IN FACT AND IN LAW

FEBRUARY 2010

lavery

LAW ▸ BUSINESS

Pension and Benefits

THE MEMBER-FUNDED PENSION PLAN: A DEFINED BENEFIT PENSION PLAN THAT LIMITS THE EMPLOYER'S FINANCIAL RISK

JOSÉE DUMOULIN and FRANÇOIS PARENT

THE DECISION BY AN EMPLOYER TO OFFER A PENSION PLAN TO ITS EMPLOYEES IS AN IMPORTANT ONE. VARIOUS TYPES OF PENSION PLANS MAY BE OFFERED, AND THE FINANCIAL RISK OF THE EMPLOYER DEPENDS ON THE TYPE OF PLAN CHOSEN.

While unions and employees generally prefer defined benefit pension plans,[1] employers are now very reluctant to implement such plans because of the financial liability they entail. Indeed, when a defined benefit plan shows a deficit, the employer must make special payments into the plan to cover it. These special payments, which are in addition to the employer's regular contributions, often represent significant amounts. The strict funding rules applicable to traditional defined benefit pension plans are one of the main reasons why so few of these plans have been established in Quebec in recent years.

The Quebec Government was aware of this situation and took action in February 2007 to permit the creation of a new type of defined benefit pension plan which limits the employer's financial risk.[2] This new type of plan is called the "Member-Funded Pension Plan" ("MFPP"). The MFPP is mainly intended for unionized workers, since the tax rules require such plans to be implemented pursuant to a collective agreement, except where the Minister of National Revenue waives this requirement. Accordingly, an exemption must be obtained from the Minister of National Revenue where one wishes to set up an MFPP that applies both to unionized and non unionized employees.[3]

The following are the main features of the MFPP:

- it must set the employer's contribution and the normal pension in advance;[4]
- it must provide that the active members of the plan are responsible for the cost of the plan's commitments, less the employer's contribution;
- it must contain a provision preventing the employer from unilaterally amending or terminating the plan;
- it must stipulate that only members and beneficiaries are entitled to any surplus assets (more commonly called "surpluses") determined upon termination of the plan;
- the effective date of the plan must be subsequent to March 15, 2007.

Under the MFPP, the active members bear the financial risk. Therefore, their contributions must not only be at least equal to the balance of the cost of the plan, they must also make the special payments to cover the deficits, if any.

In addition to the foregoing, it is important to note that the MFPP:

- may not include a defined contribution component;
- may not be an insured plan;[5]
- must be a *"career earnings"*[6] or *"flat benefit"*[7] type of plan;
- may not provide for the automatic indexation of pensions, either prior to or after retirement;
- may not be validly implemented by converting a traditional defined benefit plan into an MFPP.[8]

1 I.e. plans that promise in advance to pay a specific pension amount to the member upon his retirement.

2 This new type of pension plan is permitted under the *Regulation respecting the exemption of certain categories of pension plans from the application of provisions of the Supplemental Pension Plans Act* (the "Regulation").

3 According to the Régie des rentes du Québec, such an exemption should be granted if the MFPP covers the majority of the employer's employees.

4 A normal pension is a retirement pension which starts being paid at the normal retirement age, generally 65.

5 I.e. a plan whose benefits and refunds are guaranteed at all times by an insurer.

SETTING UP THE MFPP

An employer may set up an MFPP for its employees. However, the consent of the active members must be obtained because they bear the financial risk under this type of plan. The Regulation provides for specific rules in this regard. With respect to the active members who are unionized, a written declaration is required from the union. In this declaration, the union must acknowledge, on behalf of the members it represents, the obligations incumbent on each of them under the plan. In the event that certain active members are not represented by a union, their consent must be obtained in accordance with the consultation process provided under the Regulation.

ADMINISTERING THE MFPP

Like any traditional pension plan, the MFPP must be administered by a pension committee in accordance with the requirements of the *Supplemental Pension Plans Act.*[9]

CONTRIBUTION HOLIDAYS

The rules governing the employer's contribution holidays under a traditional defined benefit pension plan do not apply to the MFPP. In the case of the MFPP, surplus assets may be used to pay the employer's contribution only if doing so is necessary to comply with the tax rules.

6 I.e. a plan in which the salary used to calculate the member's pension corresponds to the salary attributed for each of the member's eligible years of service.

7 I.e. a plan in which the member's pension is determined by multiplying the fixed amount set out in the plan by the member's number of eligible years of service.

8 Also, no split or merger can occur between a traditional defined benefit plan and an MFPP.

9 R.S.Q., c. R-15.1.

AMENDING THE MFPP

As with the traditional defined benefit pension plan, the plan text of the MFPP must specify who may amend the plan and the conditions for doing so. However, as stated above, the plan text of the MFPP may not give the employer the power to amend it unilaterally.

Note that even if the plan text of the MFPP gives the union the power to unilaterally amend the provisions of the plan, any amendment which would either increase or decrease the employer's contribution requires the employer's consent, except if such amendment becomes mandatory as a result of the application of a new legislative provision which allows for no discretion.

TERMINATING THE MFPP

The plan text of the MFPP must indicate who has the power to terminate the plan and the conditions for doing so. As with the power to amend the provisions of the plan, the MFPP may not grant the employer the power to unilaterally terminate the plan.

The process for terminating the MFPP is the same as for the traditional defined benefit plan, except with respect to the allocation of the surplus assets or payment of the deficit, as the case may be. If the MFPP shows a surplus, it is allocated to the members. Conversely, if it shows a deficit, the rights of the members are reduced. Indeed, the employer is not required to pay into the pension fund the amount necessary to make up the deficit. It is only required to pay its contributions which are due but not yet paid as of the termination date.

OTHER SPECIAL RULES APPLICABLE TO THE MFPP

In addition to the features described above, other special rules also apply to the MFPP, particularly concerning the valuation standards applicable to this type of plan.

CONCLUSION

By adding a new type of defined benefit pension plan in which the employer assumes a limited risk, the Québec Government is offering a new option which may be interesting to some employers. Indeed, where a union requests a defined benefit pension plan, the MFPP may be an option to consider.

JOSÉE DUMOULIN
514 877-3088
jdumoulin@lavery.ca

FRANÇOIS PARENT
514 877-3089
fparent@lavery.ca

YOU CAN CONTACT THE FOLLOWING MEMBERS OF THE PENSION AND BENEFITS GROUP WITH ANY QUESTIONS CONCERNING THIS NEWSLETTER

JOSÉE DUMOULIN 514 877-3088
jdumoulin@lavery.ca

GUY LEMAY, CRIA 514 877-2929
glemay@lavery.ca

CATHERINE MAHEU 514 877-2912
cmaheu@lavery.ca

FRANÇOIS PARENT 514 877-3089
fparent@lavery.ca

MARIE-CLAUDE PERREAULT, CRIA 514 877-2958
mcperreault@lavery.ca

EVELYNE VERRIER 514 877-3075
everrier@lavery.ca

SUBSCRIPTION: YOU MAY SUBSCRIBE, CANCEL YOUR SUBSCRIPTION OR MODIFY YOUR PROFILE BY VISITING PUBLICATIONS ON OUR WEBSITE AT lavery.ca OR BY CONTACTING CAROLE GENEST AT 514 877-3071.

► lavery.ca