

Promoting the development of private pension plans

# NEW LEGISLATIVE PROVISIONS

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on supplemental pension plans

Information presented as questions and answers

Revised on 15 January 2001

*This document takes into account the Act to amend the Supplemental Pension Plans Act and other legislative provisions (Bill 102) passed on 29 November 2000 (S.Q. 2000, chapter 41) and assented to on 5 December 2000.*

Québec 

This publication explains the main measures contained in the *Act to amend the Supplemental Pension Plans Act and other legislative provisions* (S.Q. 2000, chapter 41) It does not have force of law. In cases of conflicting interpretation, the *Act* prevails.

Version originale française disponible sur demande.

15 January 2001

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# Promoting the development of private pension plans

The *Act to amend the Supplemental Pension Plans Act and other legislative provisions*, is the result of more than 2 years of discussions between the Régie des rentes du Québec and various groups and individuals in the fields of employee benefits and pension plans in Québec. It is balanced legislation that proposes a group of measures that are favourable both for pension plan members and their employers. The *Act* expresses the Québec government's desire to maintain and even increase the number of pension plans in Québec, thereby contributing to the financial security of future generations of Quebeckers.

In the coming years, Québec, like all other Western societies, will have to deal with an aging population. The effects will be felt more in Québec than in the rest of Canada or in the United States of America. For example, we know that in Québec, there are currently 5 workers for each retiree. In 2050, there will be only 2 workers for each retiree. The accelerated aging of the Québec population will put pressure on our system of income security after retirement and will make it even more important for workers to increase their private retirement savings.

Overall, 45% of Québec workers are members of supplemental pension plans. However, only 1 worker in 4 in the private sector is covered by such plans. Likewise, overall, a meagre 20% of the income of Québec retirees comes from private savings, which includes supplemental pension plans and registered retirement savings plans (RRSPs). In Ontario, the proportion is 27%. These few figures alone point out the importance of creating a climate favourable to the development of pension plans so as to increase the proportion of income derived from retirement savings instruments.

The new legislative provisions, which affect the pension plans of around 620 000 people are the following:

- dissipate the uncertainties that hinder plan development by spelling out clear, stable rules for everyone, particularly by clarifying the right of employers to take contribution holidays;
- increase the confidence of workers in their plans by emphasizing plan openness;
- improve the situation of young workers by allowing them to become entitled to the employer's contributions as soon as they join a plan;
- take into account the greater mobility of workers by provisions to increase termination benefits;
- simplify the work of plan administrators by easing statutory requirements.

I hope that the information in this document will help you more clearly understand the issues behind the new legislative provisions and the main measures that result from them. The *Act* is intended to update pension plans, an instrument that contributes to the financial security of many Quebeckers.

ANDRÉ BOISCLAIR  
Minister of Social Solidarity  
Gouvernement du Québec

# Introduction

## **Why were amendments to the *Supplemental Pension Plans Act* needed?**

Amendments to the *Supplemental Pensions Act* were needed for 3 reasons.

First, the right of employers to take contribution holidays had to be clarified. The government wanted to dissipate the uncertainties that surround this matter without, however, interfering in the specific arrangements of each pension plan. In many cases, contribution holidays were being taken without any notice to plan members. Plans must be more open in this regard.

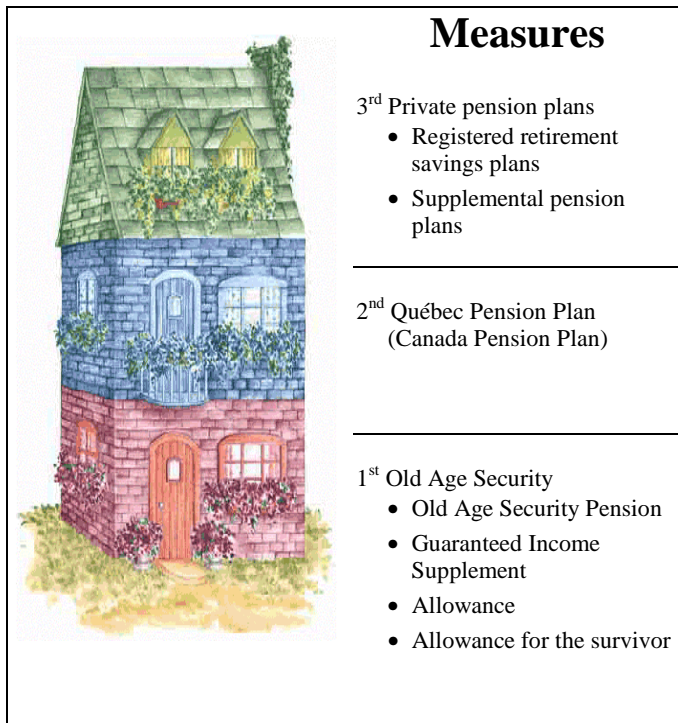
Second, it was imperative to adapt pension plans to the new realities of the workplace. In particular, termination benefits had to be strengthened since workers can now be expected to have several jobs over the course of their active lives and there had to be immediate vesting of a pension as soon as a worker joins a pension plan.

