Quebec: Bill respecting the funding of defined benefit pension plans

Bill 57 An Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans was tabled in the Quebec National Assembly on June 11, 2015. It comes into force on January 1, 2016 and concerns actuarial valuations dated after December 30, 2015.

The bill applies to all defined benefit plans (including defined benefit components) and significantly changes the funding rules for such plans.
Main measures proposed by the bill

| Funding basis | • Solvency eliminated (for valuation purposes)  
  • Funding maintained, plus stabilization provision (“SP”) |
| Stabilization provision (SP) level | • Scale to be specified by regulation, based on asset mix in investment policy (probably 15% if 50% of the pension fund is in variable securities) |
| SP funding | • Contributions to fund SP for current service  
  • Contributions (or letters of credit) to fund SP-5% for past service  
  • Actuarial gains |
| Amortization of funding deficiencies and SP-5% | • Over 10 years (instead of 15), with a transition rule |
| Employer use of surplus | • New “banker’s clause,” including:  
  • contributions to fund the unfunded liability  
  • contributions to fund the SP-5% for past service  
  • accrued interest |
| Permitted use of surplus, over and above:  
  a) Solvency basis  
  b) Funding basis | • a) 105%  
  • b) 105% + SP |
| Limit on use of excess surplus | • The employer may take a contribution holiday, up to the balance of the banker’s clause  
  • Up to 20% per year of the excess surplus assets (remaining after a holiday) may be refunded to the employer or used to fund benefit improvements |
| Funding of benefit improvements | • No more than 20% per year of the excess surplus (remaining after a holiday)  
  • Immediate funding if funding ratio < 90%  
  • Otherwise, funding over a period of up to 5 years |
| Valuation frequency | • Required no less than every three years  
  • Actuary must estimate the solvency ratio at the start of each year (within first four months)  
  • If the ratio is below 85%, an actuarial valuation must be performed |
| Termination benefit | • Transfer value multiplied by the solvency ratio  
  • Unless the member cannot choose a deferred pension  
  • The plan may apply a ratio of more than 100%  
  • The additional benefit is eliminated (i.e. indexing before age 55) |

Plans in the municipal and university sectors are exempt from these new rules, given the special rules for the municipal sector under Bill 15 An Act to foster the financial health and sustainability of municipal defined benefit pension plans, and those for the university sector expected soon in a different bill. In the event of divergence, both take precedence over the regular SPP Act funding rules.

After release of the D’Amours report in 2013 (Innovating for a Sustainable Retirement System), task forces were set up. One of the key points of the report was the elimination of solvency valuations and the introduction of an “enhanced” funding method. The Comité consultatif du travail et de la main-d’œuvre (CCTM), a labour and workforce advisory committee, held meetings between representatives of employers and unions in an effort to achieve a consensus, particularly with respect to clearer definition of the rules for the “enhanced” funding method. Some of the guidelines the CCTM provided to the government were used as a starting point for bill 57.

**Funding and amortization of unfunded liabilities**

The requirement to fund unfunded solvency liabilities has been removed. However, plan solvency ratios will continue to be determined and reported. The solvency ratio will be taken into account with respect to use of the actuarial surplus as well as the calculation of transfer values in the event of membership termination.
Unfunded funding liabilities, as well as the new stabilization provision less 5%, must now be amortized over 10 years (instead of 15) and may be consolidated at each actuarial valuation. The bill provides for a gradual reduction, over the next five years, of the 15-year amortization period to 10 years. Under the current rules, new unfunded solvency liabilities would be amortized over five years starting in 2016; the temporary relief period ends on December 31, 2015.

Furthermore, to avoid a significant short-term increase in contributions, if the employer’s contributions under the new rules are higher than they would have been in 2016 under the existing rules (including on a solvency basis), the increase can be spread out over three years. In such a case, a third of the increase would be contributed in 2017 and two-thirds in 2018.

Improvement unfunded actuarial liabilities will be amortized over a maximum of five years, but must be funded immediately, along with the stabilization provision (“SP”), if the funding ratio is below 90% before the improvement.

