Knowledge & Insights

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2015 Survey – Economic assumptions for accounting

Recently, Morneau Shepell issued its 15th annual survey on the economic assumptions used by Canadian public companies to account for the costs of their defined benefit plans. The data was gathered from audited financial statements as at December 31, 2014.

Here are a few highlights of the survey:

- Following last year's increase (the first in five years), the discount rates used for pension plans have decreased again. The median discount rate as at December 31, 2014, was 3.95%, a 0.80% drop from the previous year's median rate of 4.75%. The discount rates used for non-pension benefits are similar to those used for pension benefits.

- About three quarters of the companies surveyed used a compensation increase assumption between 3.0% and 4.0% (median of 3.25%, equal to the previous year's median).
- Companies surveyed showed a 91% overall ratio of pension assets to defined benefit obligation for accounting purposes, a slight decline over last year's ratio of 95%.
- The median assumption for the short-term medical cost trend rate was 6.5% (a 0.5% decrease over the previous year's median), while the median ultimate trend rate was 4.5% (a 0.1% drop over the previous year's median).

The survey also provides relevant data about how companies disclosed additional information to comply with the revised IAS 19 disclosure requirements in 2014.

For complete details of the survey, please refer to the document available on the Morneau Shepell website.

IFRS accounting: Proposed amendments to IAS 19

In June 2015, the International Accounting Standards Board ("IASB") issued an Exposure Draft that proposes changes to the IAS 19 accounting rules for defined benefit plans. The changes target two specific areas of IAS 19 and would be applied retrospectively. Earlier application would be permitted.

Remeasurement on a plan amendment, curtailment or settlement

When a defined benefit plan is amended, curtailed or settled during a reporting period, IAS 19 requires the remeasurement of the net defined benefit liability (asset) in order to measure the cost of the plan amendment, curtailment or settlement. For the remaining period following the remeasurement, the current service cost and net interest were still calculated using the assumptions and net defined benefit liability (asset) at the start of the reporting period (adjusted for contributions and benefit payments).

The IASB now proposes that if the defined benefit plan is remeasured following a plan amendment, curtailment or settlement, the current service cost and the net interest for the remaining period would be determined using the assumptions used for the remeasurement and the remeasured net defined benefit liability (asset). The IASB was concerned that "*ignoring the effect of such an event [...] would not result in useful information*" and that the benefits from this change would bring enhanced understandability and eliminate diversity in accounting, even if the implementation proves to be costly.

It is important to note that for defined benefit plans for which no such event occurs during the reporting period, the proposed change has no impact on the entity's practice with respect to its interim reporting. However, if any of these events occur and a remeasurement is required, this would mean that the costs reported in the subsequent interim periods would have to be adjusted as well.

Availability of a refund from a defined benefit plan

IAS 19 requires an entity to limit the defined benefit asset to the lower of the surplus and the asset ceiling (i.e. the economic benefits available in the form of surplus refunds or reductions in future contributions or a combination of both, in accordance with IFRIC 14).

The Exposure Draft considers whether the availability of a refund should be affected by other parties' (such as plan trustees) power to enhance benefits for plan members or wind up a plan. If the other parties can use a portion of the surplus to enhance benefits for plan members without the entity's consent, then the asset recognized by the entity on the basis of a future refund should not include this amount. Moreover, if other parties can wind up the plan without the entity's consent, then the entity should not assume a gradual settlement of the plan as the justification for the recognition of the asset. However, if the other

parties have the power to buy annuities or make other investment decisions without changing the plan members' benefits, then this shouldn't affect the availability of a refund for the entity.

These changes may have a limited impact on the financial reporting of defined benefit plans in Canada, as entities usually have control over these decisions (benefit enhancements, wind up), as opposed to some European countries, where plan trustees can use these powers without the entity's consent.

The IASB welcomes any comment by the public received by **October 19, 2015**.

Newfoundland and Labrador: Teachers' pension plan changes

On June 16, 2015, the Government of Newfoundland and Labrador and the Newfoundland and Labrador Teachers' Association ("NLTA") announced major changes to reform the Teachers' Pension Plan ("TPP"). They had reached a tentative agreement in April, and teachers in the Province have voted overwhelmingly in favor of the deal, with an 80% turnout rate and 91% in favor.

