

Special Communiqué

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Morneau Sobeco Income Fund is the largest Canadian-owned firm providing human resource consulting and outsourcing services.

Through Morneau Sobeco and Shepell•fgi, the firm delivers solutions to assist employers in managing the financial security, health and productivity of their employees.

With over 2,300 employees in offices across North America, Morneau Sobeco Income Fund offers its services to organizations that are situated in Canada, in the United States and around the globe.



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Amendments to Funding Rules for University Sector Pension Plans

The Quebec government recently amend the *Supplemental Pension Plans Act* ("SPP Act"). You may recall that certain organizations, such as universities, were exempted from the application of certain provisions of the SPP Act. As such, a regulation outlining the rules that are applicable to these pension plans was expected.

The draft of the expected regulation concerning funding of municipal sector and university sector pension plans (*Règlement concernant le financement des régimes de retraite des secteurs municipal et universitaire*) was published on December 23, 2009. The main objective of this regulation is to harmonize certain funding rules applicable to university sector pension plans with those of the private sector. In addition, in light of the financial crisis that began in the fall of 2008, relief measures were proposed to mitigate the impact of that crisis on university sector pension plans.

Temporary Relief Measure Proposed Following the Financial Crisis

Since the financial crisis had a devastating impact on the financial position of many plans, certain organizations face, or will soon face, a substantial increase in their contributions. Therefore, the legislator proposed implementing

Reminder

Amendments to Pension Plan Funding Rules Implemented at the end of 2006

Since December 28, 2006, university sector pension plans are subject to new funding rules whose main provisions may be summarized as follows:

- > Funding of solvency deficiencies is no longer required;
- > Asset smoothing methods are not allowed for the purposes of going-concern actuarial valuations;
- > When a pension plan in a deficit position is amended, the value of the additional obligation on a going-concern basis must be amortized over a maximum period of 5 years (instead of 15 years). In addition, a special contribution payable in cash may be required if the solvency ratio is below 90%.
- > A contribution holiday requires an annual certification by an actuary, and the employer may take a contribution holiday only if the plan is at least 100% solvent.

a temporary relief measure that may help ease the funding of defined benefit pension plans in the university sector, as was done for the private sector plans.

The new measure will allow sponsors to pay **20%** of the required amortization contributions:

- > for 2009, 2010 and 2011;
- > with respect to a technical unfunded liability determined by an actuarial valuation between December 31, 2008, and December 30, 2011.

The full contribution will be required from January 1, 2012.

This measure is intended to smooth the impact of the financial crisis and cannot be applied to the amortization payments determined before December 31, 2008, nor to amortization payments with respect to an improvement unfunded liability.

Example

Technical unfunded liability revealed as at December 31, 2009 of \$20M and no previous deficiency

	Minimum Required Amortization Payment	
	Without Relief (Amortization over 15 Years)	With Relief
2010	\$2.0M	20% x 2.0 = \$0.4M
2011	\$2.0M	20% x 2.0 = \$0.4M
2012	\$2.0M	\$2.0M

It should be noted that this measure will only ease the funding of a pension plan on a temporary basis as it pertains solely to the 2008 financial crisis. In fact, in the event

that returns do not materialize by 2012, deficits will have to be ascertained and substantial amortization payments may be required. Thus, this new measure will be useful only if the stock markets bounce back; otherwise, it is only delaying the funding of the crisis.

The employer will need to provide instructions to the pension committee informing it of whether or not it intends to avail itself of the relief measure.

Permanent Changes to the Funding Rules that Came into Force on December 31, 2008

Confirmation of Certain Existing Provisions

Actuarial valuations will not be required on an annual basis for university sector bodies; however, they will still be required every three years. If a pension plan is amended and this impacts its financial position or if the employer takes a contribution holiday,

an actuarial valuation is required. This valuation may be partial but it must then be produced at fiscal year end.

A solvency actuarial valuation is still required. However, the funding of the deficits revealed by this valuation is still not required.

For the purposes of the going-concern valuation, the assets will have to be determined based on their market value and, therefore, cannot be smoothed or adjusted.

Consolidation of Funding Deficiencies

Technical unfunded liabilities (other than improvement unfunded liabilities) may now be consolidated at each actuarial valuation. Accordingly, when an actuarial valuation reveals a technical unfunded liability, it will be amortized over a new 15-year period, regardless of previously established amortization payments.

As for improvement unfunded liabilities, they cannot be consolidated and must therefore be maintained if necessary.

For actuarial valuations between December 31, 2008, and December 30, 2011, the consolidation only applies to a technical unfunded liability revealed after December 30, 2008. As of December 31, 2011, the consolidation will apply to all technical unfunded deficiencies.

Reserve and Provision for Adverse Deviations (PfAD)

The government proposed introducing a mandatory reserve for university sector plans (similar to Bill 30 requirements for the private sector). This reserve is intended to provide for greater contribution stability: the reserve is built up during prosperous periods, providing a safety cushion, which can be used to fund certain deficiencies when the financial position is not as rosy.

Total assets would therefore consist of two notional accounts: a general account, to be used for determining the going-concern financial position, and the reserve that will be accounted for in a separate theoretical account.

Creating the Reserve

- > Actuarial surplus that is recognized in the first actuarial valuation after December 30, 2008
- > Actuarial gains (experience, change of assumptions, etc.) recognized in each actuarial valuation
- > Credited with the same returns as the general account



Using the Reserve

- > 50% of the annual amortization payments of the technical unfunded liability
- > Cannot be negative



Maximum Reserve = Provision for Adverse Deviations (PfAD)

- > Based on the investment policy, the risk and the plan's maturity
- > About 7% of the solvency liability

The obligation to create such a reserve has the following consequences:

- > Henceforth, the employer will often have to fund larger deficiencies, since actuarial gains will have to be transferred to the reserve and will, therefore, not be recognized on the balance sheet.
- > On the other hand, gains that were formerly used to lower amortization payments (starting with the furthest years in the amortization schedule) will now

be transferred to the reserve, which in turn will be used to reduce amortization payments by half for the first three years of the schedule.

- > Since the going-concern position will be determined by comparing the unfunded liability to the general account, the chance that the plan will have a surplus is reduced. Thus, using the surplus for pension improvements or contribution holidays will be limited.



Did you know that ...

In the event that the surplus is used to fund an amendment, it must respect the principle of equity between active and non-active members that was introduced by Bill 30.

Conclusion

The legislator is of the opinion that these new rules should allow for greater **stability** of amortization payments and calls for increased **prudence** regarding pension plan funding by imposing the creation of a reserve used for adverse deviations. However, the obligation to create such provisions would result in higher contributions and limited use of the surplus.

The legislator anticipates that this regulation will be adopted in the spring. Therefore, the deadline for submitting an actuarial valuation with a date that is after December 30, 2008, and before September 30, 2009, may be submitted by April 30, 2010, without penalty. We believe that the government will grant an additional extension considering the planned adoption date.