**Stabilization provision**

One of the major changes the bill introduces is a stabilization provision (“SP”) to replace plan funding on a solvency basis.

The level of the provision depends on the plan’s investment policy, with specific reference to the level of investment risk, and must apply the scale that will be established by regulation.

It appears that the goal is to ensure an 85% probability of maintaining at least the same level of plan funding over a three-year period. The provision would range from about 5% - 25% depending on the percentage of assets held in variable securities (e.g., equities traded on the stock market). For example, if the percentage of plan assets held in variable securities is 50%, the target level of the provision should be about 15%. For this article, we are assuming a provision target level of 15%.

The provision is funded by contributions and by actuarial gains, as follows:

- **Past service** (i.e., before the valuation date): additional contributions are required to achieve the target level (we’re using a level of 15% in our example) minus 5% (which leaves 10% in our example); the latter 5% plus another 5% beyond the target level, which is an additional reserve (which results in a total of 20% in our example), come from actuarial gains.

- **Future service** (i.e., as of January 1, 2016): additional contributions for current service are required to achieve the target level (which is 15% in our example). For a contributory plan, the 15% SP would be added to the total cost, not just the portion currently paid by the employer.

The bill does not specify whether funding valuations will continue to include a margin for adverse deviation (in addition to the new SP), as is currently required by the policies of the Régie des rentes du Québec.

**Banker’s clauses**

The bill proposes a legislative framework for “banker’s clauses,” provisions to reimburse to the employer certain contributions made to fund a deficiency when the plan subsequently shows an actuarial surplus, whether by means of a contribution holiday, a refund or at plan termination.

In the bill, the contributions covered by the banker’s clause are as follows:

- Contributions to fund a funding deficiency;
- Contributions to fund the stabilization provision for past service (but not for current service).

The banker’s clause must be monitored separately and includes the pension fund investment returns.

Amortization payments made before January 1, 2016 and covered by a banker’s clause provided for under the plan may be accounted for under the new rules, on the condition that the actuarial valuation as at December 31, 2015 report such accounting.
Use of the actuarial surplus

The rules regarding the use of a plan’s actuarial surplus (while the plan is ongoing and in the event of plan termination) are being significantly altered.

Subject to applicable requirements, when the plan reaches a funding ratio of at least 120% (that is 5% above the 15% hypothetical target level in our example) and funding on a solvency basis is at least 105%, depending on which amount is higher, the employer may use the excess surplus to take a annual contribution holiday up to the balance of the banker’s clause, or apply a portion of up to 20% each year of the balance of the excess surplus as a refund to the employer, or to fund a benefit improvement.

The pension committee must inform the members of any use of the surplus, even if this use is not the result of a plan amendment.

All provisions concerning the use of surplus assets (while the plan is ongoing and in the event of plan termination) must be grouped in an easily identifiable section of the plan. There is a mechanism for member consultation to amend the plan to include such provisions. If 30% or more of the members and beneficiaries oppose the proposed amendment, it is deemed rejected and cannot be made.

The provisions of the SPP Act regarding the principle of equitable use of surplus assets have been eliminated.

If the plan is not amended (or the amendments are unconfirmed as described above) before January 1, 2017, the plan will be deemed to include the following provisions:

- In the event of plan termination, the surplus assets will be distributed equally among the employer and the members and beneficiaries.
- While the plan is ongoing, if a portion of the surplus assets is used to pay the employer contributions (or is refunded to the employer), an equal portion must be used to pay the additional obligations arising from an amendment to the plan in favour of members and beneficiaries proportionately to the value of their benefits.

Payment of benefits

1. Annuity purchases

When plan benefits are paid through a plan’s annuity purchasing policy that meets regulatory requirements, such payment can constitute final payment of the benefits paid.

However, members and beneficiaries whose benefits have been paid in this manner retain, for three years, their status as a member or beneficiary under the plan for the purpose of the allocation of surplus assets in the event of plan termination.

