MERCER

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COMMUNIQUÉ

Quebec Expert Committee Report on a Sustainable Retirement System

The Expert Committee was created late in 2011 to make recommendations on the future of the Québec retirement system. On April 17, the Expert Committee released its long awaited report which contains its analysis, conclusions and recommendations for innovation.

The Expert Committee observed that:

- Retirement savings are often insufficient for average and above-average income workers;
- Public programs do a good job at protecting low-income workers; and
- Defined benefit pension plans provide the best financial security but are under significant pressures.

The Expert Committee identified a series of objectives, values and principles regarding Quebec's retirement system, including:

- The retirement system must provide financial security for the greatest number of retirees;
- It has to be funded and sustainable;
- It must provide for intergenerational equity, transparency and accountability;
- The actual costs of pension plans must be reflected in funding;
- Multiple sources of retirement income are preferable;
- The legal environment must be flexible; and
- Risk pooling must be promoted.

Based on its analysis, the Expert Committee has presented 21 recommendations (summarized later in this Communiqué), many of them applicable to pension plans from both the private and public sectors that are under the supervision of the Régie des rentes du Québec (RRQ).

Soon after the release of the report, the government announced that it will propose a public consultation on the retirement system, to take place in the fall. In the coming months, Minister Agnès Maltais will also ask the government to extend existing funding relief measures beyond December 31, 2013, and ask the National Assembly to study a bill concerning Voluntary Retirement Savings Plans (VRSPs). Minister Sylvain Gaudreault also announced that he intends to quickly

amend the regulations applicable to the pension plans of municipalities to give them access to additional tools that could be used in the short term.

Mercer Comments

We acknowledge the contribution and expertise of the Expert Committee. We do believe that it is necessary to find the best solution to the major issues surrounding retirement. In this respect, the Expert Committee's analysis of the situation is correct. It recognizes the urgency of dealing with the actual costs of pension plans. A number of recommendations will create the flexibility needed and will be well received by plan sponsors, especially in the private sector:

- Enhanced funding is not based on the hypothetical termination of plans. As a result, enhanced funding is equivalent to the permanent extension of the amortization period for solvency deficiencies.
- Unions will be allowed to negotiate an adjustment of vested rights to ancillary benefits, thereby eliminating the obligation to obtain individual consent.
- The measure allowing the withdrawal of certain surplus assets is a step in the right direction for correcting the long standing asymmetry problem with the funding of pension plans.

Many will be concerned, however, by the likely increase in contributions in the long term following the increase in the provision for adverse deviations to 15%, which will have the effect of locking capital in the pension fund when it could have been used to fund business operations. The application of enhanced funding measures for public sector plans will create substantial funding issues for those organizations. Will the flexibility brought about by the restructuring measures allow them to deal with this increase and achieve their objectives?

The Expert Committee has opened the debate on the best way to share the responsibilities related to retirement between private and public programs. It concludes that some of those responsibilities must be transferred to public programs, thereby recognizing the private sector's difficulties in finding an effective solution to insufficient retirement savings among the middle class and to the risk of longevity. We feel that it is appropriate to debate this division of responsibility and to find the most effective solution.

Finally, the Expert Committee has confirmed that we need to move ahead with the implementation of a new type of pension plan − the Voluntary Retirement Savings Plan (VRSP) − to improve the system's effectiveness. Employers that have five employees or more and that do not have a formal savings program will be required to offer this plan to their employees, including low-income earners, with a contribution of up to 4%. It would have been preferable for VRSPs to be optional as is the case elsewhere in Canada. Like the Expert Committee, we recognize that management fees should be carefully monitored.

Changing the Québec retirement system will not be easy and it will require coordinating measures with the other provinces and the federal government, as well as harmonizing tax requirements, all the while taking into account government employees plans. It will also be necessary to reconcile the different interests of multiple stakeholders, including employers, unions and retirees. We can only hope that our political leaders will see the urgency to act and will recognize that the solution decided upon will not fully satisfy all stakeholders.

