Régie des rentes du Québec

Supplemental Pension Plans

Newsletter

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Temporary measures to ease the burden of funding defined benefit pension plans

This issue of the *Newsletter* provides pension plan administrators with information which will allow them to understand and correctly apply the measures defined in the *Act respecting the funding of certain pension plans* (the Act) and the *Regulation respecting the application of the Act respecting the funding of certain pension plans* (the Regulation). The following points are addressed:

- consolidation and extension of the amortization period;
- consent of the members and beneficiaries;
- funding of the amendments;
- guarantee required to extend the amortization period of the consolidated deficit;
- special provisions applicable to pension plans in the municipal sector.

To clarify certain technical aspects relating to the application of the measures, an explanatory document will be prepared for actuaries.

Consolidation and extension of the amortization period

According to the Act, it is the employer who decides to consolidate the solvency deficits. It is also the employer who decides to amortize the consolidated deficit over a maximum period of 10 years. The decision to apply these measures cannot be made by the pension committee or any other entity. The employer has 2 choices: consolidation alone or consolidation **and** extension of the amortization period.

The relaxed measures apply only to the first complete actuarial valuation of a plan carried out at a date after 30 December 2004. The Act provides for rules and defines certain time limits[1] for the application of the measures.

On the date of the first complete actuarial valuation after 30 December 2004, it is possible that there is no solvency deficit as determined by a prior actuarial valuation. The absence of such a deficit does not prohibit an employer from requesting consolidation and amortization

[1] The time limits provided for under the Act were described in the *Newsletter Express* of 7 July 2005.

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of the consolidated deficit over a maximum period of 10 years.

Municipalities and universities[2] may amortize the consolidated deficit of the plans to which they are party over a maximum period of 10 years without having to meet other conditions. For other plans, extending the amortization period is possible only if the employer provides the required guarantee or if the plan members and beneficiaries agree to it. The employer does not have to demonstrate that it is able to respect one or the other of these conditions at the time it sends the pension committee instructions related to the application of the measure. If the employer neither obtains the required consent nor provides the required guarantee, the instructions become invalid. The only relaxed measure then applicable to the plan will be that of consolidation of solvency deficits.

Multi-employer plans[3]

In the case of a multi-employer plan, the instructions related to the consolidation of solvency deficits and the amortization of a consolidated deficit over a maximum period of 10 years must come from the participating employers jointly. If an employer does not give the required instructions as to one or the other of the relaxed measures, that measure cannot be applied to the plan.

If the employers jointly gave instructions to amortize the consolidated deficit over a maximum period of 10 years, failure by one employer to obtain the required consent or to provide the required guarantee renders the relaxed measure inapplicable for all the employers.

In a multi-employer plan in which the solvency deficit is amortized over a maximum period of 10 years, it is possible to have up to 3 categories of employers: employers who are municipalities or universities, employers who provide a letter of credit and employers who have obtained the required consent from plan members and beneficiaries. Once a multi-employer plan includes more than one category of employers, the Regulation provides for the distribution of the plan's assets and liabilities into as many portions as there are categories. The distribution is made according to the rules provided for under the *Supplemental Pension Plans Act* (SPP Act) for a division. The distribution ceases at the end of the period of application of the relaxed measures.

If one or some of the employers choose to obtain the required consent from the plan members and beneficiaries bound to them in order to amortize the consolidated deficit over a maximum period of 10 years, then the required consent of the members and beneficiaries **not bound to an employer** participating in the plan (for example, members and beneficiaries of an employer who has withdrawn from the plan and who have chosen to leave their benefits in the plan) must also be obtained.

Consent of the members and beneficiaries

In order to amortize the solvency deficit over a maximum period of 10 years, certain employers must obtain the consent of plan members and beneficiaries.

To help each member and beneficiary decide whether or not to agree to the relaxed measure, the Act provides that the pension committee must send each of them a notice containing the information prescribed by the Regulation.

[2] In the text, the word "municipality" also applies to a body referred to in section 18 of the *Act respecting the Pension Plan of Elected Municipal Officers*. The word "university" applies to an educational institution at the university level referred to in any of paragraphs 1 to 11 of section 1 of the *Act respecting educational institutions at the university level*.

