

Newsletter

On supplemental pension plans 

Québec 

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Additional pension benefit

*Among the amendments made to the Supplemental Pension Plans Act on 1 January 2001 is one intended to adapt **defined benefit** pension plans to the greater mobility of today's workers.*

Worker mobility has increased over the years. When a mobile worker who is a member of several pension plans during his or her career retires, he or she may receive a lower pension than a stable worker who remains a member of only one plan. Section 60.1¹ of the Act reduces the gap by providing for an additional pension benefit. The new benefit is intended to adapt pension plans to the reality of modern times. It is added to the deferred pension and to any excess member contributions.

This issue of Newsletter informs plan administrators and consultants about how to set the amount of the additional pension benefit. The information is based on the Draft Regulation respecting supplemental pension plans, which may undergo some changes before it is finally adopted.

Conditions for granting the additional pension benefit

The test provided for in section 60.1 must be made at the time a member ceases to be an active member and is less than 10 years under the normal retirement age under the plan. The

test applies to every cessation of active membership, whether because of a change of employment, death, disability or any other reason. Please note that the plan administrator must apply the test provided for in section 60.1 whether or not the member opts to leave his or her benefits in the plan or to transfer them to another instrument.

As a general rule, section 60.1 of the *Act* applies to the member's or beneficiary's vested pension benefit for credited service under the plan for a period of employment after 31 December 2000. (However, section 60.1 does not apply to service credited on or after 1 January 2001 that is related to a period of employment prior to 1 January 2001.) Nevertheless, the plan may provide that section 60.1 applies to credited service for periods of employment prior to 1 January 2001.

In the case of workers subject to a collective agreement, an arbitration award in lieu thereof, or an order or decree rendering compulsory a collective agreement, the additional pension is the vested benefit for credited service under the plan that is related to a period of employment after the expiry of the collective agreement or arbitration award or after expiry, prolongation or renewal of the order or decree.

¹ Section 60.1 is reproduced at the end of this document.

Calculating the value of the additional pension benefit

The value of the additional pension benefit is equal to the **difference** (if it is positive) between:

- Element A, which corresponds to the value of an **indexed pension** and the benefits derived therefrom, to which is added the value of any excess member contributions; and
- Element B, which corresponds to the value of the pension provided for under the plan and the benefits derived therefrom, to which is added the value of any excess member contributions.

Determining the indexed pension

The indexed pension must have the same characteristics as the normal pension. It must be determined by supposing that pension payments begin at the normal retirement age under the plan. Early retirement benefits, a bridging pension² and any other advantage provided for under the plan, including optional forms of a subsidized pension for a spouse, are not taken into account in calculating the value of the indexed pension.

Indexation of the pension

Indexation must be 50% of the change in the Consumer Price Index (CPI) (annualized rate not less than 0% nor more than 2%) between the date of cessation of active plan membership and the date on which a member reaches an age that is 10 years under the normal retirement age under the plan.

Where a plan already provides for partial indexation of a deferred pension, such indexation must not be taken into account in determining the value of the indexed pension contained in element A. (However, a partial indexation provided for under the plan must be

² Where the normal retirement age provided for in the plan is under 65, the indexed pension must include the part of the bridging pension payable between the normal retirement age under the plan and age 65, provided the member meets the conditions of the plan for entitlement to a bridging pension.

taken into account to determine the value of the pension contained in element B.) Where the plan provides for indexation of the pension after the normal retirement age, such indexation must be considered in determining the value of the pension contained in both elements A and B.

➤ *Tax impact on the application of the test*

The current ceiling under tax rules for a life pension is 1 722 \$ per year of service and will remain at that level until 1 January 2005. For members whose active membership ends between now and that date, while entitled to a pension up to that ceiling, the application of section 60.1 may seem, at first glance, incompatible with the tax rules. Note should be taken that section 60.1 establishes a value test which, if positive, leads to the granting of an additional pension benefit. Therefore, the value of the member's pension, which is determined by using all the latitude allowed by the tax rules³, is at least equal to the value of the indexed pension according to the parameters of section 60.1. The tests made indicate whether there is sufficient tax room for the additional pension benefit.

