Québec: Retraite Québec provides details about the new rules

On April 14, 2016, Retraite Québec (RQ) published some details on the new Supplemental Pension Plans Act (Act) rules which took effect on January 1, 2016, after Bill 57 was adopted in November 2015 (see the December 2015 News & Views).

The RQ website now has a new section called Private-sector pension plans, which explains the new rules pursuant to Bill 57, including those affecting additional pension benefits and partial payments.
In early May 2016, the RQ also published Newsletter No. 31 “Amendments to the Supplemental Pension Plans Act effective 1 January 2016”. The French version of the newsletter was published before that, in April 2016.

The following are some of the highlights of the Newsletter:

• **Excluded Plans**: The new provisions of the Act do not apply to plans whose funding is subject to exemption via regulation, particularly plans in the municipal and university sectors. In the case of those plans, the Act as it read prior to January 1, 2016 continues to apply, adapted as required in accordance with the provisions of various exempting regulations. However, the new provisions regarding the funding policy do apply to these plans.

• **Actuarial valuation**:
  - For the purposes of the actuarial valuation as at December 31, 2015, the amortization payments required for an unfunded actuarial liability determined in a prior actuarial valuation are eliminated.
  - An actuarial valuation is also required where:
    1. final payment of the benefits of retired members and beneficiaries is made by purchasing an annuity from an insurer;
    2. an amendment has an impact on funding;
    3. surplus assets are allocated to the payment of employer contributions.

In such cases, a partial valuation can be done. However, in the latter two cases, the valuation can be partial provided that it is produced at the end of the plan’s fiscal year and that no complete actuarial valuation is required under the Act or by RQ.

• **Banker’s clause**:
  - A person or body who has made amortization payments to the pension fund for certain deficiencies can recover those amounts first, in particular by taking a contribution holiday when the plan’s financial situation so allows.

  All amounts appropriated for that purpose must be deducted from the contributions subject to special monitoring.

  - If contributions paid before January 1, 2016 were, in accordance with the plan text, the subject of special monitoring (or banker’s clause), those contributions must be recognized and shown in the actuarial valuation of the plan as at December 31, 2015.

• **Surplus assets**:
  - All plan texts, regardless of their type or effective date, must now contain a special section that is easily recognizable and includes all provisions related to the use of surplus assets during the life of the plan. The provisions related to the allocation of surplus assets in the event of plan termination must also be in a special section. These two provisions can be presented separately or together, but the rules that apply in the two situations must be separate from the rest of the plan text and clearly identified.

  - The simple fact of moving the existing provisions to a new section does not constitute an amendment that would require the consultation of plan members and beneficiaries as required by the Act (i.e., the opposition of more than 30% of the members and beneficiaries defeating other types of proposed amendments on surplus).

• **Use of surplus assets during the life of the plan**: a summary of the rules is provided and the newsletter states that the new limits could prevent the plan from taking a contribution holiday, even if the plan has considerable surplus assets. However, under section 146.9 of the Act, it is permitted to amend a plan text to authorize a contribution holiday greater than the amounts subject to special monitoring, providing the conditions regarding the use of surplus assets are met.

• **Distribution of surplus assets in the event of termination**: the arbitration procedure for the allocation of surplus assets in the event of termination no longer applies.
**Additional pension benefit (APB):**

- Plan provisions concerning the APB continue to apply as long as the plan has not been amended to remove them. Also, section 60.1 of the Act (APB) continues to apply to members who ceased to be active before January 1, 2016.
- Since section 60.1 (APB) no longer applies, the APB provided for under the plan can no longer be paid in a lump sum as it would violate section 67.1 of the Act, which provides that no pension plan may provide for refunds contrary to the provisions of the Act. This raises questions about possible alternative methods of paying the APB (e.g.: additional life annuity or basic pension indexation during the deferred period).
- If it is decided before January 1, 2017 to remove the benefit, the amendment can take effect from January 1, 2016 or after, and apply to all service regardless of the effective date of the collective agreement or the date on which a notice is sent to the members. The consent of the members is not required.
- If, in 2016, it is decided to remove the APB retroactively, caution should be exercised in order to avoid administrative complications related to the recovery of any overpayments. For example, an effective date could be chosen for the amendment that is after the date on which the notice is sent to the members. It would also be possible to indicate in the text related to the amendment that the members who requested a refund or transfer of their benefits before the decision to amend the plan are not affected.
- It is also possible to remove the portion of the indexation that is equal to the APB under section 60.1 of the Act, and under the same conditions.