2. Termination of active membership

Members’ benefits are paid according to the plan’s solvency ratio, without residual benefits, except in the case of members and beneficiaries who are required to transfer their benefits without having the option of leaving them in the plan. The solvency ratio applied is normally limited to 100%, unless a plan allows the use of an unlimited ratio, which would then result in a distribution of the surplus on a solvency basis. This is a major change.

Other measures proposed by the bill

The bill also proposes the following measures:

- A funding policy that meets the requirements prescribed by regulation must be established by the party who may amend the plan.
- Actuarial valuations on a funding basis: must be performed every three years, or every year if the solvency ratio is below 85%. An annual notice on the financial position of the plan must be sent to the Régie within four months after the end of the plan’s fiscal year.
- Asset smoothing: smoothing of the asset value on a funding basis is allowed, but the averaging period cannot exceed five years.
- Letters of credit: letters of credit are allowed for the purpose of funding the stabilization provision for past service, but only up to 15% of the funding liability. Existing letters of credit shall, as of January 1, 2016, be considered to be provided under the new rules.
• Funding of plan improvements: funded over five years. If the plan’s funded ratio, excluding the stabilization provision, is below 90%, the new obligation is payable in a lump sum.

• The additional benefit is eliminated. A plan amendment to remove the additional benefit, if made before January 1, 2017, is not subject to the SPP Act conditions regarding amendments to reduce benefits retroactively.

**Impact of new rules on contributions**

The new rules will have different impacts on the sponsor’s contributions depending on the specific characteristics of each pension plan. The main characteristics to consider are as follows:

a) **Current financial position**: whether there is currently a surplus or a deficit on a solvency basis

b) **Type of plan**: whether the plan provides a flat benefit formula, a career average earnings formula or a final average earnings formula

c) **Closed module**: whether the DB module is closed or not to new employees

d) **Plan maturity**: whether the plan has a great portion of its liabilities in respect of retired members, and the average age of its active and inactive members

e) **Contributory or not**: whether the employees make contributions or not (impact on current service contribution)

The investment and risk management policies may also influence the impact of the new rules compared to the current rules. In addition, the new funding rules could have an impact on the employer’s pension cost on an accounting basis, depending on which accounting standards the employer uses.

Different combinations of characteristics will thus have different impacts on individual plans.

**Conclusions and what to expect**

Given the highly diverse nature of pension plans in the private sector, the proposed measures will have a different impact on each plan. Nonetheless, the elimination of solvency-based funding, and the addition of an objective greater than 100% on a funding basis, are major changes.

Note that the bill does not address benefit restructuring for past service, as was the case recently for plans in the municipal sector.

A public consultation is expected for the late summer. The bill is slated to be passed by the end of 2015.

In the meantime, plan sponsors will now have an idea of the impact these measures will have on the contributions they must make to their pension plans. These new rules could also spur some administrators to review their current investment or risk management policies, which were designed for a substantially different environment. We invite you to contact your Morneau Shepell consultant, who can provide you with useful information obtained from a modelling tool developed for this purpose.

**Canadian endowments and foundations: Standing out by staying put with their investments**

Endowments and foundations (E&Fs) play an important role in society by providing ongoing benefits to social, educational, health-related, community, or other types of beneficiaries. In many ways, an E&F is like a defined benefit pension plan – both prioritize sustainability, have a long investment horizon and target a specific return to meet their requirements (pension liability/ targeted spending). We were curious to see if E&Fs shared a similar investment philosophy and approach as their defined benefit counterparts. To this end, Morneau Shepell decided to conduct its first Endowment and Foundation survey to better understand the current state of the E&F landscape, including investment strategy, asset allocation, spending policies, future considerations, challenges and trends.

The survey was sent out to E&Fs across Canada. Thirty-two responded, representing a cross section that varied by size, sector and geographical location.
Survey results

We started by asking how E&Fs are investing their assets. On average, the respondents have asset mixes close to 60% equity and 40% fixed income, although a handful of them have incorporated alternative asset classes such as real estate and infrastructure. The average portfolio breakdown for our respondents is shown in the first chart below. Among the respondents, the average allocation towards fixed income is approximately 34%. Most of these E&Fs are primarily invested in Canadian Universe bonds, although several have diversified their fixed income holdings to include corporate bonds, foreign fixed income, and long-term bonds.