[3] In the text, the expression "multi-employer plan" refers to those plans as well as plans not considered as such under section 11 of the *Supplemental Pension Plans Act*.

Among other things, the notice must describe the effect of extending the amortization period of the consolidated deficit on the plan's degree of solvency five years after the date of the first complete actuarial valuation after 30 December 2004. This requirement does not necessitate the projection of the assets and liabilities determined on a solvency basis over a period of 5 years in order to estimate the degree of solvency. The intention is to provide members and beneficiaries with information that will allow them to estimate the effect of this **single** measure on changes in the degree of solvency. The effect is thus evaluated assuming, for the period, that there is neither a profit nor a loss on a solvency basis, that no amendment is made to the plan and that the current service contribution covers the increase in obligations on a solvency basis.

The notice must also specify that no amendment intended to improve the benefits of the members or beneficiaries may be made to the plan unless the employer immediately pays an amount which corresponds to the total cost of the amendment. This prohibition applies as long as there is a consolidated deficit.

Finally, the notice must state the rule relating to the consent of the members and beneficiaries. If less than 30% of the active members **and** less than 30% of the non-active members and beneficiaries are opposed to the application of the measure, then the members and beneficiaries are deemed to have consented to it. The opposition of a member or beneficiary will be associated with the group to which he or she belonged on the date that the notice was sent.

If the pension committee was not able to personally notify all the members and beneficiaries whose consent is required, the law also provides for a public notice. The public notice essentially repeats the information contained in the notice sent to individuals, but excludes the financial information.

The members and beneficiaries have 30 days after the personal notice is sent, or, if a notice was published, after its publication, **whichever is later**, to notify the pension committee in writing of their opposition.

If **all** the active members are represented by one or several unions, the members are deemed to have consented to the application of the measure if the union or unions agree to it. If consent is obtained, the information and consultation process does not apply to these members. If one or several active members are not union members, the process must be directed at all the active members, including those who are unionized. Regardless of the approach used to obtain the active members' consent to extending the amortization period of the consolidated deficit, the information and consultation process must always be applied to the group formed of non-active members and beneficiaries.

Funding of the amendments

The Act provides several measures that concern the funding of improvements made to the plan.

The date on which an amendment was made is often a determining factor in the application of the measures. In the context of the Act, the expressions used in the French version, "*modification intervenue*" and "*modification apportée*" have the same meaning and are both rendered in English as "amendment made". An amendment made during a certain period is an amendment which was decided during that period. For example, if the employer **alone** can amend the plan, the date on which the board of directors adopted the resolution amending the plan will be the date of the decision. The date on which an amendment is made is thus different from the effective date or the registration date.

Amendment for which the cost is determined by a partial actuarial valuation

The first measure, and the most important, **applies to all plans**, whether or not the employer used the relaxed measures. It is aimed at amendments for which the value is determined by a partial valuation.

For the period beginning on 6 May 2005 and ending 5 years after the date of the first complete actuarial valuation after 30 December 2004, the Act provides that the value of any **amendment made** during that period and determined by a partial valuation is equal to the greater of the following values:

- the value of the obligations determined on an on-going basis;
- the value of the obligations determined on a solvency basis.

On an on-going basis, the value and, if applicable, the variation in the current service contribution must be determined using the same assumptions and methods as those used for the preceding actuarial valuation, unless they are not appropriate in view of the nature of the amendment made to the pension plan. On a solvency basis, the value of the amendment must be determined using the assumptions and methods applicable on the date of the valuation.

It is clear from the preceding information that an amendment made before 6 May 2005 is exempt from the application of the specific rule described above. Its value must be determined according to the rules of the SPP Act. Under that act, the value can be limited to the value determined on an on-going basis if it is determined by a partial valuation.

Amendment for which the cost is determined by the first complete actuarial valuation after 30 December 2004

In the case of a plan in which the employer gave instructions to consolidate the solvency deficits, the Act provides specific rules if the first complete actuarial valuation after 30 December 2004 also determines the value of an amendment made after 5 May 2005.

Note that the relaxed measures, and in particular the measure allowing the extension of the consolidated deficit over a maximum period of 10 years, is intended for solvency deficits resulting from poor returns on pension funds and the decrease in interest rates which consequently increased the value of the obligations. The specific rules mean that the share of the solvency deficits resulting from an improvement made to the plan after 5 May 2005 (the date of the presentation of Bill 102 to the Québec National Assembly) cannot derive an advantage from the measures.