**Payment of benefits:**

- The plan may contain more advantageous provisions and provide for payment of the value of benefits (for members and beneficiaries) in a higher proportion than its solvency ratio. In such cases, the amounts must be funded before payment, in order to protect the plan’s financial health.
- The pension committee must inform members, in their termination statement, of the potential consequences of having their benefits transferred. The termination statement must also clearly show that the solvency ratio applied to the transfer value will be the one established as at the date of payment.
- For members who requested payment of their benefits before January 1, 2016, the provisions of the Act as it read prior to that date apply. They are therefore entitled to 100% of the value of their benefits, even if no payment had been made by January 1, 2016.
- If the plan provides that the benefits of members are to be paid in full when they leave the plan, payment must be made in accordance with the plan text, provided it has not been amended and given that it is more advantageous than the provisions provided for in the Act.
- The minimum value test (i.e., 20% of Maximum Pensionable Earnings [MPE]) is carried out on the total value of a member’s benefits, regardless of the solvency ratio applicable to the payment of the member’s benefits.

**Letter of credit (LC):**

- The maximum LC that can be considered in a valuation is:
  - on a solvency basis: 15% of the liabilities established for the going concern or solvency basis, whichever is lower;
  - on a going concern basis: 15% of the going concern liability.

**Cost sharing and excess contributions:** the minimum employer contribution test now makes it possible to distinguish amortization payments (if a portion is paid by members) from current service contributions. The test now must be done in two parts, determining a member’s current service contribution and amortization contribution. In order for a member contribution to be deemed
an amortization payment, the plan text must provide for it.

- **Divisions:** the provisions of the Act concerning the confirmation of the right to appropriate surplus assets during the life of the plan have been repealed. As a result, in the event of plan division, the requirement to contain provisions having the same effect now applies in all cases, and not only where the initial plan provisions were confirmed.

- **Mergers:**
  - The effect of provisions regarding the allocation of surplus assets during the life of an absorbing plan must now be identical to those of the absorbed plan. With regard to plan provisions in the event of termination, the rules have not changed. The provisions regarding the allocation of surplus assets must have the same effect as those of the absorbed plan or be more advantageous.
  - RQ may only authorize plan mergers if the solvency ratio of the absorbing plan after the merger meets certain conditions.

- **Withdrawal of an employer:** under the Act, members and beneficiaries affected by an employer’s withdrawal can no longer retain their benefits in the plan. Therefore, in the case of retirees, an annuity must be purchased from an insurer, whereas the value of the benefits of non-retirees must be transferred.

- **Funding policy, annuity purchasing policy, investment policy:** a summary is provided, but does not really provide any new information.

- **Internal by-laws** (must now also set out how the risks that face the plan are quantified): no details provided.

Following the April 6, 2016 publication of the draft regulation for the new stabilization provision (see the [April 2016 News & Views](https://www.morneaushepell.com/news-events/news-vews)), more regulations regarding the implementation of Bill 57 will be issued, including the conditions that apply to funding policies and annuity purchasing policies.

**Ontario: more details on ORPP**

On April 14, 2016, the Ontario Government announced additional design details regarding the Ontario Retirement Pension Plan (ORPP) and introduced the new Ontario Retirement Pension Plan Act (*Strengthening Retirement Security for Ontarians*), 2016 (Bill 186), which builds on previously enacted ORPP legislation. The announcement reiterates previously announced design details but includes some new information.