Determination of the value of excess member contributions

The member contributions that must be used in applying each element of the test are those related to all periods of employment to which section 60 applies. (In fact, the administrator

³ It should be noted that the tax rules permit the determination of the value of a deferred pension by taking into account the changes in the ceiling between 1 January 2005 and the normal retirement age. Take the example of a worker whose active membership ends on 1 January 2002, at age 52, and who is entitled to a pension of 1 722 \$ for each year of service. The normal retirement age under his plan is 65. By using all the latitude allowed by the tax rules, the value of his pension may be determined by taking into account **100% of the increase in the average wage** for the **10 years** between 1 January 2005 and 1 January 2015. It is obvious that the value thus determined will be greater than the value of the indexed pension provided for in section 60.1, which calls for taking into account **50% of the increase in the Consumer Price Index** for the **3 years** between 1 January 2002 and 1 January 2005.

does not have to distinguish between member contributions made before 1 January 2001 and those made thereafter.)

The value of the excess member contributions in **element A** is determined as a function of the value of the **deferred** pension under the plan related to all periods of employment between the date on which section 60⁴ began to apply to the plan and 31 December 2000. To that value must be added the value of the **indexed** pension determined for all periods of employment to which section 60.1 applies⁵.

The value of the excess member contributions in **element B** is determined as a function of the value of the deferred pension provided for under the plan and related to all periods of employment to which section 60 applies. It is to be noted that the excess member contributions included in element B are the same as those to which the member is entitled under the plan.

Death of a member during active membership

Where a member dies during active membership, some plans provide that his or her spouse is entitled to a pension rather than the death benefit provided for by the *Act*. In determining the additional pension benefit, the value of that pension must not be used in element B. Instead, the value of the deferred pension to which the deceased member would have been entitled if his or her active membership had ceased on the day of death for a reason other than death must be used.

⁴ In principal, section 60 covers service rendered as of 1 January 1990 and until the date on which the member becomes entitled to a pension. However, the plan may provide that section 60 applies to a period prior to 1 January 1990. The application of that section may also be delayed to a later date because of a collective agreement, an arbitration sentence in lieu thereof, or an order or decree.

⁵ Generally speaking, section 60.1 applies as of 1 January 2001. However, the application of the additional pension benefit provisions may be delayed in the case of workers governed by a collective agreement, arbitration award in lieu thereof, or an order or decree rendering compulsory a collective agreement.

Nevertheless, plans that provide for such a pension for a spouse will, from now on, have to meet a stricter test. The value of the spouse's pension will have to be at least equal to the sum of the following values: the value of the deferred pension described above, the value of the excess member contributions and the value of any additional voluntary contributions entered in the member's account, to which must now be added the value of the additional pension benefit referred to in section 60.1.

Disability

In the event of disability, some plans provide that the member is entitled to a disability pension whose value is higher than the value of the benefits he or she would have had in the absence of disability. In such cases, the determination of an additional pension benefit is made by using, in element B, the value of the pension to which the member would have been entitled in the absence of disability.

Furthermore, section 82 provides that the value of the disability pension must be at least equal to the benefits that the member would have had in the absence of disability. The value of such benefits must now include the value of the additional pension benefit.

Form of the additional pension benefit

In the case of a member who does not use his or her transfer right, the additional pension benefit is determined according to the conditions set out in the plan. The Draft Regulation provides that the benefit may be paid in the form of a life pension purchased as at the date on which the member ceased to be an active member. Where the value of the additional pension benefit cannot be entirely used to increase the total amount of the pension paid to the member, the portion that exceeds the maximum pension benefits allowed under the *Tax Act* must be refunded in a lump sum to the member.

If the plan so provides and the member consents thereto, the additional pension benefit may be paid in the form of some other ancillary benefit determined as at the date on which the member

ceased to be an active member and with a value at least equal to the value of the additional pension benefit.

The value of the benefits resulting from the additional pension benefit must be determined according to the assumptions provided for in section 61 of the *Act*.⁶

Exemption

Under section 290.1 of the *Act*, some plans may still today be exempted from the application of section 60.1. They are plans for workers subject to a collective agreement⁷ that was in effect on 1 January 2001 and is still in effect. Three conditions must be met to obtain the exemption.

First, a provision of the plan providing that the deferred pension is indexed before retirement must have been in effect on 16 March 2000 and registered with the Régie.

Second, the application for exemption must be filed no later than the day preceding the day on which the collective agreement expires.