A summary of the recommendations of the Expert Committee follows.

Establishment of a Longevity Pension Payable at Age 75

The Longevity Pension would exist alongside the Quebec Pension Plan and be administered by the RRQ. It would apply to all workers and would provide a defined benefit pension payable at age 75. The pension credit would amount to 0.5% of earnings per year, up to the Yearly Maximum Pensionable Earnings of the Quebec Pension Plan. The total annual cost, estimated at 3.3 % of earnings, would be shared equally between employers and employees and the benefit would be fully funded. The program would be implemented gradually over a period of 5 years and would apply to future service.

Pension plans would be allowed to offset the longevity pension, and for pension plans in the public sector an offset would be mandatory.

Enhanced Funding Method

The Expert Committee recommends using a single valuation method to determine the funding requirements for all pension plans under the supervision of the RRQ.

This method, termed an “enhanced funding method,” would apply equally to both private sector plans and public sector plans, such as those applicable to municipalities, universities and day-care centres.

The enhanced funding method would be based on a going-concern valuation, but performed using a discount rate derived from the yields on high quality corporate bonds in respect of liabilities for retirees, as well as for the period during retirement for active members. For this purpose, the Expert Committee suggests using the methodology developed by the CIA for accounting discount rates. The discount rate for the period prior to commencement of pension could continue to be based on the expected return on plan assets reflecting the investment policy of the plan.

Deficits determined under the enhanced funding method would be amortized over a period of 15 years initially, with the amortization period gradually decreasing to 10 years over the first 5 years after implementation of the new rules. Deficits and special payments would be consolidated annually, but special payments could not be reduced as long as a deficit exists. Smoothing of the asset value could be applied, over a period of up to 3 years.

Funding of solvency deficiencies would no longer be required, but the solvency valuation would continue to be performed as it would be used to determine the ability to apply surpluses towards contribution holidays or benefit improvements. Contribution holidays and benefit improvements would continue to be subject to the provision for adverse deviations being funded, and the plan also being funded in accordance with the new enhanced funding valuation. The solvency valuation would also be used to determine the portion of a commuted value that could be transferred by a plan member from an insolvent plan (the remainder to be transferred over a maximum of 5 years as per current rules). The provision for adverse deviations would be increased from 7% to 15 % of solvency liabilities. The solvency deficiency in the event of plan termination would continue to be considered a debt of the employer.

The Expert Committee recommends allowing separation of the assets of the pension plan into two accounts, one for retirees and one for other members. This allocation would allow separate

determinations of the degree of solvency and funded ratio, and would remove the requirement to use surplus equitably in funding benefit improvements for different member groups.

The Expert Committee addressed the asymmetry in current surplus ownership rules by recommending that the employer be able to withdraw a portion of surplus subject to specific conditions.

Annual valuations would be required except for fully funded and fully solvent plans.

The Expert Committee recommends that employers be required to establish a funding policy that would define objectives in light of various factors, including the security of benefits. An evaluation of the risks would be required periodically. The report notes that, for large plans, a stochastic analysis would constitute the best tool to meet this requirement.

Commuted Values

Modification of the commuted value calculation is recommended for non indexed pensions for members terminating their employment. The interest rate assumption to be used would reflect the curve based on the methodology developed by the CIA for accounting discount rates. It is also recommended to let the RRQ and the CIA determine the proper rule for indexed pensions. The new methodology would also be used to establish solvency liabilities for active and deferred members.

Plan Restructuring

The Expert Committee recommends that parties to a pension plan should have a one time opportunity to restructure plans over a five-year period following the introduction of the new funding rules. The parties could reformulate vested rights, even for past service for active and deferred members. Pensions in payment could not be reduced.