**Federally regulated employers and the self-employed**

Individuals who work in federally regulated industries such as banks, telecommunications, railway and air transportation, would not be eligible to participate at this time, due to the current structure of federal income tax and pension rules. The province is currently in discussions with the federal government to support the participation of federally-regulated employees (except those working at Crown corporations) and the self-employed in the ORPP.

**Size of Ontario employer for purposes of phase-in**

Contributions to the ORPP will occur in waves, starting on January 1, 2018, depending on the size of the employer. Employer size for the purposes of this phase-in would be based on the number of T4s that were issued to Ontario employees in 2015.

**Upper income threshold**

The amount of contributions and pension benefits will be based on earnings up to an annual limit of $90,000 in 2017 dollars (i.e. adjusted after that year based on increases in average wages). The previous upper income threshold was to be $90,000 in 2014 dollars.

**Timing of future developments**

The government intends to formalize additional plan design details, including those previously announced, in regulations expected this summer and in future legislation.
An education campaign targeting employers will be launched in the summer. The ORPP Administration Corporation (the “ORPP AC”) is expected to begin contacting employers to determine their status for ORPP implementation (i.e. which wave they fall into). Employee enrolment in the ORPP is expected to start in early 2017, and the collection of contributions on January 1, 2018.

**Ontario: new guidance for interest on late pension payments**

On April 11, 2016, the Financial Services Commission of Ontario (FSCO) issued guidance on the crediting of interest on late pension payments to Ontario pension plan members. FSCO’s guidance addresses the situation where a retired member is paid retroactive pension payments (i.e., monthly pension payments paid after the due date).

According to FSCO, interest should be paid at the same rate used to determine interest on contributions made by members and former members, as set out in section 24 of the Ontario Pension Benefit Regulation, namely the interest rate applicable to five-year personal fixed-term chartered bank deposit rates, as reported by Statistics Canada. Interest should be applied to each late pension payment from the date it was due until the beginning of the month in which it is paid. The lump sum amount owing to the retired member is, therefore, the sum of each of the pension payments plus interest on each specific pension payment.

It is important to note that FSCO’s guidance is not affected by the reason for the late payment or based on a determination of fault.

FSCO’s guidance should be considered by administrators of pension plans making payments to retired Ontario members.

**Conclusion**

The announcement that federally regulated employees in Ontario will be excluded from the ORPP for now will be welcome to federally regulated employers, but the Ontario government’s intention to request the expansion of the ORPP to cover such employees (excluding Crown corporations) may be of concern to such employers. It is not clear how the federal government will respond to the Ontario government’s request. Our understanding is that federally regulated employees would be subject to a different implementation schedule, if they are to be included.

The information regarding the test on employer size for the phase-in provides welcome clarity for multi-jurisdictional employers without registered pension plans who were not sure at which point they would be required to start contributing to the ORPP.

Employers can expect to receive information on the ORPP starting in the summer and to be officially contacted by the ORPP AC in the fall.
Tracking the funded status of pension plans as at April 30, 2016

This graph shows the changes in the financial position of a typical defined benefit plan with a medium duration since December 31, 2015. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2015. The estimate of the solvency liabilities reflects the new CIA guidance published in January 2016 for valuations effective December 31, 2015 or later. The following graph shows the impact of three typical portfolios on plan assets and the effect of interest rate changes on solvency liabilities of medium duration.

The evolution of the financial situation of pension plans since December 31, 2015

During the month of April, Canadian long term bonds, Canadian long term provincial bonds as well as Canadian equity markets showed positive returns, while Canadian universe bonds, global equity markets and alternative investments showed negative returns. With a return of 0.6%, the 60/40 portfolio outperformed the low volatility portfolio (LDI) (0.4%) and the highly diversified portfolio (HD) (-0.1%). The outperformance of the 60/40 portfolio is explained by a larger weight in Canadian equities and no exposure to alternative investments in the portfolio. Annuity purchase rates as well the rates used in the calculation of solvency liabilities increased during the month, decreasing the solvency liabilities by 0.9% for a medium duration plan. In all cases, the combined effect increased the solvency ratio.

