Knowledge & Insights

MORNEAU SHEPELL

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Ontario announced new solvency funding framework

On May 19, 2017, the Ontario government announced a new defined benefit (DB) pension plan funding framework, expanded coverage under the Pension Benefits Guarantee Fund (PBGF), and a number of related measures. These measures were discussed in detail in our recent *Special Communiqué*.

The new framework

Highlights of the new funding framework for DB pension plans include:

- Requiring funding on enhanced going concern basis, including a Provision for Adverse Deviation or PfAD;
- Shortening the going concern amortization period from 15 years to 10 years, with special payments consolidated into a single schedule; and

- Requiring funding on a solvency basis to 85 per cent, as opposed to 100%.

Related Measures

The government also announced several related measures, namely:

- Increasing by 50 per cent the maximum guarantee provided by the PBGF, covering monthly pensions up to $1,500 instead of $1,000;
- Providing a discharge of liabilities upon the purchase of buy-out annuities;
- Imposing enhanced funding for benefit improvements;
- Restricting contribution holidays;
- Requiring funding and governance policies; and
- Permitting temporary funding relief measures for valuation reports dated on or after December 31, 2016 and before December 31, 2017.

Conclusion

Detailed proposals and legislative changes to implement these changes are expected by this Fall.

Ontario: Proposed regulations on administrative penalties

On May 9, 2017, the Ontario Government released proposed regulatory changes stipulating the procedures and proposed amounts relating to administrative penalties. The proposal will be of significant interest to administrators of Ontario-registered pension plans and others involved in administering such plans.

Background

The Pension Benefits Act (PBA) was amended in November 2016 to permit the Superintendent of Financial Services (the "Superintendent") to impose administrative penalties on plan administrators and other persons without requiring a prosecution and conviction for a provincial offence (see our *News & Views* of December 2016)

A "general administrative penalty" would be imposed for non-compliance with a substantive requirement of the PBA, while a "summary administrative penalty" would be imposed for failing to make required regulatory filings in accordance with regulatory deadlines.

Penalty amounts and criteria

The Superintendent would have the discretion to determine the amount of a general administrative penalty, subject to the current maximum amounts of $10,000 for an individual and $25,000 for an entity.

The Superintendent would have the ability to levy summary administrative penalties ranging from $100 or $200 per day, subject to the same $10,000 and $25,000 maximums.

The Superintendent would be required to consider the following criteria when imposing an administrative penalty:

- The degree to which the contravention or failure to comply was intentional, reckless or negligent;
- The extent of the harm or potential harm to others resulting from the contravention or failure to comply;
- The extent to which the person tried to mitigate any loss or to take other remedial action;
- The extent to which the person derived or reasonably might have expected to derive any economic benefit from the contravention or failure to comply; and
- Any other contraventions of or failures to comply with a requirement under the PBA during the preceding five years.

Deadline for payment

The proposed regulations would require payment of penalties within 30 days after the order imposing the penalty is given to the person, or such longer time as specified. Payment would be delayed if the person appealed to the Financial Services Tribunal or courts.

Source of payment

It should be noted that the PBA stipulates that an administrative penalty may not be paid out of the pension fund, which could be problematic for multi-employer pension plans, since it may be difficult to collect amounts for remitting administrative penalties directly from participating employers.

Public Comments

Stakeholders were invited to make submissions on the proposed regulations by **June 12, 2017**.

British Columbia: Guideline on records retention

In April 2017 the British Columbia Financial Institutions Commission (FICOM) released a draft Records Retention Guideline (the "draft Guideline") for consultation. The draft Guideline addresses legislative requirements for records retention by British Columbia registered pension plans, and further outlines FICOM's expectations with respect to how pension plan records will be managed.

