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Funding of Quebec Pension Plans: Second Draft Regulation Published

On July 12, the Quebec government published a draft Regulation to amend the Regulation respecting supplemental pension plans (Regulation). This is the second version of the draft Regulation that was pre-published on July 20, 2016. Due to the numerous changes made to the initial version and new issues addressed in this second version, the draft Regulation is subject to pre-publication once again. Comments can be submitted to Retraite Québec within the 45-day period after the date of publication. It is anticipated that the final Regulation will come into effect in early fall.

As the notice presenting the draft Regulation indicates, the purpose of the Regulation is to follow through on various measures concerning the funding of pension plans enacted in Bill 57, An Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans.

A separate regulation published on July 13, 2016, clarified the content of the notice to establish the degree of solvency and set the rules for the stabilization provision for defined benefit pension plans (for more details, see our [Information Bulletin](#)).

The following issues were addressed in the initial draft and remain in this second version of the draft Regulation:

- content of the pension plan's actuarial valuation report and various statements stipulated in the Supplemental Pension Plans Act (SPPA)
- letters of credit
- rules for marriage breakdowns and the seizure of benefits
- specific conditions for variable benefits
- fees

The following new issues are addressed in this second version of the draft Regulation:

Annuity purchase policy

The regulatory provisions for this policy have been highly anticipated by some stakeholders. The draft Regulation defines the funding requirement and the rules that must be laid down in the annuity purchase policy. It also specifies the minimum content of such a policy. Among other matters, an annuity purchase policy must provide for:

- the frequency and circumstances in which an annuity may be purchased from an insurer
- the criteria for selecting which annuities are subjected to an annuity purchase
- the insurer selection process and criteria

We want to emphasize that an annuity purchased under such a policy would constitute a final settlement of the benefits of the member or beneficiary in question. As soon as the regulatory provisions concerning the annuity purchase policy come into effect, final settlement without the explicit consent of the member or beneficiary will be permitted. This is an option that was not previously permitted by the SPPA in an ongoing plan.

For annuity purchases other than those made under an annuity purchase policy – whether these purchases were made before the establishment of the policy or after – we understand that such annuities can be settled by “subrogating the member or beneficiary of the annuity in the rights of the pension fund as regards the contract entered into with the insurer”. The subrogation replaces the contractual relationship that exists between the pension fund and the insurer by creating a direct link between the member and the insurer, bypassing the

- requirements related to the funding policy for defined benefit pension plans
- requirements that a plan's annuity purchase policy must satisfy, the financial requirements related to full settlement of benefits based on that policy, and the terms for calculating and paying the special annuity purchasing payment
- topics that must be on the agenda at the annual assembly

This bulletin discusses the main changes proposed in comparison to the previous draft Regulation published on July 2016 and in relation to the Regulation as it currently stands.

pension fund. This provision was requested by many stakeholders.

According to the funding rules applicable to purchases made under an annuity purchase policy, the plan's solvency ratio before the purchase must be determined. If the solvency ratio is less than 100%, a special annuity purchasing payment must be paid to bring it back to the level determined before the purchase. If the solvency ratio is 100% or more and the purchase reduces it to below this percentage, a special annuity purchasing payment must also be made to bring it back to 100%.

However, an actuarial valuation report is required on the purchase of an annuity under the annuity purchase policy (**on the date of the agreement with the insurer**) and the information that must be included in such a report – even for a partial valuation – make this new option burdensome. The proposed legal framework does not enable multiple annuity purchases in the same year and entails significant costs. With minor adjustments, we feel the funding aspects could be simplified without increasing the financial risk for the members who remain with the plan. Aon Hewitt will be submitting proposals to Retraite Québec in this regard.

In addition, please note that the annuity purchase policy must be established by the entity empowered to amend the plan.

Marriage breakdowns

In the existing regulations, the status of member can be granted to a spouse for “pension entitlements” attributed to the spouse due to a marriage breakdown. Although this option is rarely used, it gives the spouse the choice between a deferred pension payable from the plan or the transfer of the value of that pension to an authorized vehicle. In the July 2017 version of the draft Regulation, this option is eliminated. This amendment means that the value of the spouse’s pension entitlement must be transferred, which prevents this value from being adjusted to take the solvency ratio into account.

In our opinion, the option of granting the status of member to the spouse should be maintained for pension entitlements. We believe that it is up to the entity empowered to amend the plan to decide whether to force a transfer of the sum attributed to the spouse and, if it makes that choice, to assume the additional cost. The SPPA currently allows this flexibility for the death benefit and the repayment of small amounts.

Another important proposed amendment is the obligation to adjust the offset pension resulting from a partition of benefits to subsequently take into account any change to the normal pension made after the date of the valuation that would have had an effect on the value of the benefits of the member at the date of marriage breakdown. In the case of an amendment that increases the amount of the pension accrued by the member (e.g., revaluation of a pension accrued in a “career average earnings” plan), the proposed adjustments create an unfavorable environment for the member by automatically increasing the amount of the offset pension, depriving the member of part of this increase.

Statements of benefits

The draft Regulation also adjusts the content requirements for statements of benefits to take account of the final benefits settlement based on the solvency ratio that is now applied by certain plans, the elimination of the additional benefit, the possible sharing of amortization payments, the amounts recognized in the employer and employee banker’s clauses and the funding and annuity purchase policies.

A transitional provision stipulates that the annual statements for a year ending before December 31, 2017, can be produced using the regulatory provisions currently in effect.

