The deal reached in June by the finance ministers to enhance the CPP was supposed to have been ratified by July 15, but BC Premier Christy Clark, who faces an election next year, wanted more time to explain the merits of the enhancement to British Columbians. The biggest opposition to the deal appears to be coming from small businesses, who are dismayed by the eventual increase in CPP contributions that the enhancement would entail. The BC government issued a call for public comments on July 15, but did not specify a deadline or a clear process. The enhancement is still likely to be ratified but it is not clear when.

CPP Expansion: Update

The deal reached in June by the finance ministers to enhance the CPP was supposed to have been ratified by July 15, but BC Premier Christy Clark, who faces an election next year, wanted more time to explain the merits of the enhancement to British Columbians. The biggest opposition to the deal appears to be coming from small businesses, who are dismayed by the eventual increase in CPP contributions that the enhancement would entail. The BC government issued a call for public comments on July 15, but did not specify a deadline or a clear process. The enhancement is still likely to be ratified but it is not clear when.
All of the other provinces, and the federal government, have already accepted the enhancement, with the exception of Quebec, which will be putting forth a proposal of its own for changing the QPP in the fall. Until now, the QPP has been virtually identical to the CPP (except for the contribution rate), but that could well change in the future. While this divergence may make administration a little more difficult for national employers, it is unlikely to derail the CPP enhancement announced in June.

In the wake of the CPP deal, the Ontario government announced there is no longer any need for the ORPP.

Ohio: Consultation on solvency funding reform

On July 26, 2016, the Ontario Ministry of Finance released a consultation paper on solvency funding reform. In the 2016 budget, the Ontario government had announced the appointment of David Marshall, former president and CEO of the WSIB, to lead the solvency funding review.

The consultation paper sets out an array of potential reforms to the funding regime for Ontario-registered defined benefit (DB) pension plans, ranging from solvency funding reform (Approach A) to the complete abolition of solvency funding in Ontario and its replacement with a reformed going-concern model (Approach B). The consultation paper also presents a set of additional complementary reform measures that would potentially enhance benefit security to offset the impact of funding reform.

For a detailed summary of the proposals, refer to our Special Communiqué on the consultation paper.

Approach A:
Modified solvency funding rules

Approach A maintains the principle of solvency funding for DB plans and considers possible modifications to existing requirements.

There are seven options under Approach A, including allowing for a solvency deficit amortization period greater than the current five years, requiring only partial solvency funding, or allowing letters of credit above the current 15% limit. Solvency reserve accounts, which would allow employers to withdraw surplus regardless of plan terms, are also considered.

Approach B:
Eliminate current solvency funding rules and strengthen going-concern funding

Approach B considers relying on strengthened going-concern funding requirements for DB pension plans as the basis for establishing contribution requirements. Solvency funding would not be required, but solvency valuations could continue to play a role with respect to transparency and disclosure to regulators and members.

Going-concern funding could be enhanced by requiring the funding of a cushion, also referred to as a reserve or Provision for Adverse Deviation (PfAD), which could vary depending on the plan’s investments or demographics, or by shortening the going-concern unfunded liability amortization period from the current 15 years.

The consultation paper suggests that, in the absence of solvency funding, Pension Benefit Guarantee Fund (PBGF) contributions would likely need to be increased to reduce the risk to the PBGF in the case of employer insolvency. The consultation paper also suggests that PBGF coverage could be enhanced.

Additional complementary reform measures

There may be several additional changes that could be introduced along with either Approach A or B described above. These potential measures include a requirement for annual valuation reports, a requirement for written governance and funding policies, reducing commuted value payouts to reflect plan funding and restrictions on contribution holidays and benefit improvements. In addition, legislation could be amended to permit annuity buy-outs to legally discharge an administrator’s liability.
Ontario: Solvency funding relief for certain public sector pension plans

Ontario is proposing legislative amendments that will allow sponsors of broader public sector (BPS) pension plans to temporarily reduce the minimum-required level of solvency funding. This proposal follows solvency relief measures that applied to those plans in recent years (see News & Views edition of November 2015).