Pension plan records include records related to the day-to-day operation of the pension plan, records required by legislation and individual records. The draft Guideline includes the following details:

- A plan administrator should establish a written policy on records management and retention, which will include a range of considerations including how documents will be stored, accessed and backed up.
- Records should be retained for as long as they may have applicability to the plan or persons entitled to benefits from the plan. This means records may need to be kept even after an individual's entitlement has been transferred out to a personal savings vehicle or after termination of the plan. While it is not prohibited to eliminate certain individual records, a record summary with various details should be kept.
- Where electronic records are kept, there should be proper back up and security measures to prevent loss of information or a privacy breach. It is good practice to have a process to substantiate that the electronic format of a record is authentic and has not or cannot be altered.
- Participating employers in multi-employer pension plans are expected to maintain a record of remittance of contributions to the plan administrator and copies of all other information provided to the plan administrator. Participating employers should also establish their own record management and retention policies.

Conclusion

The considerations outlined in the draft Guideline include important factors that plan administrators should consider in their management of pension plan records. Unlike many provinces, British Columbia does not impose a minimum record retention period. However, like Ontario, British Columbia will have a detailed record retention guideline that includes the requirement for a written record retention policy, along with other minimum requirements.

The consultation period for the draft Guideline ends on **June 28, 2017**. FICOM is expected to issue a final version of the Guideline that will be effective **January 1, 2018**.

Saskatchewan clarifies tax on insurance premiums

The government of Saskatchewan announced changes to Saskatchewan's provincial sales tax (PST) affecting insurance premiums in its 2017-2018 budget (see our *News & Views* of April 2017). There have been two further changes since the budget was tabled in March.

Following consultations with the insurance industry, the effective date for PST being applied to insurance premiums has been delayed from July 1, 2017 to August 1, 2017.

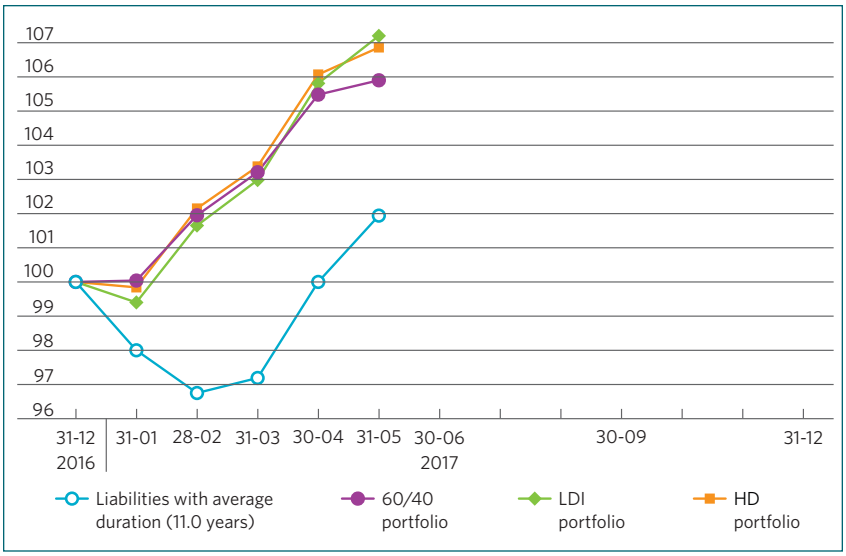
The original budget documents specified that PST would not apply to reinsurance, self-insurance, annuity contracts, contributions or premiums paid for the Canada Pension Plan, Employment Insurance or Workers Compensation. However, it has since been clarified that self-insured group benefit arrangements, also known as Administrative Services Only (ASO) arrangements, will be subject to PST.

This change affects employers with employees in Saskatchewan, even if the organization is headquartered in another province.