Third, it was important to simplify plan administration.

By strengthening pension plans as retirement savings instruments, the government wants to maintain and even increase the number of supplemental pension plans in Québec, thereby contributing to the financial security of future generations of Quebecers. Faced with the rapid aging of the Québec population, it was important to take steps that will make pension plans more appealing.

## The circumstances

### What sources of income are available after retirement?



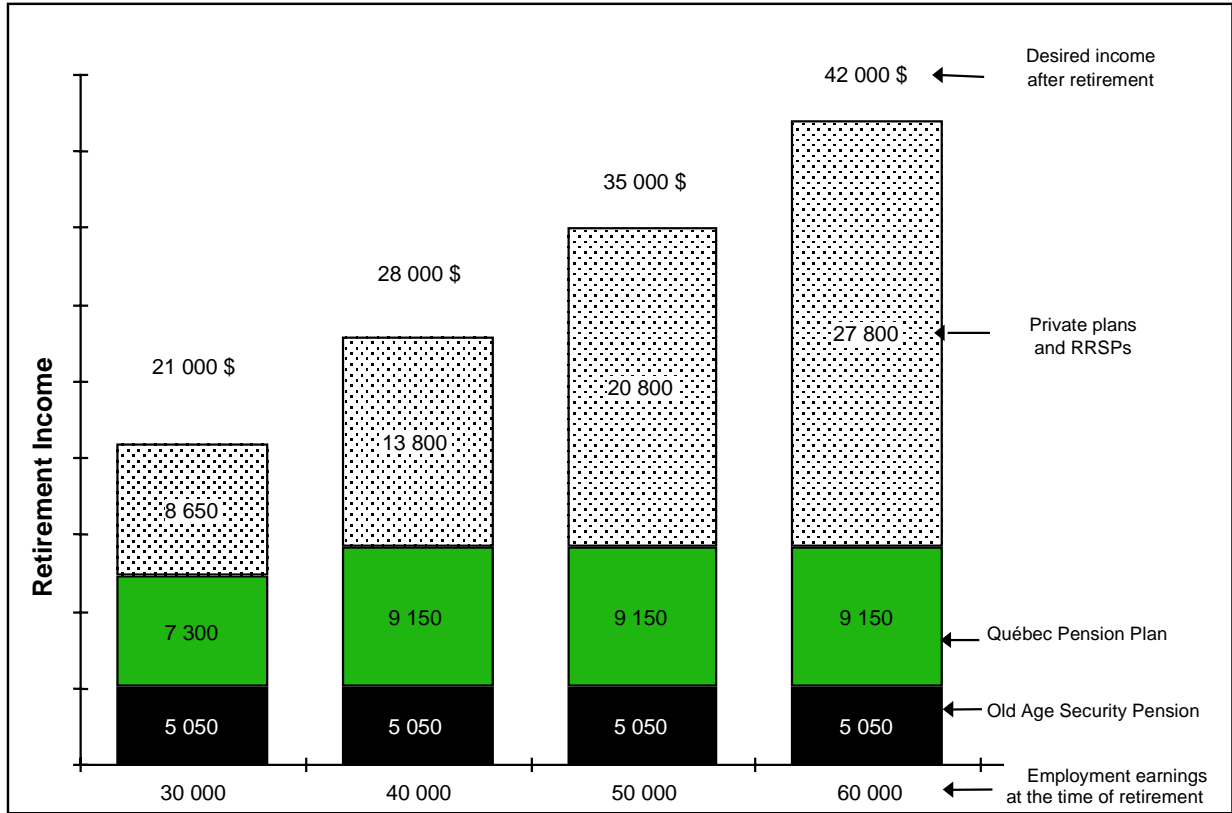
The income security system in Québec can be compared to a 3-storey house. The first floor represents assistance measures administered by the federal government—the Old Age Security pension, the Guaranteed Income Supplement and the Allowance and the Allowance for the survivor. The second floor is occupied by the Québec Pension Plan, which provides financial protection to workers. The third floor contains private pension sources; they include supplemental pension plans (pension funds) and registered retirement savings plans (RRSPs).