The structure of the proposed relief would be as follows:

- the relief is in respect of the first report filed after the Stage 2 valuation report and with a valuation would no longer on or before December 31, 2018 (the “First Subsequent Report”);
- the solvency funding requirement would be reset to be midway between the solvency ratio, calculated as solvency assets / solvency liabilities (as determined in the First Subsequent Report) and 100%;
- the solvency deficit would have to be liquidated by equal monthly instalments over a period of no longer than 7 years, commencing no later than 12 months after the First Subsequent Report valuation date; and
- the next required actuarial report filing following the First Subsequent Report would have to be no later than three years after the valuation date of the First Subsequent Report and normal funding rules in effect at that time will apply.

The minimum special payments for the period starting no later than 12 months after the First Subsequent Report valuation date until the date the next valuation report is filed would be the sum of:

- going concern special payments;
- special payments to liquidate the new solvency deficit; and
- interest payments on the remainder of the solvency deficit that is not being liquidated, based on the solvency valuation interest rates as of the First Subsequent Report date.

Comments

Comments on the proposed regulation may be submitted by September 9, 2016.
Québec: Draft regulation to amend the regulation respecting supplemental pension plans

A draft regulation to amend the Regulation respecting supplemental pension plans was published in the Gazette officielle du Québec on July 20, 2016. The purpose of the draft regulation is to set out various measures enacted by the Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans (Bill 57, which became Law 29), adopted in November 2015 (see our December 2015 News & Views). The measures particularly concern the contents of the report on the actuarial valuation of a pension plan and the various notices provided for under the Supplemental Pension Plans Act (SPP Act), and the special conditions regarding variable benefits and other items. Here is a brief summary of these measures.

Actuarial valuation report and letters of credit

The draft regulation provides clarifications on the disclosures required in an actuarial valuation report. These are mainly related to the new stabilization provision. The report on the actuarial valuation as at December 31, 2015, required by all pension plans subject to Chapter X of the SPP Act, must take these amendments into account.

The draft regulation also includes certain clarifications regarding the use of surplus assets to reduce the amount of a letter of credit.

On August 1, 2016, in conjunction with the publication of the draft regulation, Retraite Québec also released guidelines regarding the application of the new funding rules. Among other things, it was stated that, in the case of plans that used relief measures in 2015, such measures can be extended for the purposes of determining the employer’s contributions in accordance with applicable rules as at December 31, 2015. Another clarification was made regarding the inclusion of explicit fees in the calculation of the current service stabilization contribution.

Annual statements and additional pension benefit

The draft regulation stipulates that:

- annual statements produced prior to January 1, 2017 may be made in accordance with the provisions of the SPP Regulation in effect on December 31, 2015;
- the provisions of the SPP Regulation regarding the additional pension benefit continue to apply to pension plans that have maintained such a benefit established in accordance with the provisions of section 60.1 of the SPP Act in effect on December 31, 2015. The annual statements must therefore include information related to the additional pension benefit.

Due to the changes made to the SPP Act by Law 29, the contents of the statement of termination of active membership and the annual statements are also adjusted accordingly.

Variable benefits under a defined contribution provision

The draft regulation provides for a set of rules applicable where a pension plan provides for the payment, as a life income, of the variable benefits under a defined contribution provision. It is thus foreseen that:

1. for each fiscal year, the member sets the income to be received as variable benefits;
2. the minimum income paid as variable benefits during a fiscal year is the one prescribed under subsection 5 of section 8506 of the Income Tax Regulations (as for a RRIF);
3. the maximum income paid as variable benefits during a fiscal year is set in accordance with the rules applicable to the life income fund (LIF), which apply with the necessary modifications.
Other changes

The draft regulation also provides that:

- the provisions to be applied in the event of a seizure effected by a member’s spouse or on his or her behalf, are amended when the benefits attributed to the spouse are paid from the pension benefits of the member;
- the provisions of the SPP Regulation regarding the reserve and the provision for adverse deviations are revoked;
- the content of the notice prescribed for the merger of the assets and liabilities of several plans is also amended;
- the valuation report to be produced following the withdrawal of an employer that is a party to a multi-employer pension plan must now state the reason for the employer’s withdrawal;
- the pension plan termination report must now provide certain types of information if the plan has surplus assets.

Comments

Comments regarding the draft Regulation may be submitted by August 19, 2016, following which a final version of the regulation is expected to be published this fall.

2016 Survey: economic assumptions for accounting

Recently, Morneau Shepell issued its 16th 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, 2015.