In announcing these changes, the Government noted a commitment to target full funding of the TPP, and to continue operating the plan on a defined benefit basis. The changes are similar to those made to the Province's Public Service Pension Plan ("PSPP") (see our *News & Views* bulletin of September 2014), including increased contributions, benefit changes for active teachers, and a move to a jointly trusteed structure.

Specific details on these changes are as follows:

- Member contributions will increase by 2% of earnings to 11.35% effective September 1, 2015, with the Government matching these contributions.
- Post-retirement indexing, which is currently provided at a rate of 60% of CPI, to a maximum annual increase of 1.2%, will continue to be provided in respect of service accrued up to September 1, 2015, but indexing will be suspended in respect of service accrued after that date. Current retirees are therefore not impacted.
- The earnings averaging formula will change from a 5-year average to an 8-year average, provided that the new average will be no less than the frozen 5-year average at September 1, 2015 for service accrued to that date.
- Effective September 1, 2016, vested teachers who terminate employment before being eligible for early retirement and who have less than 24.5 years of service will be entitled to a deferred pension payable at age 62, an increase from the prior unreduced age of 60.

Of note, there was no change in the TPP's early retirement provisions for teachers retiring from active service.

In addition to these changes, the Government will issue a promissory note worth $1.862 billion, to be amortized over 30 years with annual special payments of $135 million commencing on August 31, 2016.

As with the PSPP, the NLTA and the Government have agreed to operate the TPP on a jointly trusteed basis going forward, with all surpluses or deficits equally shared between the Government and members. The TPP will be run by an independent trustee corporation, and further details on a formal funding policy and the corporation's framework will be completed in the near-term.

With this latest announcement, the Province has now reformed its two largest defined benefit pension plans, covering government employees, health care employees, the education sector, and employees of various Crown corporations. At December 31, 2013, these two plans cover approximately 36,000 active members and 26,000 retirees, and had a combined $7.6 billion in assets and $12.4 billion in obligations.

Bill C-377 finally adopted despite labour opposition

More than three years after being introduced, the federal government has passed Bill C-377, which received Royal Assent on June 30, 2015. Bill C-377, *An Act to Amend the Income Tax Act*, is intended to increase transparency and accountability of labour unions by amending the *Income Tax Act* to require unions to disclose certain financial information, including:

- a statement of the **aggregate** amount of disbursements to employees and contractors;
- a statement of **individual** disbursements over $5,000 to contractors or over $100,000 to officers, executives and employees, including gross salary, stipends, periodic payments, and benefits (including pension obligations);
- financial statements including details of spending, borrowing and accounts receivable;
- details of spending on lobbying, political activities and other non-labour relations activities.

The Bill applies to every labour organization and every labour trust with the exception of:

- a labour-sponsored venture capital corporation; and
- a labour trust limited to the administration, management or investments of a deferred profit sharing plan, an employee life and health trust, a group sickness or accident insurance plan, a group term life insurance policy, a private health services plan, a registered pension plan or a supplementary unemployment benefit plan.

The Bill applies in respect of fiscal periods that begin on or after January 1, 2016. Failure to comply with the disclosure requirements carries a fine of $1,000 for each day that a union contravenes the section, up to a maximum of $25,000 per year. The information disclosed will be made accessible to the public on the Canada Revenue Agency website.

The Bill is controversial, with opponents claiming it is anti-union and unconstitutional in that it infringes on the provincial regulation of labour. There are also privacy issues, as the federal privacy commissioner raised concerns the Bill infringes on privacy rights. It appears likely that the Bill will be challenged in court.

Ontario: Draft regulations for merger or conversion of SEPPs into JSPPs

On June 26, 2015, the Ontario Ministry of Finance released draft regulations for the merger or conversion of single employer pension plans (SEPPs) in the broader public sector into jointly sponsored pension plans (JSPPs). A draft framework was discussed in our *News & Views* bulletin of February 2015.

The two major changes arising from public feedback on the earlier framework are as follows:

- the maximum transfer amount for a plan merger is the wind-up liabilities related to the accrued benefits of the SEPP members being transferred into the JSPP; and
- the earliest effective date of the transfer of assets for a plan merger is the date on which the required consent thresholds have been achieved.