The tables below shows the impact of past returns on plan assets and the effect of interest rate changes on solvency liabilities, based on the plan’s initial solvency ratio as at December 31, 2015 as well as the asset allocation of the three typical portfolios.

<table>
<thead>
<tr>
<th>Initial solvency ratio as at December 31, 2015</th>
<th>Evolution of the solvency ratio as at April 30, 2016 for three different portfolios</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>60/40 portfolio</td>
</tr>
<tr>
<td>100%</td>
<td>96.5%</td>
</tr>
<tr>
<td>90%</td>
<td>86.8%</td>
</tr>
<tr>
<td>80%</td>
<td>77.2%</td>
</tr>
<tr>
<td>70%</td>
<td>67.5%</td>
</tr>
<tr>
<td>60%</td>
<td>57.9%</td>
</tr>
</tbody>
</table>

Since the beginning of the year, driven by negative returns within the global equities and alternative investments markets and by positive returns within the Canadian equity market, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 0.7 %, 0.8 % and -1.0% respectively. The solvency liabilities increased over that same period between 4.1% and 4.5% depending on the duration of the group of retirees. The decrease in the plan’s solvency ratio as at April 30, 2016 depends on the plan’s initial ratio, but stands between 2.1% and 5.2%.

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

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 (CIA) for the purpose of determining pension commuted values.

3. 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.

4. Assets are shown at full market value. Returns on assets are based on three typical benchmark portfolios.
Impact on pension expense under international accounting as at April 30, 2016

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

The 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, 2015

<table>
<thead>
<tr>
<th>Date</th>
<th>Contributory plan</th>
<th>Non-contributory plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-12-15</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>31-01-16</td>
<td>105</td>
<td>110</td>
</tr>
<tr>
<td>29-02</td>
<td>110</td>
<td>115</td>
</tr>
<tr>
<td>30-03-16</td>
<td>115</td>
<td>120</td>
</tr>
<tr>
<td>30-04-16</td>
<td>120</td>
<td>125</td>
</tr>
<tr>
<td>30-05-16</td>
<td>125</td>
<td></td>
</tr>
<tr>
<td>30-06-16</td>
<td>130</td>
<td></td>
</tr>
<tr>
<td>30-07-16</td>
<td>135</td>
<td></td>
</tr>
<tr>
<td>30-08-16</td>
<td>140</td>
<td></td>
</tr>
<tr>
<td>30-09-16</td>
<td>145</td>
<td></td>
</tr>
<tr>
<td>31-10-16</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>31-11-16</td>
<td>155</td>
<td></td>
</tr>
<tr>
<td>31-12-16</td>
<td>160</td>
<td></td>
</tr>
</tbody>
</table>

The table below shows the discount rates for various 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

<table>
<thead>
<tr>
<th>Duration</th>
<th>December 2015</th>
<th>April 2016</th>
<th>Change in 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>3.71%</td>
<td>3.44%</td>
<td>-27 bps</td>
</tr>
<tr>
<td>14</td>
<td>3.91%</td>
<td>3.58%</td>
<td>-33 bps</td>
</tr>
<tr>
<td>17</td>
<td>4.04%</td>
<td>3.66%</td>
<td>-38 bps</td>
</tr>
<tr>
<td>20</td>
<td>4.12%</td>
<td>3.70%</td>
<td>-42 bps</td>
</tr>
</tbody>
</table>

Since the beginning of the year, the pension expense has increased by 22% (for a contributory plan) due to the decrease in the discount rate and to the poor returns on plan assets (relative to the discount rate).

Comments

1. The expense is established as at December 31, 2015, based on the average financial position of the pension plans used in our 2015 Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits report (i.e. a ratio of assets to obligation value of 91% as at December 31, 2014).

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.
Morneau Shepell is the only human resources consulting and technology company that takes an integrative approach to employee assistance, health, benefits and retirement needs. The Company is the leading provider of employee and family assistance programs, as well as the largest administrator of retirement and benefits plans and the largest provider of integrated absence management solutions in Canada. 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 almost 4,000 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)