Here are a few highlights of the survey:

- Discount rates at December 31, 2015 have remained relatively flat when compared to the prior year. The median discount rate was 4.00% as at December 31, 2015 compared to 3.95% a year earlier. The discount rates used for non-pension benefits are similar to those used for pension benefits.
- Three quarters of the companies surveyed used a compensation increase assumption between 2.75% and 3.75% (median of 3.00%, which is 25 basis points lower than the previous year’s median).
- Companies surveyed showed a 94% overall ratio of pension assets to defined benefit obligation for accounting purposes, a small increase over last year’s ratio of 91%.
- The median assumption for the short-term medical cost trend rate was 6.20% (a decrease of 35 basis points from the previous year’s median), while the median ultimate trend rate was 4.5%, which is identical to last year.

The survey also provides relevant data about how companies disclosed additional information to conform to the revised IAS 19 disclosure requirements in 2015.

For complete details of the survey, please refer to the document available on the Morneau Shepell website.
Tracking the funded status of pension plans as at July 31, 2016

This graph shows the changes in the financial position of a typical defined benefit plan with an average 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 May 2016 for valuations effective March 31, 2016 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 July, Canadian long term bonds, Canadian long-term provincial bonds, Canadian universe bonds, Canadian and global equity markets and alternative investments showed positive returns. With a return of 3.2%, the low volatility portfolio (LDI) outperformed the 60/40 portfolio (3.1%) and the highly diversified portfolio (HD) (3.1%). The outperformance of the LDI portfolio is explained by a larger weight in Canadian long-term provincial bonds. Annuity purchase rates and the rates used in the calculation of solvency liabilities decreased during the month, increasing the solvency liabilities by 4.4% for a medium duration plan. For this type of plan, an investment in either of the 60/40, the LDI or the HD portfolio resulted in a solvency ratio decrease. The table below shows the impact of past returns on plan assets and the effect of interest rate changes on solvency liabilities of a medium duration plan, 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 July 31, 2016 for three different portfolios</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>60/40 portfolio</td>
</tr>
<tr>
<td>100%</td>
<td>97.6%</td>
</tr>
<tr>
<td>90%</td>
<td>87.9%</td>
</tr>
<tr>
<td>80%</td>
<td>78.1%</td>
</tr>
<tr>
<td>70%</td>
<td>68.3%</td>
</tr>
<tr>
<td>60%</td>
<td>58.6%</td>
</tr>
</tbody>
</table>

Since the beginning of the year, driven by strong returns within the Canadian equity and the Canadian fixed income markets, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 6.9%, 8.4% and 5.0% respectively. The solvency liabilities increased over that same period between 8.7% and 9.8% depending on the duration of the group of retirees. The variation in the plan’s solvency ratio as at July 31, 2016 stands between -4.1% and -0.6%.

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 July 31, 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>31-12</th>
<th>31-01</th>
<th>29-02</th>
<th>31-03</th>
<th>30-04</th>
<th>31-05</th>
<th>30-06</th>
<th>31-07</th>
<th>30-09</th>
<th>31-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate (%)</td>
<td>4.0</td>
<td>4.0</td>
<td>3.9</td>
<td>3.7</td>
<td>3.6</td>
<td>3.4</td>
<td>3.2</td>
<td>3.1</td>
<td></td>
</tr>
<tr>
<td>Return on assets (60% equities) (%)</td>
<td>0.0</td>
<td>-1.6</td>
<td>-1.0</td>
<td>2.8</td>
<td>0.6</td>
<td>2.1</td>
<td>0.8</td>
<td>3.1</td>
<td></td>
</tr>
</tbody>
</table>

The table below 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

<table>
<thead>
<tr>
<th>Duration</th>
<th>December 2015</th>
<th>July 2016</th>
<th>Change in 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>3.71%</td>
<td>2.96%</td>
<td>-75 bps</td>
</tr>
<tr>
<td>14</td>
<td>3.91%</td>
<td>3.08%</td>
<td>-83 bps</td>
</tr>
<tr>
<td>17</td>
<td>4.04%</td>
<td>3.14%</td>
<td>-90 bps</td>
</tr>
<tr>
<td>20</td>
<td>4.12%</td>
<td>3.18%</td>
<td>-94 bps</td>
</tr>
</tbody>
</table>

Since the beginning of the year, the pension expense has increased by 44% (for a contributory plan) due to the decrease in 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)