We understand that it is possible for the plan to provide more advantageous provisions and not to adjust the offset pension. In our opinion, the regulatory provisions should allow the offset to be adjusted when the plan is improved, rather than stipulating an automatic adjustment.

For a plan with a solvency ratio under 100%, full settlement of the amount attributed to the spouse no longer obliges the employer to pay an additional sum to cover the deficit. Under the proposed amendments, the amount owing to the spouse must be paid in full by the pension fund. If necessary, the effects of this full settlement will be taken into consideration in the determination of new technical actuarial and stabilization deficiencies.

Under the transitional rules in the draft Regulation, the new provisions on marriage breakdown will apply to partitions carried out beginning the first day of the third month following the publication of the final version of the draft Regulation. These transitional rules also stipulate that the member’s offset pension and residual benefits established before this date must be calculated again to take into account any amendment to the normal pension which occurs or takes effect after the benefits valuation date (but after December 31, 2013) and would have altered the value of the member’s benefits on the valuation date.

Funding policy

The prescribed content for the funding policy is still very general. In part, it must describe the main characteristics of the employer and its sector that may affect the funding of the plan and the main risks related to its funding.

The funding policy must be established no more than 12 months after the final version of the draft Regulation comes into effect, which is expected in fall 2017

Once the funding policy is determined by the entity empowered to amend the plan, the pension committee will have all the tools needed to review its investment strategy. This is required as a result of the recent amendments made to the SPPA in terms of funding rules and the obligation now set out in the SPPA for the investment policy to take the funding policy into account.

Variable benefits

The possibility of gradually drawing on pension capital accrued in a defined contribution plan or in the defined contribution part of a defined benefit plan, without needing to transfer the entitlements out of the plan, is an option that has long been requested by many stakeholders.

Letter of credit

The initial version of the draft Regulation published July 20, 2016, stipulated that an allocation of surplus assets to reduce the amount of letters of credit would also reduce the amounts recognized under section 42.2 of the SPPA, or the banker's clause. This requirement no longer appears in the second version of the draft Regulation, establishing symmetry that was lacking in the initial version. Under the SPPA, amortization payments settled by a letter of credit are not recognized in the banker's clause. The draft Regulation now stipulates that the use of surplus assets to reduce the amount of letters of credit has no effect on the banker's clause.

The draft Regulation defines the surplus assets that may be used to reduce the amount of letters of credit in the same way the SPPA does for the other uses it stipulates. We understand that the SPPA defines a mandatory order of use for this surplus. If the balance of the employer banker's clause is positive, the surplus assets that may be used must be allocated, by priority, to the payment of the employer's current service contributions.

The proposed section 60.13 in the current draft Regulation introduces some confusion in the roles of the pension committee and the body empowered to amend the plan, generally the employer. This section of the draft Regulation would benefit from greater clarity so the roles of these two bodies are clear for all the stakeholders involved.

This proposed amendment would be very popular, but it does not allow the longevity risk to be shared and, when a choice of investments is offered to the members, it offers suboptimal investment risk protection. We believe that other options could be offered that intrinsically share these risks, inspired mainly by target benefit pension plans.

If the plan text does not impose any restrictions on the use of the balance of surplus assets that may be used still available after this mandatory allocation, the full balance can be used to reduce the amount of letters of credit. Its use is therefore not restricted to the 20% limit on certain uses of this balance (e.g., funding an amendment, return of the surplus to the employer). This is a difference that must be taken into consideration when deciding whether to make an amortization payment by paying a sum or issuing a letter of credit.

There are still, however, certain problematic situations. This is the case, particularly, when a letter of credit is reduced or eliminated by the payment of a sum to the pension fund by the employer. This sum is not recognized in the banker's clause, but it should be. We hope that the required changes will be made to the final version of the draft Regulation or in a future bill.

Actuarial valuation report

The draft Regulation adjusts the content requirements for the various actuarial valuation reports that are submitted to Retraite Québec to include the stabilization provision, the possible sharing with the members of the amortization payments for certain deficiencies and the presence of employer and employee banker's clauses. Although it would require an amendment to the SPPA, we believe that, to simplify cost-sharing, the SPPA should allow for the deferment of amortization payments – and the deferment of the current service contribution when it is also subject to sharing – as is possible in the municipal and university sectors.

The information requested for certain types of partial actuarial valuation appears to us to be excessive or inappropriate. The comments that we will submit to Retraite Québec concerning the draft regulation will cover these issues.

Topics on the agenda for the annual assembly

In addition to the topics already mentioned in the SPPA (amendments to the plan, conflicts of interest, financial situation of the plan and election of the pension committee members), the draft Regulation now sets out other topics that will have to be discussed at the annual assembly:

- the main risks related to the funding of the plan identified in the funding policy
- the measures taken, in the plan's fiscal year, to manage the main risks related to the funding of the plan
- information related to the annuity purchase policy

The information to be communicated when the plan has an annuity purchase policy does not seem to us to be relevant at such an assembly.

Conclusion

As was the case with previous draft regulations, Aon Hewitt intends to submit comments to improve this most recent version. Nevertheless, we feel that there have already been several improvements over the previous draft. Once the Regulation is published in its final version, pension plan sponsors will be able to finalize their funding policies, review their letter of credit strategies and assess whether to establish an annuity purchase policy. Furthermore, certain administrative changes will have to be made, particularly in terms of communications with members and marriage breakdowns.

Contact Information

Should you wish additional information on this topic, please contact your local Aon Hewitt Consultant, or send an email to info@aonhewitt.com.

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