Time for a change?

When asked if they intend to change their allocation to the various fixed income classes over the next year, the majority of respondents indicated that they will be maintaining their current allocation, although the second chart below shows that some E&Fs are planning on increasing their allocation to several fixed income classes over the coming year.

Implications of standing pat

Why stick with the 60/40 investment model and why stick with Canadian bonds? Endowments and foundations invest in bonds to obtain predictable income, to add diversification to their portfolio and to provide added returns when interest rates move in their favour. The return of a bond is comprised of the return from the coupon plus the return on the price of the underlying bond in reaction to changing interest rates. Over the past 30 years, interest rates in Canada have generally followed a downward path which has created a positive environment for bond prices - when interest rates go down, bond prices go up. As a result, the long-term historical return of the bond universe in Canada is about 6%. Considering the long-term required return for most E&Fs we surveyed is about 6% (nominal), the inclusion of bonds in the asset mix makes sense.

But what about the next 20 years? The interest rate trajectory cannot be sustained. Given where interest rates are today, the forecast return for bonds over the next 15 years is a little better than 3%. The rationale for including bonds in the portfolio has diminished; the fund receives a predictable income and return that does not meet the required return for the fund. Bonds will be nothing more than expensive diversification – providing only about 50% of the desired return.

An updated approach to fixed income allocations

If investors have a long time horizon, they should seek to maximize long-term yield while managing risk according to their risk tolerance. This will lead the investors to look at fixed income classes such as corporate bonds, mortgages, foreign governments, global credit, high yield, bank loans, and emerging market debt. Approximately 97% of the world’s debt
markets lie outside of Canada; this offers investors the potential for more diversification and also an increased yield profile not necessarily available at home.

One approach to deal with the anticipated return shortfall of Canadian bonds is to allocate less to domestic bonds and look for higher performing bond or bond-like investments elsewhere. Some alternative assets such as real estate and infrastructure, which obtain the majority of their return through income, behave like bonds and can be considered.

An effective strategy for participating in alternatives is a limited partnership arrangement between the investor and the fund manager. Until recently, Canada Revenue Agency rules prohibited E&Fs from investing in this form. After years of lobbying from various industry groups, the restriction was lifted in the most recent federal budget. This important legislative change offers an enormous opportunity for Canadian E&Fs to broaden and diversify their investment portfolios with alternative assets.

Over time, Canadian bonds will become an unattractive option for meeting an E&F’s spending target. Fortunately investors have choices that will give them potentially a bigger bang for the buck without ballooning their risk budget. Before making such a transition, however, endowments and foundations should ensure any new or updated strategy is consistent with their principles and policies.

The fixed income allocation is just one interesting finding revealed in our survey. In the full report, we contrast Canadian and US E&F asset allocations and analyze our respondents’ answers to questions about their current investment and spending policies, risk tolerance, use of investment consultants, and the major challenges they anticipate moving forward.

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1 Morneau Shepell Actuarial Forecast

Quebec: Adoption of Bill 28 and cost of medications

On April 21, 2015, the Quebec government assented to Bill 28, which has important consequences for private insurance plans in Quebec. In this article we flesh out the information about Bill 28 provided in our News & Views of February 2015.

Lowest price policy

A number of stakeholders pointed out to the parliamentary committee consultation on Bill 28 that private plans could not fully apply generic substitution, because the existing legislation required that private plans refund all prescription drugs at a rate of at least 67.5% once the deductible had been paid. If a plan issued refunds based on the lowest price on the market, it would have to refund brand name drugs at 67.5% even if a cheaper generic drug was available. For example, if an insured chose a brand name drug that cost $100 and a generic drug was available for $40, the plan would have to pay $67.50 and not 80% of $40, or $32 (for a plan with 80% coinsurance payment).