If the value of an amendment made after 5 May 2005 must be determined at the time of the first complete actuarial valuation after 30 December 2004, then the valuation must be made carried out in 2 steps. First, the value of the obligations is determined **without taking into account** the amendment. The solvency deficit thus determined is the one which will be able to be amortized over a maximum period of 10 years.

Subsequently, the value of the obligations is determined **taking into account** the amendment. Usually, this will entail the determination of an improvement unfunded liability and, in certain cases, another solvency deficit. The solvency deficit must be amortized over a maximum period of 5 years.

Note that if an amendment is made before 6 May 2005, then the usual rules of the SPP Act are used to determine the resulting deficit. In other words, the requirement to carry out an actuarial valuation in 2 steps does not apply.

Amendment made to a plan when the members and beneficiaries have agreed to an extension of the amortization period

In the case of a plan in which the members and beneficiaries have agreed to an extension of the consolidated deficit over a maximum period of 10 years, no amendment can be **made to the plan during the period that the measure applies** unless an amount equal to the greater of the following values is paid to the plan:

- the value of the obligations determined on an on-going basis;
- the value of the obligations determined on a solvency basis.

This amount must be paid into the pension fund as soon as the report on the actuarial valuation that determines the cost of the amendment is sent to the Régie des rentes du Québec. Any interest accrued between the valuation date and the date of payment into the pension fund must be added, calculated at the rate referred to in section 48 of the SPP Act.

The "**period that the measure applies**" begins on the date of the first complete actuarial valuation after 30 December 2004 and ends on the date on which the amortization payments related to the consolidated deficit were all paid.

Finally, note that an amendment **made** during the period during which the consolidated deficit is amortized over a maximum period of 10 years is exempt from the requirement to pay in a lump sum if the amendment was made before 6 May 2005.

The payment **in a lump sum** of the cost of an amendment is an important constraint fixed by the Act in cases where the members and beneficiaries have agreed to an extension of the amortization period of the consolidated deficit. Note that the objective of the temporary measures is to ease the financial burden of certain pension plans and the enterprises that offer them. The goal is thus not to provide manoeuvring room that would allow the funding of new improvements to the plan. It is also important to emphasize that an amendment whose cost would not be funded by a lump sum payment would lead to an immediate deterioration in the financial position of the plan. This would then put the members and beneficiaries at a greater risk than that presented to them at the time they agreed to the application of the measure.

Guarantee required to extend the amortization period of the consolidated deficit

The option for an employer to amortize the consolidated deficit over a maximum period of 10 years by providing an appropriate guarantee is, without a doubt, the most innovative of the measures defined under the Act and the Regulation. It is clear that the resolutely prudent nature of certain provisions takes into account that the measure represents, in Canadian terms, a first in the field of pension plans.

Form, terms and conditions of the guarantee

The guarantee to be provided by the employer must be in the form of an irrevocable standby letter of credit. The financial institution issuing the letter of credit must have the minimum rating required from at least one of the rating agencies named in the Regulation.

The Regulation specifies the content of the letter of credit, including the following requirements:

- the letter must specify the date of its issue and of its expiry. The date of expiry must coincide with the date on which the pension plan's fiscal year ends;
- it must indicate that it is governed by the laws of Québec and that the standards provided for in the Rules on International Standby Practices, 1998 apply unless they are incompatible with the provisions of the Regulation;
- it must stipulate that it will be **automatically renewed** for successive periods of one year, at the anniversary of its expiry, unless the issuer notifies the pension committee and the employer, not less than 90 days before that date, that the letter will not be renewed;
- in the event of non-renewal, it is **payable on the date of expiry** unless the pension committee has sent the issuer and the Régie, at least 30 days before that date, a notice certifying that no payment is required.

For example, no payment is required if the letter was replaced by a letter of credit issued by another financial institution or if a recent actuarial valuation shows that it is no longer necessary. A pension committee affirming that no payment is required without valid reason to do so would clearly be failing its fiduciary obligations.