Finally, the indexation formula must be approved by the Régie des rentes.

recognized service related to any period of work during which the indexation provided for in section 60.1 applies—in accordance with parameters equal to or more advantageous than those provided for in that section. In such a case, the value of the additional pension benefit will be nil. Moreover, a plan does not have to be amended to provide for the test provided for in section 60.1

Plan amended to provide for a deferred pension according to the parameters of 60.1

A plan can also be amended to provide for indexation of the deferred pension—for

⁶ The assumptions are those listed in section 3 of the standard of practice entitled “Recommendations for the Computation of Transfer Values from Registered Pension Plans”, dated 13 July 1993 and adopted by the Canadian Institute of Actuaries. With respect to mortality assumptions, the rates must vary according to the sex of the member. With the Régie’s authorization, a plan can use assumptions that are more advantageous.

⁷ The same rule applies where there is an arbitration award in lieu thereof or an order or decree rendering compulsory a collective agreement in effect on 1 January 2001. In that case, the application for exemption must be filed with the Régie before the expiry of the arbitration award or before the expiry, prolongation or renewal of the order or decree.

Example

An employee ceases to be a plan member on 1 January 2005, after 7 years of membership. The plan administrator has the following information:

- Value of the deferred pension for the period between 1 January 1998 and 31 December 2000 6 600 \$ (1)
- Value of the deferred pension for the period between 1 January 2001 and 1 January 2005 8 800 \$ (2)
- Value of the indexed pension for the period between 1 January 2001 and 1 January 2005 13 200 \$ (3)
- Value of the member contributions as at 1 January 2005 11 300 \$ (4)

How is the value of this member's benefits determined ?

Step 1. Calculating elements A and B

Element A	Element B
(1) Value of the member contributions as at 1 January 2005 (4) 11 300 \$	(5) Value of the member contributions as at 1 January 2005 (4) 11 300 \$
(2) Minimum employer contribution ⁸ 9 900 \$	(6) Minimum employer contribution ⁹ 7 700 \$
(3) Excess member contributions [(1) - (2)] 1 400 \$	(7) Excess member contributions [(5) - (6)] 3 600 \$ (5)
(4) Value of the indexed pension for the period between 1 January 2001 and 1 January 2005 (3) 13 200 \$	(8) Value of the deferred pension for the period between 1 January 2001 and 1 January 2005 (2) 8 800 \$
Element A [(3) + (4)] 14 600 \$	Element B [(7) + (8)] 12 400 \$

Step 2. Calculating the additional pension benefit

(9) Element A	14 600 \$
(10) Element B	12 400 \$
Additional pension benefit [(9) - (10)]	2 200 \$ (6)

Step 3. Calculating the value of the benefits

(11) Value of the deferred pension for the period between 1 January 1998 and 31 December 2000 (1)	6 600 \$
(12) Value of the deferred pension for the period between 1 January 2001 and 1 January 2005 (2)	8 800 \$
(13) Excess member contributions (5)	3 600 \$
(14) Additional pension benefit (6)	2 200 \$
Value of the benefits [(11) + (12) + (13) + (14)]	21 200 \$

⁸ For element A, the minimum employer contribution is equal to 50% x [(1) + (3)], that is, 9 900 \$.

⁹ For element B, the minimum employer contribution is equal to 50% x [(1) + (2)], that is, 7 700 \$.

Section 60.1 of the *Act* reads as follows:

A member who ceases to be an active member is entitled to an additional pension benefit determined as prescribed by regulation and equal to or greater than the amount by which A exceeds B, where

"A" is the value of the pension determined pursuant to the second paragraph and of related benefits, increased by the member contributions which, assuming the member had been entitled to such a pension under the plan, would be above the limit set in section 60; and

"B" is equal to the value of the pension benefit to which the member would be entitled without reference to the second paragraph and of related benefits, increased by the member contributions which are above the limit set in section 60.

For the purpose of calculating the additional pension benefit, the value of a pension having the same characteristics as the normal pension, except the pension supplement provided by the pension plan for the payment of a minimum pension, shall be determined, based on the assumption that payment of the pension begins at the normal retirement age and allowing for adjustment of the pension between the date the member ceases to be an active member until the date the member reaches the age that is ten years under normal retirement age. The adjustment shall be the percentage corresponding to 50% of the change in the seasonally unadjusted All-Items Consumer Price Index for Canada published by Statistics Canada between the month the member ceases to be an active member and the month the adjustment ceases; however, the annualized adjustment rate cannot be less than 0% or greater than 2%.

If the member dies before becoming entitled to a pension, the value of the additional pension benefit shall be determined based on the assumption that the member ceased to be an active member on the day of the member's death, for a reason other than death.

This section does not apply to benefits referred to in subparagraphs 1 to 6 of the second paragraph of section 60.

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