may only authorize plan mergers if the degree of solvency of the absorbing plan after the merger is

- at least 85% or, in the case of the merger of plans to which the same employer is a party, at least 100%; or
- not more than five percentage points below the degree of solvency of either the absorbing plan or the absorbed plan before the merger.

Legal reference: section 196 of the Act

Withdrawal of an employer

From now on, if the employer no longer has active members in its employ, the plan must be amended in order to withdraw the employer, unless the amendment provides for a substitution.

The amendment has effect no later than on the end date of the fiscal year in which the last member ceases to accrue benefits. In the case of an employer all of whose employees covered by the plan are hired on an ad hoc, fixed-term basis, the withdrawal of the employer is only required if 12 months have elapsed since the employer ceased to have active members in its employ.

Under the Act, members and beneficiaries affected by an employer’s withdrawal can no longer retain their benefits in the plan. Therefore, in the case of retirees, an annuity must be purchased from an insurer, whereas the value of benefits of non-retirees must be transferred.

Legal reference: sections 198, 199.1 and 200 of the Act

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