A Questions and Answers document on the draft regulations has been published by the Ministry of Finance.

The deadline for public comments is **August 10, 2015.**

Ontario: Wind-up of a defined benefit plan replaced by a defined contribution plan

On June 12, 2015, the Financial Services Commission of Ontario (FSCO) released *Policy W100-803 - Original and Successor Pension Plans - Section 81 Does Not Preclude Wind-Up of Original Plan* (the "Policy"). The Policy addresses the rules for winding up a defined benefit (DB) pension plan when a successor defined contribution (DC) pension plan exists.

FSCO's previous interpretation of the *Pension Benefits Act* prevented DB pension plans from being wound up when a successor DC pension plan exists.

In order to approve the wind up, FSCO must be satisfied that the DB and DC plans are separate pension plans. FSCO will require the administrator to provide submissions with respect to the pension plan and pension fund documentation (such as board resolutions and trust agreements or insurance contracts).

The new Policy will be of interest to sponsors of Ontario-registered DB pension plans who replaced it with a DC plan and who may wish to wind up their frozen DB provisions. This could avoid future administrative costs as well as volatility of contributions, and conclusively extinguish their DB liabilities.

Ontario: Draft policies on DC investments and ESG factors

On June 30, 2015, the Financial Services Commission of Ontario (FSCO) released two guidance notes for public consultation. The first draft Guidance Note sets out FSCO's expectations for Statements of Investment Policies and Procedures (SIP&Ps) for member-directed investments, which are typically found in defined contribution (DC) pension plans and provisions. The second draft Guidance Note provides additional information on environmental, social and governance (ESG) factors, as they relate to SIP&Ps and plan investments.

Member directed DC plans

As previously reported in our *News & Views* bulletin of May 2015, FSCO's view is that Ontario-registered member-directed DC pension plans and provisions are still required to establish SIP&Ps, although federal rules regarding SIP&Ps no longer apply. The draft Guidance Note IGN-003 outlines FSCO's expectations regarding the minimum content of SIP&Ps for member-directed DC plans/provisions, including the following:

- Investment philosophy statements
- Permitted asset classes from which investment funds can be selected
- Default investment option for member accounts where no selection is made, and an explanation as to why it is appropriate given the plan membership
- The process for monitoring service providers
- The process for selecting, monitoring, and terminating investment managers and funds
- Guidance concerning plan expenses and investment fees related to the DC plan/provision
- Related party transactions
- Information guidelines for plan members on investment options, and
- Information as to whether ESG factors are incorporated into the plan's investment policies and procedures, and if so, how those factors are incorporated.

IGN-003 does not set out an effective date for the new requirements. However, Ontario-registered plans must file a SIP&P with FSCO within 60 days of January 1, 2016.

Environmental, social and governance factors

Effective January 1, 2016, the SIP&P for a pension plan registered in Ontario will be required to include information as to whether ESG factors are incorporated into the plan's investment policies and procedures, and if so, how this is done.

There is no standard definition of ESG factors that has been accepted amongst the investment community nor is there a standard approach to incorporating such factors into investment policies and procedures for pension plans. Accordingly, the draft Guidance Note IGN-004 seeks to provide background information on ESG factors and guidelines to assist pension plan administrators in meeting the disclosure requirements.

FSCO expects that:

- A plan administrator will, after appropriate consultation, establish and document its own view or understanding on what is meant by ESG factors, and then consider whether or not it will incorporate ESG factors and document the basis for its decision.
- If ESG factors are not incorporated into a plan's SIP&P, the administrator should include a statement to that effect in the SIP&P. FSCO suggests that the administrator may also wish to include a brief explanation of their rationale in the SIP&P itself, in the interest of transparency to members and beneficiaries.
- If ESG factors are incorporated into a plan's SIP&P, the administrator should include a statement to that effect in the SIP&P as a well as a description as to how those factors have been incorporated. While the Regulation does not provide further details, FSCO expects the following information to be disclosed:
    - either a broad statement that the administrator incorporates all ESG factors, or an enumeration of ESG factors that are incorporated;
    - a brief explanation of the methodology used by the plan to incorporate ESG factors; and
    - a description of the scope of the application of ESG factors.