As of October 1, 2015, private plans will be able to issue refunds based on the price paid for the lowest cost drug on the market. It is estimated that this measure will have a 5% impact on plans that have a lowest price policy. Plan sponsors should ensure that their plan provisions take full advantage of this new measure.

New pharmacists’ fees

Effective June 20, 2015, the Régie de l’assurance maladie du Québec will determine, by government regulation, the services for which pharmacists are permitted to bill. These services must be refundable by both the public and private plans, but private plans may choose to reimburse only the services that are reimbursed by the public plan. This measure will increase the financial impact on plans and plan sponsors should determine the refund level covered by the plan. The impact of this measure will depend on the provisions in the regulation that define the refundable services, their rates and applicable conditions.
Listing agreements with drug manufacturers

The government confirmed its right to make listing agreements with drug manufacturers for the public plan. In doing so, the government has lost an excellent opportunity to negotiate prices for all Quebeckers, since private plans cannot benefit from these agreements. This measure will further widen the gap between the drug prices paid by private plans vs public plans, which is currently 17% in favour of the public plan.

Federal government proposes possible Canada Pension Plan expansion

On May 26, 2015, the Federal Government announced an intention to give Canadians the option to voluntarily contribute more to the Canadian Pension Plan (CPP) in order to supplement their current CPP retirement savings. The announcement was made by Finance Minister Joe Oliver during Question Period, and was contextualized as building on the Federal government’s record of creating options for Canadians to save.

The only known feature at this time is that this potential CPP expansion will be voluntary in nature. In fact, Minister Oliver opened his remarks by stating that the government “understands that Canadians want low taxes and the freedom to make their own financial decisions”. Therefore, while eligible Canadians could make the individual decision to contribute more to the CPP, they wouldn’t be required to do so.

In addition, Minister Oliver contrasted this proposal for a CPP expansion to “creating a mandatory payroll tax”. This statement strongly suggests that employers would not be required make additional matching contributions to the CPP on behalf of employees who decided to exercise the option to make additional contributions.

At this point in time, no further details relating to the features of the proposed CPP expansion have been released, and without further details the full impact cannot yet be explored. Accordingly, the full impact on stakeholders is unclear, including any potential impact on the Ontario government’s plans to proceed with the Ontario Retirement Pension Plan.

The Federal Government has indicated an intention to engage in consultations on this proposal during the summer of 2015. It is anticipated that further details of this proposal will be released in advance, or upon the commencement of these consultations. We will continue to monitor and analyse developments related to this proposal to extend the CPP.

Pooled registered pension plans bill passes in Ontario legislature

On May 26, 2015, the Ontario legislature passed Bill 57 - the Pooled Registered Pension Plans Act. The Act creates a framework for Ontario businesses to offer PRPPs to their employees, and makes PRPPs available to the self-employed. As we previously commented in our News & Views of December 2014, the legislation is broadly consistent with the model introduced by the Federal Government.

On May 28, 2015, the Bill received Royal Assent but there are still a number of steps required before the Act comes into effect making PRPP’s a reality in Ontario. Such steps include drafting regulations and establishing the administrative structure for the management and investment of the pooled funds.

Alberta extends compliance deadlines under the Employment Pension Plans Act

Alberta’s current Employment Pension Plans Act and the related Employment Pension Plans Regulation (the "New Act and Regulation") came into force on September 1, 2014. Since then, compliance deadlines related to the New Act and Regulation have been revised. We previously reported that...
Quebec: Régie des rentes to be combined with CARRA

On June 11, 2015, Sam Hamad, Minister of Labour, Employment and Social Solidarity, introduced Bill 58 in the Quebec National Assembly. The purpose of the bill is to combine the operations of the Régie des rentes du Québec (RRQ) with those of the Commission administrative des régimes de retraite et d'assurances (CARRA). This initiative was announced in the budget of March 26, 2015.