### What is the role of private pension sources?

For most workers, the basic retirement income from public plans will not be enough for them to maintain their pre-retirement level of income. It is generally recognized that workers who want to maintain the life style they have enjoyed in the years preceding retirement will need an annual retirement income of around 70% of their employment income. It is important to supplement the basic income from public plans with additional income from private sources.

Among private pension sources, supplemental pension plans are a key element to adequately complete the income from public plans. A supplemental pension plan (sometimes called a private, or company, pension plan) is a contract by which workers and an employer, or sometimes the employer only, agree to contribute to a pension fund. The sums accumulated in that way will serve to pay refunds and benefits to which members and retirees are entitled.

*The role of public and private plans in replacing 70% of pre-retirement income*



As the accompanying chart shows, private sources play an important role in ensuring the financial security of workers after retirement and that role increases in proportion to the worker’s income level. The time has come to correct the shortcomings that hinder their development and that reduce their appeal to workers and employers.

**How many Quebecers are members of supplemental pension plans?**

Overall, 45% of Québec workers are members of a supplemental pension plan. That is a bit higher than the 41% rate for their neighbours in Ontario. Coverage is very high in the Québec public sector. In the private sector, however, only 1 worker in 4 is a member of a pension plan. The low level of plan membership for private sector workers is cause concern. It becomes even more worrisome when we recall that small and medium-sized businesses have become major creators of employment and that pension plan coverage in that sector is minimal (between 5% and 10%). It seems entirely appropriate to take action to increase that rate of coverage.



## **What is the government's role with regard to supplemental pension plans?**

The government's main role in this area is supervisory. It must ensure that the administration and operation of pension plans respect certain minimum standards. In 1965, the Québec National Assembly passed the *Act respecting supplemental pension plans*, which was replaced in 1990 by the *Supplemental Pension Plans Act*. The administration of those laws was confided to the Régie des rentes du Québec.

The *Supplemental Pension Plans Act* defines certain minimum standards for benefits and plan operation. It does not, however, determine the provisions of pension plans. It is up to the employer or, in some cases, a labour union representing a plan's members to determine the plan's provisions. Establishing a pension plan is not compulsory. Thus, there are limits to the rules that the government can impose.

## **What plans and workers are subject to the *Supplemental Pension Plans Act*?**

Some 620 000 Québec workers are protected by the *Supplemental Pension Plans Act*. They are members of around 3 900 plans.

It is important to note that some supplemental pension plans are not subject to the *Act*. They include:

- plans established by a specific Québec law, for example, the Government and Public Employees Retirement Plan;
- plans established by a specific federal law, for example, the plan for employees of the Royal Canadian Mounted Police;
- plans subject to the federal *Pension Benefits Act*, which covers employment sectors under federal jurisdiction, for example, chartered banks.

## **What are the various types of supplemental pension plans of which Québec workers are members?**

There are 2 main types of plans: defined benefit plans and defined contribution plans. For plans under the supervision of the Régie des rentes du Québec, 15% of currently active plan members have defined contribution plans and 85% have defined benefit plans.

### ***Defined contribution plans***

A defined contribution plan is something like a bank account. The contributions paid by the employer and the pension plan member accumulate in a pension fund (the "bank"). Each plan member has an account to which are credited his or her contributions and the employer's contributions. This type of plan does not set in advance, directly or indirectly, the amount of the pension. When the time to retire comes,

a member's pension will depend on the total amount of the contributions made plus his or her share of the investment income earned over time by the pension fund.

In a defined contribution plan, the members bear the entire financial risk as well as all the advantages and inconveniences of that mode of operation. Members are thus at the mercy of poor economic conditions that may exist when retirement comes or that of poor returns on the pension fund's investments during the members' working lives. In contrast to that, in a defined benefit plan, the employer assumes those risks and, if the plan has a deficit, the employer must make an additional contribution.