FSCO cautions that the administrator is responsible for ensuring compliance with the SIP&P, not only by itself, but by its delegates. Accordingly, the language concerning the incorporation of ESG factors to be included in the SIP&P should be drafted in such a way that it can be complied with by the administrator and, where applicable, external investment managers. In this regard, the administrator may want to engage with its external managers in preparing its ESG disclosure language for the SIP&P.

FSCO advises that, where the administrator does not believe it has sufficient knowledge on the topic of ESG factors, it would be prudent for it to seek advice from an external advisor.

The Guidance Note includes a reminder of the legislative requirement that the administrator review its SIP&P at least annually.

The draft Guidance Notes will be of interest to administrators of DB and DC pension plans registered in Ontario as they review their SIP&Ps in advance of filing them with FSCO in early 2016. In particular, IGN-003 will provide welcome guidance to DC plan administrators in the drafting and review of a SIP&P. However, IGN-004 still does not provide a single definition of ESG factors and, accordingly, plan administrators will have to draw their own conclusions with the assistance of their professional advisors.

Public comments on the two Guidance Notes will be accepted until **August 28, 2015**.

Ontario: Draft policy on alternative settlement options

On July 3, 2015, the Financial Services Commission of Ontario ("FSCO") released draft Actuarial Guidance Note 004 ("AGN-004") to clarify FSCO's expectations on the use of alternative settlement methods in calculating the wind-up and solvency positions of an ongoing defined benefit (DB) pension plan.

This draft guidance is related to the release, on September 18, 2013, by the Actuarial Standards Board (ASB) of revised standards of practice and

by the Canadian Institute of Actuaries (CIA) of an Educational Note to guide actuaries (see our *News & Views* bulletin of September 2013).

FSCO is of the opinion that the use of some alternative settlement methods may not be appropriate for an actuarial valuation under the Ontario Pension Benefits Act, and has accordingly issued the following guidance:

- If an alternative settlement method is used, the actuary should be prepared to justify and provide adequate support as to why the benefits could not be settled by the purchase of annuities and why it would not be appropriate to assume settlement by annuity purchase.
- In determining the capacity of the life insurance market to provide group annuities, the actuary may not rely solely on the thresholds stated in the CIA's Educational Note, since these thresholds may change over time. Actual annuity transactions that have taken place, as well as input from insurance companies, should also be considered in estimating the threshold.
- FSCO would accept an alternative settlement method which contemplates an exercise of regulatory discretion or a change in legislation, if the resulting liabilities are no less than the liabilities produced using the prevailing annuity proxy issued by the CIA assuming no capacity constraints. In all other situations, FSCO will consider, on a case by case basis, submissions from the actuary and expects that the method be reasonable, supportable and appropriate given the plan's circumstances.
- AGN-004 does not apply to actual wind-up situations. FSCO would not accept the use of any alternative settlement methods for actual wind up valuations.
- If an alternative settlement method is used, FSCO may request other information or documentation in support of the rationale for the alternative settlement method assumed (in addition to the disclosures required in the Standards of Practice and the Educational Note).

Alternative settlement methods

AGN-004 makes the following comments on specific alternative settlement methods:

- **Purchase of a series of annuities:** In the case where the actuary assumes that the liabilities would be settled through a series of purchases over a period of time, FSCO expects that the liabilities would not be less than the liabilities produced using the prevailing annuity proxy issued by the CIA and assuming no capacity constraints. The actuary should disclose the assumptions made with respect to estimating future annuity purchases in addition to justifying the provision for expenses over the duration of the annuity purchases.
- **Establishment of a replicating portfolio:** If the actuary is contemplating the use of a replicating portfolio as an alternative settlement method, FSCO would require that the actuary provide significant disclosures including appropriate justification for the use and rationale for this method, which should include (but not limited to):
  - comments on the relevant fixed income investment market capacity;
  - information about the credit and liquidity profile of the instruments included;
  - the key risks considered in setting the margins for adverse deviations;
  - description of the margins for adverse deviations to ensure a high probability that the pension benefit promises will be met;
  - the allocation of investments in the portfolio and justification of the allocation;
  - the mortality experience applied to the expected benefit cash flows and justification if such experience does not reflect plan-specific experience;
  - justification of the level of expenses associated with establishing and maintaining the portfolio;

- the average duration of the liabilities to be settled and the average duration of the portfolio;
- the assumptions regarding the options elected by plan members;
- adequate information for FSCO to make an assessment of the level of benefit security provided by the replicating portfolio, which should be the same or similar to that of an annuity purchase settlement without capacity limitations.

