After 18 months of work, a committee of experts studying the future of Quebec’s retirement system, led by Mr. Alban D’Amours, released its report titled *Innovating for a Sustainable Retirement System* on April 17, 2013. The report contains 21 recommendations for improving Québec’s retirement savings system and ensuring its sustainability. Generally speaking, the recommendations target mainly defined benefit plans overseen by the *Régie des rentes du Québec*. Government pension plans, such as the Government and Public Employees Retirement Plan (RREGOP), were not analyzed.

**Main findings of the Report**

- Canada enjoys one of the best retirement savings systems in the world, but fewer than 20% of private sector workers have a defined benefit (DB) plan, as opposed to the great majority of public sector workers.
- Quebeckers don’t save enough for retirement, and it would be better to protect and improve DB plans.
- The public pension plans alone do not provide sufficient income replacement.
- The concept of vested rights in a pension plan needs to be reformulated and the issue of major actuarial deficits addressed.
- Coverage of workers across the province needs to be enhanced by creating a new mandatory DB pension plan, on top of what the Québec Pension Plan (QPP) provides.

The chart below shows the distribution of sources of income at age 65 to reach an income replacement rate of 70% at that age (in 2013):

**Distribution of income sources for a minimum 70% income replacement, 65-year-old individual**

The main recommendations of interest to our clients follow.
The "Longevity Pension" – New fully funded DB plan

A new compulsory defined benefit component for all workers would gradually be implemented within three to five years. This plan would be fully funded and administered by the Régie des rentes, with assets managed by the Caisse de dépôt et placement du Québec.

The pension benefits, whose accumulation would only target future service (following the implementation of the plan), would be 0.5% of eligible earnings (yearly maximum pensionable earnings under the QPP) indexed over the course of a person's career, and payable starting at age 75. During the contribution period, it would be indexed in accordance with inflation and would be conditional on the financial health of the plan. The pension would be guaranteed for five years.

The plan’s cost is estimated to be 3.3% of earnings up to the maximum pensionable earnings, with the cost shared equally by employers and workers. Some four million workers would therefore be eligible, with total annual contributions of $4B.

The following table illustrates the contributions and benefits (in today's dollars) for a participant whose salary corresponds to at least the maximum pensionable earnings in 2013:

<table>
<thead>
<tr>
<th>Number of years of contribution</th>
<th>Contributions paid by worker</th>
<th>Annual benefit payable at age 75</th>
</tr>
</thead>
<tbody>
<tr>
<td>40 years</td>
<td>$33,700</td>
<td>$10,200</td>
</tr>
<tr>
<td>20 years</td>
<td>$12,650</td>
<td>$5,100</td>
</tr>
<tr>
<td>5 years</td>
<td>$4,200</td>
<td>$1,200</td>
</tr>
</tbody>
</table>

Although we believe that it is generally a step in the right direction, the option of increasing the QPP pension does not seem to have been considered. Such an increase would be effective for increasing the coverage of workers, ensuring sufficient income and lightening the burden on DB plans in the future. Such amendment to the QPP, on the basis of its funding, would also address intergenerational equity criteria.

Recommendations for defined benefit plans

Deficits on a solvency basis (i.e. theoretical full winding-up) of private sector DB plans stood at about $26B as at December 31, 2012, while those for public sector (municipality and university) plans were about $5B (going concern basis). Note that public sector plans have been exempt from funding to a theoretical solvency basis since 2007.

Recommendations for funding DB plans

- Have identical funding rules for all pension plans, i.e. eliminate the special exemption applicable to municipal and university plans.
-Prescribe the discount rate actuarial assumption for the retirement period. The plan's actuary would therefore no longer be free to determine this assumption and the plan's investment policy would no longer affect it.
- Provide for an "enhanced" funding method whose performance would lie between the plans' current solvency and funding figures. The D'Amours Committee presents this approach as one that defines "actual costs."
-Review the bases for transfer values in order to reduce payments made outside the plan.
-Automatically share the cost of current service equally for public sector plans, while specifying that active participants may in addition contribute to funding any deficits.
-Explicitly provide for employees and retirees to contribute to the funding of new deficits observed after the introduction of new measures.
-Gradually reduce the deficit amortization period from 15 to 10 years.
-Increase the provision for adverse deviations (PFAD) to about 15% of commitments (vs. a current rate of about 7%).
-Under certain conditions, allow employers to withdraw pension fund surplus assets to reimburse payments made to make up for a deficit.
-Make it mandatory to set up a funding policy.
Recommendations for benefits

- Provide opportunities to the parties (unions, active and inactive participants, retirees) to restructure plans for a period of five years.

- Reformulate the concept of vested rights by allowing the parties to abolish—with retroactive effect on accrued benefits—any right under the plan, except for the basic pension payable at age 65. Note that for retirees, only future indexing could be withdrawn.

- If no agreement has been reached at the end of a three year period, the employer could abolish the pension indexing at retirement clauses, subject to compensating the plan for the equivalent value and for the withdrawal of this right not to fund more than 50% of the deficit.

- Prohibit subsidized pensions before age 55 (without retroactive effect on accrued service).

Questioning underlying certain recommendations

The fact that the parties may be obliged to agree on the withdrawal of certain vested rights under the current law could have the adverse effect of inciting mass retirement, for fear of seeing their pensions reduced, before the actual coming into force of such provisions. This would translate into a reduced workforce for some industries and major actuarial losses for the pension funds in relation to unfunded early retirements.

As regards to the issue of "actual costs" of plans—addressed many times in the D’Amours report—the proposed method for establishing risk may not be universally accepted, and should be the focus of informed debate, namely by soliciting the position of the Canadian Institute of Actuaries.

Taking the example of municipalities and using the "enhanced" funding method, the current deficit of $5B would automatically increase to $9B, while annual contributions for current costs (about 20% of earnings split between employee/employer contributions) would jump to 24%. The situation in this sector is already problematic, and will only be exacerbated with the proposed approach.

Furthermore, the D’Amours report casts an overly strict judgment on municipal and university pension plans by implying that these plans are simply too generous, without analyzing or taking into consideration the circumstances that led to their implementation, or the fact that a pension plan is part of these employees' total compensation.

Questions that should be explored in greater depth with a view to adopting a more efficient retirement savings system

- Will the legislator authorize the use of retirement security funds separate from, but complementary to, DB pension funds?

- Will unfunded benefits one day be protected by treating them the same way as unpaid salaries in the framework of bankruptcy and restructuring proceedings?

- Shouldn’t solvency standards be reviewed? Lightened? Should some plans be exempt? Why are member-funded pension plans (MFPPs) subject to these standards? And what about multi-employer plans and negotiated contribution plans?

- Shouldn’t a provincial insurance fund be set up, so as to reduce the solvency targets to be funded?

- Shouldn’t we increase the QPP so as to reduce future pressure on private plans?

- Will regulatory corrections be made so as to be able to fully use the risk management methods that are already available?
The Parti Québécois government, further to demands by the opposition parties, seems open to holding a parliamentary committee on this topic, but the main question at this point is when such a committee could be formed. PBI will continue to monitor this issue and will make the appropriate representations in order to maintain its Canadian leadership position in terms of innovation and implementation of risk management mechanisms for the purpose of ensuring the sustainability of defined benefit pension plans.

For any questions or comments about the D’Amours report, please contact Sonia Massicotte at 514-317-2342, or via e-mail at sonia.massicotte@pbiactuarial.ca.

ABOUT PBI

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