### *Defined benefit plans*

A defined benefit plan guarantees a pension whose amount is set on the basis of a person's years of credited service under the plan. The pension is generally a percentage of salary multiplied by the number of years of credited service (covered employment). For example, if your salary is 40 000 \$, you have 25 years of credited service and the plan grants a pension of 2% per year of service, your pension could be calculated in the following way:  $40\,000 \$ \times 2\% \times 25 \text{ years} = 20\,000 \$$ . In other words, you would be entitled to an annual pension of 20 000 \$. If you had worked for the employer for only 5 years, your pension would be 4 000 \$, that is  $40\,000 \$ \times 2\% \times 5 \text{ years}$ .

## **What are surplus assets?**

A pension plan's surplus assets are the portion of the pension fund that is greater than the value of the benefits promised to the members.

## **What are excess assets?**

Excess assets are the portion of the plan's surplus assets that exceed the maximum allowed under the federal *Income Tax Act*.

Generally, a plan has excess assets if the value of its assets or pension fund exceeds 110% of the value of the benefits promised by the plan.

**Note that the special rule regarding the use of excess assets that was in Bill 102 when it was introduced was removed before the bill became law because the tax laws provide for such situations.**

## **What are the consequences for a pension plan that has excess assets?**

When a plan has excess assets, the federal *Income Tax Act* does not allow the employer to deduct its contributions to the plan. In extreme cases, excess assets can result in revocation of the plan's tax registration. The tax laws specify how to avoid having a plan's tax registration revoked.

## **What is an employer's contribution holiday?**

The expression "employer's contribution holiday" is used to describe the use of a portion of the plan's surplus assets to pay the employer contribution to the plan.

When a contribution holiday is taken, no funds actually leave the pension fund but the employer contribution is paid, in whole or in part, from the surplus assets. In other words, the employer contribution is paid by appropriating a portion of the pension fund's accumulated surplus.

Contribution holidays are an important element in pension plan management. Between 1984 and 1997, surplus assets used to allow employer contribution holidays totalled 2,4 billion \$. In many cases, plan members were not informed that surplus assets were being used in that way.

## **Today, how can surplus assets be used?**

### ***Following a plan's termination***

The allocation of surplus assets following a plan's termination (for example, after the closure of a company) was regulated with the coming into force of the *Act to amend the Supplemental Pension Plans Act* on 1 January 1993. That amendment lifted the moratorium on surplus assets that was imposed on 15 November 1988. To settle the question of surplus assets following termination, the *Supplemental Pension Plans Act*, as amended, calls for an agreement between the parties. Failing an agreement, the parties must go to arbitration in order to settle their dispute. It is estimated that 60% of surplus assets go to members and retirees following a plan's termination.

Our experience since 1 January 1993 has clearly shown that the approach taken was right. In over 90% of the cases where a plan with surplus assets is terminated, the parties are able to reach an agreement on how to allocate and distribute the surplus.

### ***During a plan's existence***

While a plan is in effect, there are 4 options for using surplus assets:

- increases in benefits;
- member contribution holidays;
- employer contribution holidays;
- refunds to the plan members.

The laws of several other provinces also allow direct, cash refunds to the employer. In Québec, however, such refunds are prohibited.

### **In what circumstances can a contribution holiday be taken?**

A contribution holiday can be taken only if there are surplus assets.

### **How much of a surplus can be used for a contribution holiday?**

The amount of surplus assets used to offset contribution holidays cannot be greater than the total surplus assets as determined at the time of the most recent actuarial valuation of the entire plan. A contribution holiday must never result in a deficit in the pension fund.

### **Can contribution holidays be taken in any type of pension plan?**

Yes. However, since surplus assets mainly exist in defined benefit plans, that type of plan is more likely to have contribution holidays.

### **Today, what is the trend in contribution holidays?**

The Régie des rentes du Québec estimates that 60% of the surplus assets used are used to increase the pension benefits of plan members and 40% are used to offset employer contribution holidays. It is important to note that surplus assets are not totally depleted. As a measure of prudence some plans maintain their surplus, in whole or in part, as a protection from any eventual deficit.

### **What are the current rules for taking contribution holidays during a plan's existence?**

Under the *Supplemental Pension Plans Act*, employer contribution holidays are neither recognized nor prohibited. The right of an employer to take a contribution holiday depends on the provisions of the pension plan text, which may grant or restrict an employer's right to take a contribution holiday. Several plan texts contain clauses on this matter, but in many cases, they are subject to conflicting interpretations because they are vague or in contradiction with other clauses, such as clauses stipulating that the pension fund is for the exclusive benefit of the plan members.