- **Lump sum payments to members:** Unless specified in the legislation, FSCO would not accept this settlement method. The *Ontario Pension Benefits Act* does not contemplate lump sum payments to retired members.
- **Assuming modifications to benefit terms:** Unless the plan is amended, FSCO will not accept this alternative settlement method.

The final form of AGN-004 is yet to be determined. However, it is important to note that FSCO will expect additional disclosures if the actuary chooses to assume alternative settlement methods in the valuation of an on-going DB pension plan in Ontario.

Public comments on AGN-004 will be accepted until **August 7, 2015.**

Alberta: Draft Interpretive Guides

On September 1, 2014, new pension legislation and regulations took effect in Alberta (see our *News & Views* bulletin of August 2014). Since then, the Alberta Treasury Board and Finance has published various draft Interpretive Guides (IG's) related to the new legislation. The draft IG's outline the Superintendent's expectations and requirements where the Superintendent has been delegated authority under the legislation, as well as the Superintendent's expectations regarding best practices and policies for registered plans in relation to each subject.

On June 11, 2015, the following draft IG's were released:

- IG-12 - Governance, Investment and Funding Policies;
- IG-13 - Plan Text Document; and
- IG-14 - Missing Members.

A summary of the matters addressed in the above-referenced draft IG's follows.

Governance, investment and funding policies (IG -12)

IG-12 is designed to explain the legislative provisions relating to the adoption and maintenance of plan governance, investment, and funding policies.

Every pension plan registered in Alberta is required to establish a governance policy. IG-12 summarizes the prescribed content for governance policies under the legislation. IG-12 also includes lists of items plan administrator should consider for inclusion in relation to the prescribed content for the policy. In particular, IG-12 refers stakeholders to the Canadian Association of Pension Supervisory Authorities (CAPSA) *Guideline No. 4 – Pension Plan Governance Guidelines and Self-Assessment Questionnaire* for further assistance in establishing an effective governance policy.

With respect to requirements for the Statement of Investment Policies and Procedures (the SIP&P), IG-12 states that the level of detail for the SIP&P will depend on the plan benefit type and who is in charge of decision making with respect to investments. Plans with defined benefit provisions or employer-directed investments in a defined contribution provision are expected to have more detailed investment policies.

As a result of recent federal changes, a SIP&P is not legally required for a defined contribution provision where members choose how their funds are invested. However, IG-12 states that a plan administrator could help demonstrate prudence and due diligence in its

administration of the pension fund by documenting how investment options were chosen, how the default option was chosen, and the supporting rationale for fees.

With respect to the funding policy, IG-12 outlines the prescribed content for this policy. IG-12 also refers stakeholders to CAPSA *Guideline No. 7 – Pension Plan Funding Policy Guideline* for further assistance in establishing a funding policy.

Finally, IG-12 states that the governance, investment, and funding policies are "living documents" that should be reviewed, and where applicable revised, at least annually. Decisions should be consistent with the established policies and where there is variance from the policies, the policies should be revised, or there should be proper documentation explaining the variance.

Plan text document (IG-13) and Missing members (IG-14)

IG-13 summarizes the plan text provisions which are required or optional under the new legislation.

IG-14 explains the legislated process for moving missing members' benefits to the Unclaimed Property Unit at Alberta Finance under the *Unclaimed Personal Property and Vested Property Act*. A search for members must be undertaken by the plan administrator and an application must be made to the Superintendent of Pensions for approval.

Public comments will be accepted until **August 11, 2015.**

New mortality table for pension commuted values

On June 15, 2015, the Actuarial Standards Board (ASB) issued a Final Communication to enable promulgation of a new mortality table for calculating the commuted value of a deferred pension. As reported in our *News & Views* bulletin of December 2014, the ASB released an Initial Communication to that effect on December 4, 2014 and invited comments.