The RRQ is responsible for the administration of the Quebec Pension Plan, as well as the supervision of supplemental pension plans and voluntary retirement savings plans. The RRQ was created by the Quebec government in 1966 at about the same time as the Caisse de dépôt et placement du Québec. The CARR (which would later become the CARRA) was created in 1973 to administer the Quebec Government and Public Employees Retirement Plan (RREGOP). Today it is responsible for the pension plans assigned to it by the Quebec Government, by the Office of the National Assembly or under specific legislation. The CARRA is thus responsible for some 30 plans, primarily in the civil service, health and social services and education sectors.

The new body would be called Retraite Québec.

On December 18, 2014 the Alberta government released amending regulations, the majority of which stipulated new compliance deadlines under the New Act and Regulation.

On May 21, 2015, the Alberta Treasury Board and Finance released EPPA Update 15-01, in which further changes to compliance deadlines were announced. The impacted deadlines have been revised to harmonize with the deadlines for similar compliance activities under British Columbia’s new Pension Benefits Standards Act and Regulation, which will take effect on September 30, 2015.

EPPA Update 15-01 stipulates a new deadline of December 31, 2015 for the following four compliance activities:

- Compliance plan amendments for all plans;
- Participation agreements (only required for non-collectively bargained multi-employer plans);
- Funding policies (only required for plans with benefit formula provisions); and
- Governance policies for all plans.

Prior to the release of EPPA Update 15-01, compliance plan amendments were due to be filed by June 30, 2015. Participation agreements were required to be updated to include prescribed content by June 1, 2015; and governance and funding polices were required to be in place by August 31, 2015.

As mentioned above, EPPA Update 15-01 has extended all of these deadlines to December 31, 2015.

The new deadline will give plan administrators more time to comply with the new requirements, and will also permit effective coordination of similar compliance activities that are required under the new pension legislation in British Columbia.
Market indices as at May 31, 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.

<table>
<thead>
<tr>
<th>Returns</th>
<th>Monthly</th>
<th>Quarter to date</th>
<th>Year to date</th>
<th>1 year</th>
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<tbody>
<tr>
<td><strong>FTSE TMX Bond Indices</strong></td>
<td></td>
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<tr>
<td>FTSE TMX Canada Universe Bond</td>
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<td>FTSE TMX Canada Mid Term Bond</td>
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<td>FTSE TMX Canada Long Term Bond</td>
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<td>FTSE TMX Canada Real Return Bond</td>
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<td><strong>Canadian Equity Indices</strong></td>
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<tr>
<td>S&amp;P/TSX Composite (Total Return)</td>
<td>-1.2%</td>
<td>1.2%</td>
<td>3.8%</td>
<td>5.8%</td>
</tr>
<tr>
<td>S&amp;P/TSX Composite Capped</td>
<td>-1.2%</td>
<td>1.2%</td>
<td>3.8%</td>
<td>5.8%</td>
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<tr>
<td>S&amp;P/TSX 60 (Total Return)</td>
<td>-1.2%</td>
<td>1.1%</td>
<td>3.6%</td>
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<td>S&amp;P/TSX Completion</td>
<td>-1.4%</td>
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<td>4.5%</td>
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<td>S&amp;P/TSX Small Cap</td>
<td>0.3%</td>
<td>5.0%</td>
<td>4.7%</td>
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<td>BMO Small Cap Unweighted</td>
<td>-0.3%</td>
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<td>-6.5%</td>
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<td>BMO Small Cap Weighted</td>
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<td>S&amp;P 500 (US$)</td>
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<td>S&amp;P 500 (C$)</td>
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<tr>
<td>MSCI ACWI (C$)</td>
<td>2.9%</td>
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<td>MSCI World (C$)</td>
<td>3.4%</td>
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<td>MSCI EAFE (C$)</td>
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<td>2.1%</td>
<td>17.0%</td>
<td>14.4%</td>
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<tr>
<td>MSCI Europe (C$)</td>
<td>2.3%</td>
<td>2.0%</td>
<td>15.4%</td>
<td>9.4%</td>
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<tr>
<td>MSCI Pacific (C$)</td>
<td>3.0%</td>
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<td>20.2%</td>
<td>24.9%</td>
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<td>MSCI Emerging Markets (C$)</td>
<td>-1.1%</td>
<td>1.9%</td>
<td>14.0%</td>
<td>15.3%</td>
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<tr>
<td><strong>Other</strong></td>
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<tr>
<td>Consumer Price Index (Canada, April 2015)</td>
<td>-0.1%</td>
<td>-0.1%</td>
<td>1.4%</td>
<td>0.8%</td>
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<tr>
<td>Exchange Rate US$/C$</td>
<td>3.1%</td>
<td>-1.8%</td>
<td>7.2%</td>
<td>14.7%</td>
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<td><strong>Morneau Shepell Benchmark Portfolios</strong>2</td>
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<tr>
<td>60% Equity/40% Bonds</td>
<td>0.5%</td>
<td>0.0%</td>
<td>6.5%</td>
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<td>55% Equity/45% Bonds</td>
<td>0.5%</td>
<td>-0.1%</td>
<td>6.3%</td>
<td>11.6%</td>
</tr>
<tr>
<td>50% Equity/50% Bonds</td>
<td>0.4%</td>
<td>-0.3%</td>
<td>6.0%</td>
<td>11.4%</td>
</tr>
<tr>
<td>45% Equity/55% Bonds</td>
<td>0.4%</td>
<td>-0.5%</td>
<td>5.8%</td>
<td>11.2%</td>
</tr>
<tr>
<td>40% Equity/60% Bonds</td>
<td>0.4%</td>
<td>-0.6%</td>
<td>5.5%</td>
<td>11.1%</td>
</tr>
</tbody>
</table>