Tracking the funded status of pension plans as at May 31, 2017

This graph shows the changes in the financial position of a typical defined benefit plan with an average duration since December 31, 2016. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2016. The estimate of the solvency liabilities reflects the new CIA guidance for valuations effective March 31, 2017 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, 2016



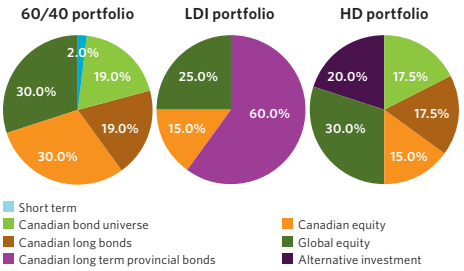
During the month of May, Canadian universe bonds, Canadian long term bonds, Canadian long-term provincial bonds, alternative investments as well as global equity markets showed positive returns whereas the Canadian equity markets showed negative returns. With a return of 1.3%, the low volatility portfolio (LDI[1]) outperformed the highly diversified portfolio (HD) (0.7%) and the 60/40 portfolio (0.4%). The outperformance of the LDI portfolio is explained by a larger weight in Canadian long-term provincial bonds. The prescribed CIA rates used in the calculation of solvency liabilities decreased during the month, increasing the solvency liabilities by 1.9% 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.

Initial solvency ratio as at December 31, 2016	Evolution of the solvency ratio as at May 31, 2017 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	103.9%	105.2%	104.8%
90%	93.5%	94.6%	94.3%
80%	83.1%	84.1%	83.9%
70%	72.7%	73.6%	73.4%
60%	62.3%	63.1%	62.9%

[1] Liability driven investment

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.



The table 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, 2016 as well as the asset allocation of the three typical portfolios.

Since the beginning of the year, driven by strong returns in the global equity markets, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 5.9%, 7.2% and 6.9% respectively. The solvency liabilities increased over that same period between 1.9% and 2.3% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at May 31, 2017 stands between 2.3% and 5.2%.

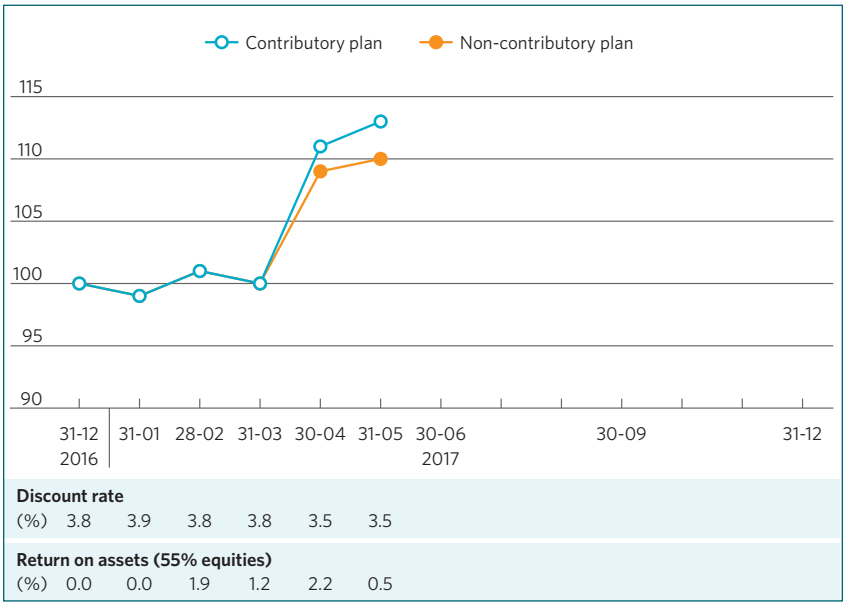
Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Impact on pension expense under international accounting as at May 31, 2017

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, 2016



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

Duration	December 2016	May 2017	Change in 2017
11	3.66%	3.25%	-41 bps
14	3.81%	3.43%	-38 bps
17	3.90%	3.54%	-36 bps
20	3.96%	3.62%	-34 bps

Since the beginning of the year, the pension expense has increased by 13% (for a contributory plan) due to the decrease in the discount rates despite the good returns (relative to the discount rate).

Comments

1. The expense is established as at December 31, 2016, based on the average financial position of the pension plans used in our *2016 Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits report* (i.e. a ratio of assets to obligation value of 94% as at December 31, 2015).
2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (55% equities and 45% fixed income), which reflects the average asset mix in our 2016 Survey.
3. The actuarial obligation is that of a final average earnings plan, without indexing (two scenarios: with and without employee contributions).

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