The jurisprudence in this area is not very conclusive. Judgments in the area of contribution holidays are very complex, and every plan's situation is a specific case. Thus, there is uncertainty surrounding an employer's right to take contribution holidays.

## **Is the issue over contribution holidays the same in the rest of Canada or in the United States?**

In the other provinces, the situation is much clearer. Some have laws that allow contribution holidays where the plan text so provides; others allow contribution holidays where the plan text does not specifically prohibit them; finally, some laws allow contribution holidays without restriction.

U.S. practices for contribution holidays are generally based on taxation rules. Those rules discourage the accumulation of excess assets beyond the maximum allowed for financing a plan's pension benefits. Any excess over deductible amounts is subject to a 10% tax. The employer is therefore forced to decrease or suspend contributions in such situations to avoid penalties.

## **THE NEW LEGISLATIVE PROVISIONS: QUESTIONS AND ANSWERS—CONTRIBUTION HOLIDAYS**

### **What are the new rules are for contribution holidays?**

The new legislative provisions provide several approaches to clarify the right of employers to take a contribution holiday. However, using those approaches is optional. To avoid lawsuits, employers should however follow the new rules contained in the *Act*.

Moreover, to increase openness in pension plan administration and no matter which approach is taken, from now on plan members will have to be informed of any contribution holidays. Thus, the *Act* recognizes the possibility for employers for take contribution holidays but grants plan members the right to be informed of any contemplated changes.

#### ***The status quo***

The new legislative provisions do not impose any option. By choosing the status quo, employers will be able to continue taking contribution holidays but will also run the risk of disputes or lawsuits.

### ***Clarifying the employer's right to take contribution holidays***

In order for employers to clarify their right to take contribution holidays, in accordance with the new rules, employers must propose an amendment to the plan text. The amendment can only come into force if the approvals required by law, the plan and the union are obtained. If the plan is a multi-employer plan, approval must be obtained from all the employers.

Furthermore, if a written contract has been reached with a party to the plan regarding the use of the surplus assets during the existence of the plan, the approval of that party must be obtained before amending the plan text.

### ***Information to members***

The new legislative provisions require that a notice to be sent to each plan member and each beneficiary whenever an amendment to the clause on contribution holidays is proposed.

Furthermore, the current regulations will be amended so that the annual statement of each member and beneficiary will contain information on contribution holidays.

## **What will happen pending court cases that were pending when the new amendments came into force?**

The coming into force of the amendments concerning contribution holidays has no effect on cases already pending before the courts. Those cases will follow the usual course and will continue to be governed by the current provisions of the *Supplemental Pension Plans Act* and of the pension plan text.

## **TERMINATION BENEFITS AND IMMEDIATE VESTING**

### **What is a termination benefit?**

A pension plan member whose active membership ends before the normal retirement age is entitled to a benefit that is payable immediately or, at the latest, when the member retires. That benefit is called a “termination benefit”.

## **Why have termination benefits been increased?**

The increases to termination benefits concern defined benefit plans only.

Until now, pension plans have not been required to adjust the pensions of workers whose active membership in the plan ends. Consequently, a worker who had several employers during his or her working life could receive a pension that was less than the pension received by a worker who always remained with the same employer. The gap in retirement income could represent between 33% and 40% of the pension paid to the worker who had only one employer.

## **How does the new act increase termination benefits?**

The *Act* proposes a minimum termination benefit whose value has to be no less than the higher of the following 2 values:

- the value of the deferred retirement pension under the pension plan;
- the value of a pension determined by assuming that it would be adjusted by 50% of the increase in the Consumer Price Index (CPI), up to a maximum of 2%, between the date of cessation of active membership in the plan and the date on which the member's age reaches 10 years under the normal retirement age.

In order to improve the openness of pension plan administration and the quality of the information to plan members, regulatory amendments will complete this measure so as to enable members to know the value of their termination benefit.

## **VESTING OF BENEFITS AND PARTIAL TERMINATION**

### **What were the previous rules for vesting?**

For service credited before 1 January 1990, the *Supplemental Pension Plans Act* provided that a member would have a vested pension after completing 10 years of service or plan membership and reaching age 45. A worker who did not meet those two conditions was only entitled to a refund of his or her contributions, with interest.