The Final Communication confirms the recommendation of the Initial Communication to promulgate CPM2014 (based on the composite public/private sector dataset), without adjustment, along with mortality improvement scale CPM-B. The effective date of the promulgation will be October 1, 2015.

However, it will still be permitted to replace the two-dimensional improvement scale CPM-B with a one-dimensional approximation (CPM-B1D2014) until December 31, 2016.

As a result of the change in mortality tables (from the current UP94 table projected with scale AA), commuted values calculated on or after October 1, 2015, can be expected to increase by about 5% - 7%. The change will also impact the liabilities assumed to be settled by commuted values under solvency and wind-up actuarial valuations with valuations dates on or after October 1, 2015. The portion of liabilities assumed to be settled through the purchase of annuities will be unaffected.

The commuted value standard is also referenced in pension legislation. In many provincial jurisdictions, as well as for plans governed under the federal *Pension Benefits Standards Act*, the relevant pieces of legislation will not require any updating as they refer to the commuted value standard "as amended from time to time" or equivalent. However, in the provinces of Ontario, Québec, and New Brunswick, the pension regulations refer to the standard as it read on a certain date. To mandate the use of the newly promulgated table, the regulations for these provinces would need to be amended in some way.

The ASB currently is also in the process of reviewing the economic assumptions underlying the commuted value standard.

Market indices as at June 30, 2015

The following table shows the Morneau Shepell monthly summary of returns from various market indices. It also includes returns from benchmark portfolios used by pension funds.

	Returns			
	Monthly	Quarter to date	Year to date	1 year
FTSE TMX Bond Indices				
FTSE TMX Canada Universe Bond	-0.6%	-1.7%	2.4%	6.3%
FTSE TMX Canada 91 Day Treasury Bill	0.1%	0.2%	0.4%	0.9%
FTSE TMX Canada Short Term Bond	0.3%	0.2%	2.1%	3.4%
FTSE TMX Canada Mid Term Bond	-0.2%	-1.2%	3.0%	6.7%
FTSE TMX Canada Long Term Bond	-1.9%	-4.6%	2.2%	10.1%
FTSE TMX Canada High Yield Bond	0.5%	2.7%	4.0%	0.1%
FTSE TMX Canada Real Return Bond	-0.8%	-3.7%	3.4%	5.6%
Canadian Equity Indices				
S&P/TSX Composite (Total Return)	-2.8%	-1.6%	0.9%	-1.2%
S&P/TSX Composite Capped	-2.8%	-1.6%	0.9%	-1.2%
S&P/TSX 60 (Total Return)	-2.8%	-1.8%	0.6%	0.7%
S&P/TSX Completion	-2.6%	-1.3%	1.8%	-6.2%
S&P/TSX Small Cap	-3.5%	1.3%	1.1%	-16.4%
BMO Small Cap Unweighted	-3.6%	1.9%	2.5%	-15.9%
BMO Small Cap Weighted	-3.6%	0.9%	0.9%	-14.6%
U.S. Equity Indices				
S&P 500 (US$)	-1.9%	0.3%	1.2%	7.4%
S&P 500 (C$)	-1.5%	-1.1%	9.0%	25.7%
Foreign Equity Indices[1]				
MSCI ACWI (C$)	-2.3%	-1.1%	10.7%	18.0%
MSCI World (C$)	-2.3%	-1.1%	10.6%	18.9%
MSCI EAFE (C$)	-2.8%	-0.8%	13.7%	12.3%
MSCI Europe (C$)	-3.1%	-1.1%	11.9%	8.2%
MSCI Pacific (C$)	-2.4%	-0.3%	17.3%	20.4%
MSCI Emerging Markets (C$)	-2.5%	-0.6%	11.1%	11.6%
Other				
Consumer Price Index (Canada, May 2015)	0.6%	0.5%	1.9%	0.9%
Exchange Rate US$/C$	0.4%	-1.4%	7.7%	17.1%
Morneau Shepell Benchmark Portfolios[2]				
60% Equity/40% Bonds	-2.0%	-2.0%	4.4%	8.1%
55% Equity/45% Bonds	-1.9%	-2.1%	4.2%	8.1%
50% Equity/50% Bonds	-1.9%	-2.2%	4.0%	8.1%
45% Equity/55% Bonds	-1.8%	-2.2%	3.9%	8.1%
40% Equity/60% Bonds	-1.7%	-2.3%	3.7%	8.1%

Asset & Risk Management

Asset Management

We provide objective advice on all aspects of asset management for pension funds, including investment policy statements, portfolio manager searches, investment performance measurement and investment strategy.