Amount of the letter of credit

In general, the amount of the letter of credit for a fiscal year is equal to the difference between the value of the amortization payments which remain to be paid toward the consolidated deficit and the value of the contributions that would remain to be paid if the deficit had been amortized over 5 years. In other words, the portion of the amortization payments not paid into the pension fund as a result of the extension of the amortization period is covered by a letter of credit given to the pension committee. Thus, the use of this type of financial instrument ensures that the extension of the amortization period will not create an additional risk for the members and beneficiaries.

The Regulation provides specific rules for determining the amount of the letter of credit for each fiscal year during which the measure allowing the extension of the amortization period of the consolidated deficit applies to the pension plan.

Note that the amounts of the letter of credit to be provided for each fiscal year of the pension plan, included in whole or in part in the period of application of the relaxed measures, must be indicated in the report on the actuarial valuation. The pension committee that sends the report to the Régie must also provide, without delay, each employer with a notice indicating that information.

It is possible that the amounts of the letter of credit may be modified between 2 complete actuarial valuations of the pension plan. For example, this may occur if the amount of the letter of credit ceases to be in conformity or if the letter of credit is realized, that is, the amount for which it is issued is paid into the pension fund. The pension committee must then send to the Régie the changes made to the report relative to the last complete actuarial valuation. These changes will affect the amortization payments required for the consolidated deficit and the amounts of the letter of credit. The committee must also provide, without delay, the employer with an update on the amounts of the letter of credit.

Normally, the employer must hand over the letter of credit to the pension committee at least 30 days before the beginning of the pension plan's fiscal year, or portion thereof, to which the letter is related.

However, the first letter of credit must be handed over to the pension committee within 30 days following the date on which the committee sent the employer the notice providing the information related to the amounts of the letter of credit. If a complete actuarial valuation determines amounts for the letter of credit that are higher than the amounts determined by the previous valuation, the employer has 30 days to hand over a letter of credit with the required amount to the pension committee.

Multi-employer plans

The Regulation defines some specific rules for multi-employer plans if any of the employers that are parties to the same pension plan have chosen the "letter of credit" approach. To begin with, each employer that is a party to this group must provide a letter of credit. A mechanism is thus provided to establish the amount of the letter of credit for each of the employers. Other specific rules are also defined if an employer's amount for the letter of credit is not in conformity or if the letter is realized.

Special provisions applicable to pension plans in the municipal sector

In July 2003, the Québec National Assembly adopted an act[4] which granted a municipality the right to reduce the contributions that it will have to pay into its pension plan if the plan has surplus assets, in order to compensate the municipality for the amortization payments paid to the plan for certain unfunded actuarial liabilities. This is commonly known as the **bank clause**.

In the fall of 2004, other provisions were enacted[5]. Those provisions allowed municipalities to pay the amortization payments related to certain technical actuarial deficiencies and solvency deficits by remittance of a municipal bond to the pension fund. The provisions also provide for the allocation of actuarial gains to buy back the bonds.

The consolidation of solvency deficits permitted under the Act eliminates the solvency deficits determined before the date of the first actuarial valuation after 30 December 2004 and, as a result, the associated amortization payments. The elimination of the contributions would cancel in part the effects of the measures described above.

Special provisions were thus provided under the Act for pension plans in the municipal sector. They provide for the division of the consolidated deficit into 3 parts and specify an order for the allocation of the amount of the deficit between the 3 parts:

1° the first part corresponds to the value of the amortization payments that remained to be paid for solvency deficits determined between 31 December 2001 and 1 January 2003;

2° the second part corresponds to the value of the amortization payments that remained to be paid for solvency deficits determined between 31 December 2001 and 1 January 2005, **excluding** the value of the amortization payments referred to by the first part;

3° the third part corresponds, where applicable, to the difference between the amount of the consolidated deficit and the sum of the values determined for the first 2 parts.

[4] *Act to amend various legislative provisions concerning municipal affairs* (2003, c. 3)

[5] *Act to amend various legislative provisions concerning municipal affairs* (2004, c. 20)

With the special provisions, the advantages related to the special measures previously adopted by the Québec National Assembly to ease the funding of pension plans in the municipal sector are maintained. The amortization payments in the first part can provide funding for the bank clause while the amortization payments of the first 2 parts can be paid by remittance of a municipal bond to the pension fund.

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