For service credited after 1 January 1990, the *Act* provided that a member would have a vested pension after completing 2 years of plan membership. A worker who did not meet that condition and whose active plan membership ceased was only entitled to a refund of his or her contributions, with interest.

## **Why change the rules to make vesting immediate?**

Because of changes in the workplace, including the increased mobility of workers, the government believes that entitlement to a pension should be vested as soon as a worker becomes a member of a pension plan. That is the meaning of the term “immediate vesting”.

This change will increase benefits for plan members and simplify plan administration, especially by eliminating partial plan terminations.

## **THE ANNUAL MEETING, THE PENSION COMMITTEE AND THE RETIREES**

### **Is an annual meeting still required?**

Yes, holding an annual meeting is still obligatory. Several comments were made about the pertinence of continuing to require that an annual meeting be held in order to ensure the openness of pension plan administration. In addition, another measure proposed will improve the quality of the financial documents sent each year to all the plan members and beneficiaries.

### **What is new for pension committees?**

The new legislative provisions give active members, as a group, and retirees, as a group, the right to designate one voting member to the pension committee for each group. Furthermore, in order to increase plan openness, each group can also designate an additional member. The additional member will not be a voting member. This will allow more representatives of active members and retirees to be involved in pension committees and to make known their point of view. The new legislative provisions also give pension committees the power to make recommendations with respect to changes or improvements to the plan.

### **For retirees, what are the gains in the *Act to amend the Supplemental Pension Plans Act and other legislative provisions*?**

The *Act* grants retirees rights similar to those of active plan members. In comparison with similar laws in the other provinces, the Québec law is the most advantageous for retirees. Access to information for retirees is entrenched in the *Act*. In fact, retirees can attend annual meetings and have the right to



designate a member to a plan's pension committee. Furthermore, they receive each year a statement of their benefits.

The *Supplemental Pension Plans Act* prohibits any reduction of pensions after payment begins. If an employer has financial difficulties during a plan's existence, it is generally the active plan members who will be affected, either by increases in the contributions that they make or by reductions in the pensions that will be paid to them later.

## **What about retirees' rights in regard to the use of surplus assets?**

The *Supplemental Pension Plans Act* is a framework law. It sets limits for the financial security of pension benefits, openness of plan administration and the minimum benefits granted. The new provisions, like the existing provisions of the *Act*, are not intended to interfere in the relationship between the parties.

It is up to those who have the power to amend the pension plan contract to determine the rules to be followed concerning the use of surplus assets. Usually that power is vested in the employer but in some cases, the consent of labour unions is required.

It is not the role of the legislature to determine the ownership of surplus assets during a plan's existence nor when a plan is terminated. In 1991, the government proposed a solution that would have taken the determination of surplus ownership out of the hands of employers and plan members. Both labour unions and employers were staunchly opposed and the government withdrew its proposal.

In the past, 60% of the surplus assets used in plans were used to increase the pension benefits of the plan's members. A portion of those assets were used to increase the pension benefits of retirees or to set up retirement incentive programs. There is no reason to believe that the situation will be any different in the future.

The *Supplemental Pension Plans Act* is similar to the pension legislation in the other provinces in that it does not grant specific rights to retirees concerning the use of surplus assets during a pension plan's existence. Up until now, no court has recognized such a right. The new legislative provisions are intended to dissipate the uncertainties surrounding contribution holidays. We must therefore give priority to agreements between the parties who have the power to change the rules.

## **What improvements are proposed for retirees in Bill 102?**

The following 6 improvements are proposed for retirees:

- Members and retirees will receive more information about their pension plan. That information would cover, among other topics, the plan's financial position, the pension fund's investments and the amounts of any surplus assets used for contribution holidays.
- Retirees will now be able to require that the coordinates of their association be provided at the same time as the annual statement that is sent to all retirees. This will allow them to better organize themselves as a group and exercise their rights with respect to the employer and union.
- Employers who wish to amend the plan to clarify their right to take contribution holidays or to use the surplus to improve benefits must first inform members, including retirees, who will then be able to express their views.
- Retiree representation at the annual meeting will also be improved because they can designate an additional (non-voting) member to the committee.
- The pension committee members to be designated by retirees and other non-active members can be designated only by persons in that category.
- The pension committees will also be empowered to make recommendations to those who are legally entitled to make amendments to the plan.