Risk Management

We provide a structured, comprehensive approach to pension risk management, including implementation of liability-driven investment strategies, advice on allocation of the risk budget within an asset-liability framework and execution of continuous and dynamic processes for risk reduction.

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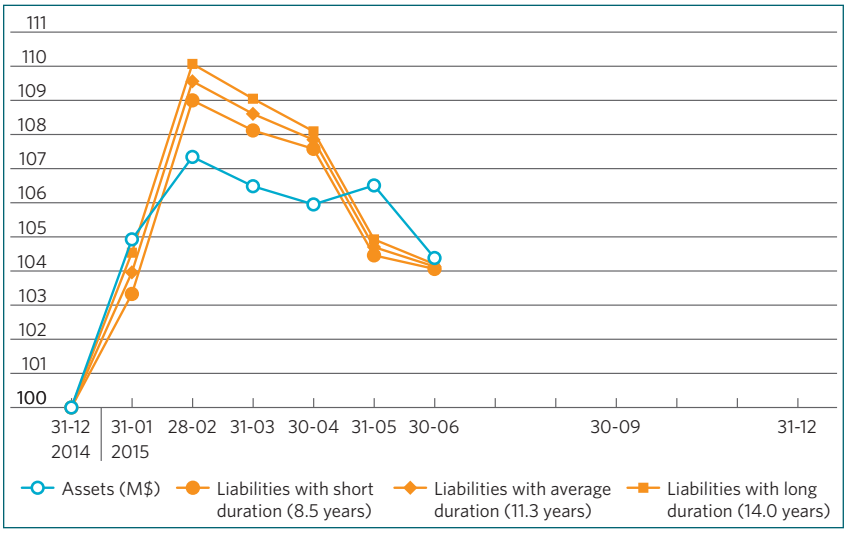
Notes:

1 Returns net of taxes on dividends, except for MSCI Emerging Markets.
2 The returns are compounded monthly.

Tracking the funded status of pension plans as at June 30, 2015

This graph shows the changes in the financial position of a typical defined benefit plan since December 31, 2014. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2014. This estimate of the solvency liabilities reflects the new CIA guidance published in May 2015 for valuations effective March 31, 2015 or later. The following graph shows the impact of past returns on plan assets and the effect of interest rate changes on solvency liabilities.

The evolution of the financial situation of pension plans since December 31, 2014



In June 2015, Canadian bonds as well as Canadian and Global equity markets (CAD) showed negative returns, decreasing assets by 2.0%. Annuity purchase rates increased during the month while the rates used in the calculation of solvency liabilities did not change, resulting in a decrease of 0.5% in solvency liabilities for the average duration plan. The combined effect decreased the solvency ratio.

The table below shows the impact of past returns on plan assets as well as the effect of interest rate changes on solvency liabilities, based on the plan's initial solvency ratio as at December 31, 2014.

Initial solvency ratio as at December 31, 2014	Evolution of the solvency ratio as at June 30, 2015 for three different groups of retirees		
	Short duration (8.5 years)	Average duration (11.3 years)	Long duration (14.0 years)
100%	100.3%	100.2%	100.2%
90%	90.3%	90.2%	90.2%
80%	80.2%	80.2%	80.1%
70%	70.2%	70.2%	70.1%
60%	60.2%	60.1%	60.1%

Comments

1. No consideration has been made for contributions paid to the plan or for benefits paid out of the plan.
2. Solvency liabilities are projected using the rates prescribed by the Canadian Institute of Actuaries for the purpose of determining pension commuted values.
3. This estimate of the solvency reflects the new CIA guidance published in January 2015.
4. The underlying typical defined benefit plan is a final average plan with no pension indexing, including active and inactive participants representing 60% and 40% of liabilities, respectively.
5. Assets are shown at full market value. Returns on assets are based on those of the Morneau Shepell benchmark portfolio (60% equities and 40% fixed income).