For active members and members entitled to a deferred pension, the following benefits could be reduced but not accrued pensions: post-retirement indexing, pre-retirement indexing, early retirement subsidies applicable upon retirement or following termination of employment, and joint and survivor pension subsidies, in addition to bridging benefits (which can already be reduced in accordance with existing legislation). Also, in the case of final average pay plans that would be converted into career average pay plans for future service, it would be possible to eliminate future salary increases on benefits already accrued.

For retirees, only post-retirement indexation could be curtailed.

To achieve such restructuring of vested rights, members would be consulted and dissenting votes would have to total less than 30% of retirees (in the case of amendments affecting retirees), or less than 30% of non-unionized employees or deferred members. In respect of unionized employees, the Expert Committee recommends allowing the union to negotiate changes applicable to service prior to the effective date of the collective agreement.

The parties could also agree that the benefits eliminated could be re-introduced if the financial position of the plan improved and specific criteria were met.

In addition, in the fourth or fifth year of the application of the enhanced funding rules, the employer could take unilateral action to amend indexation promises in respect of past service but not indexing already paid. The change would need to apply to both retirees and other members, and the change would be subject to two conditions: the enhanced funding deficit could not be reduced by more than half as a result of the change, and the employer would be required to contribute to the plan to reduce the enhanced funding deficit in the same proportion as the reduction in benefits.

All benefits reduced as a result of the restructuring would need to be restored if the plan were terminated in the 10 years that follow.

Cost Sharing

The Expert Committee also recommends that the legislation be amended to allow a better cost sharing between employers and plan members, including retirees. Cost sharing could include current service as well as deficits in respect of post-implementation service, or deficits in respect of past service. For pension plans in the private sector, it would be left to employers and employees to negotiate an acceptable arrangement but active members could fund no more than 50% of costs attributable to them while for public sector plans, equal cost sharing would be mandatory for the current service cost.

Sharing of deficits could also involve retirees. However such sharing would be limited to deficits emerging for service from the date of introduction of the new rules.

Only employee contributions for current service would be considered in determining excess contributions (minimum 50% employer cost rule).

Regardless of the cost sharing arrangement, the employer would remain liable for the entire solvency deficit in case of plan termination.

For plans where cost is shared, a benefit policy would also have to be implemented in order to better communicate rules governing benefit improvements and benefit reductions.

Annuity purchase on an ongoing basis

The purchase of annuities for retirees and beneficiaries in an ongoing plan should be allowed and be considered as a discharge of employer liability. Such purchase would have to comply with a mandatory “annuity purchase policy” which would be established by the employer in consultation with the pension committee. If the purchase reduces the degree of solvency or enhanced funding ratio, the employer would have to pay into the fund the amount required to make up the difference.

Other measures

Several other measures are proposed:

Early retirement subsidies for future service for members under age 55 would no longer be permitted.

The additional benefit introduced in 2001, representing a partial indexing from termination of employment to age 55, would be eliminated.

Members affected by the withdrawal of their employer from a multi-employer plan should no longer be allowed to remain in the plan. Current members of a negotiated cost multi-employer plan whose employer has withdrawn from the plan would have to transfer the commuted value of their benefits out of the plan, in proportion to the degree of solvency. It is also recommended that the RRQ establish funding measures suitable for negotiated cost multi-employer plans.

As announced in its 2013-2014 Budget, the Quebec government should move ahead quickly with the implementation of VRSPs. Employers offering a pension plan, a Group Registered Retirement Savings Plan or a Group Tax-Free Savings Account would be exempted from offering a VRSP.

Defined contribution plans should be allowed to offer a payout feature similar to the one available under Life Income Funds.

Accelerated withdrawal under a Locked-In Retirement Account or Life Income Fund would be allowed after age 60 to accommodate individuals who are delaying pension payment under the Quebec Pension Plan and Old Age Security. Maximum withdrawal rules would need to be determined.

The maturity age under RRSPs would increase from age 71 to age 75.

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