Since the beginning of the year, driven by strong returns in the global equity markets (CAD) the plan's assets increased by 4.4%. The solvency liabilities increased over that same period between 4.1% and 4.2%, depending on the duration of the group of retirees. The increase in the plan's solvency ratio as at June 30, 2015, depends on the plan's initial ratio, but is practically the same as at the beginning of the year.

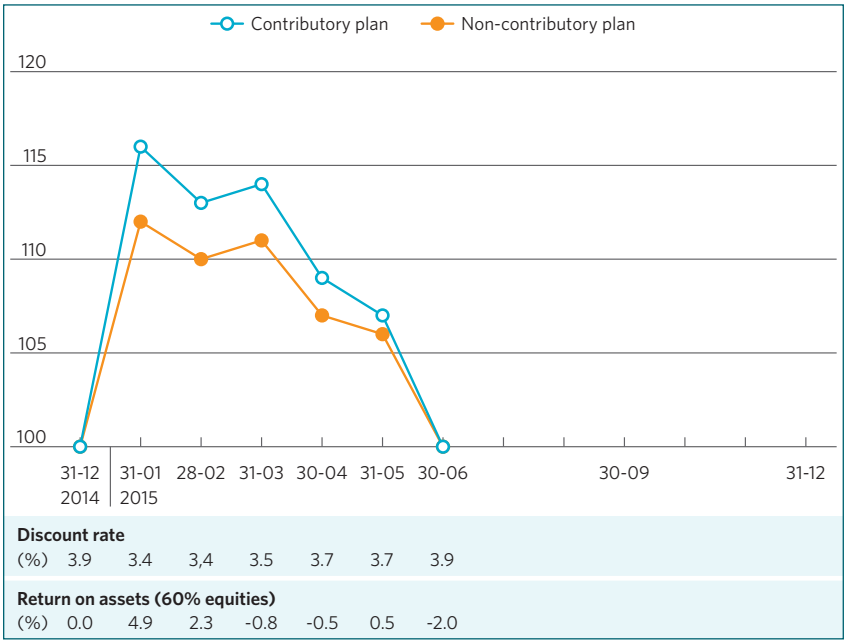
Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Impact on pension expense under international accounting as at June 30, 2015

Every year, companies must establish an expense for their defined benefit pension plans.

The following graph shows the expense impact for a typical pension plan that starts the year at an arbitrary value of 100 (expense index). The expense is influenced by changes in the discount rate based on high quality corporate and provincial (adjusted) bonds and the median return of pension fund assets.

Expense Index from December 31, 2014



The following table shows the discount rates for varying durations and the change since the beginning of the year. A plan's duration generally varies between 10 (mature plan) and 20 (young plan).

Discount rate

Duration	December 2014*	June 2015	Change in 2015
11	3.78%	3.69%	-9 bps
14	3.99%	3.96%	-3 bps
17	4.15%	4.15%	0 bp
20	4.25%	4.28%	3 bps

* The rates as at December 31, 2014 were revised to reflect a refinement in the methodology used.

The discount rate has increased in the last month, which had the effect of reducing the pension expense, despite poor returns (relative to the discount rate). Since the beginning of the year, the decrease in the discount rate was offset by good returns, and the pension expense returned to the same level it was at the beginning of year.

Comments

1. The expense is established as at December 31, 2014, based on the average financial position of the pension plans used in our *2014 Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits* report (i.e. a ratio of assets to obligation value of 95% as at December 31, 2013).
2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (60% equities and 40% fixed income).
3. The actuarial obligation is that of a final average earnings plan, without indexing (two scenarios: with and without employee contributions).

Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

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Morneau Shepell is the largest company in Canada offering human resources consulting and outsourcing services. The Company is the leading provider of Employee and Family Assistance Programs, as well as the largest administrator of pension and benefits plans. Through health and productivity, administrative, and retirement solutions, Morneau Shepell helps clients reduce costs, increase employee productivity, and improve their competitive position. Established in 1966, Morneau Shepell serves approximately 20,000 clients, ranging from small businesses to some of the largest corporations and associations in North America. With about 3,700 employees in offices across North America, Morneau Shepell provides services to organizations across Canada, in the United States, and around the globe. Morneau Shepell is a publicly traded company on the Toronto Stock Exchange (TSX: MSI).

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