Notes:
2. The returns are compounded monthly.

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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Tracking the funded status of pension plans as at May 31, 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 May 2015, Canadian bonds and Global equity markets (CAD) showed positive returns, while Canadian equity markets showed negative returns, producing a net asset increase of 0.5%. Annuity purchase rates as well as rates used in the calculation of solvency liabilities increased during the month, resulting in a decrease of 2.9% in solvency liabilities for the average duration plan. The combined effect increased 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.

<table>
<thead>
<tr>
<th>Initial solvency ratio as at December 31, 2014</th>
<th>Evolution of the solvency ratio as at May 31, 2015 for three different groups of retirees</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>102.0% 101.7% 101.5%</td>
</tr>
<tr>
<td>90%</td>
<td>91.8% 91.6% 91.4%</td>
</tr>
<tr>
<td>80%</td>
<td>81.6% 81.4% 81.2%</td>
</tr>
<tr>
<td>70%</td>
<td>71.4% 71.2% 71.1%</td>
</tr>
<tr>
<td>60%</td>
<td>61.2% 61.0% 60.9%</td>
</tr>
</tbody>
</table>

Since the beginning of the year, driven by strong returns in the Canadian bond as well as Canadian and global equity markets (CAD), the assets increased by 6.5%. The solvency liabilities increased over that same period between 4.5% and 4.9%, depending on the duration of the group of retirees. The increase in the solvency ratio as at May 31, 2015 depends on the plan’s initial ratio, but stands between 0.9% and 2.0%.

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. This estimate of the solvency reflects the new CIA guidance published in January 2015 and May 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).
Impact on pension expense under international accounting as at May 31, 2015

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, 2014**

<table>
<thead>
<tr>
<th>Date</th>
<th>Discount rate (%)</th>
<th>Return on assets (60% equities) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-12 2014</td>
<td>3.9</td>
<td>0.0</td>
</tr>
<tr>
<td>31-01 2015</td>
<td>3.4</td>
<td>4.9</td>
</tr>
<tr>
<td>30-02</td>
<td>3.4</td>
<td>2.3</td>
</tr>
<tr>
<td>30-03</td>
<td>3.5</td>
<td>-0.8</td>
</tr>
<tr>
<td>30-04</td>
<td>3.7</td>
<td>-0.5</td>
</tr>
<tr>
<td>30-05</td>
<td>3.7</td>
<td>-0.5</td>
</tr>
<tr>
<td>30-06</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30-09</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31-12</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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**

<table>
<thead>
<tr>
<th>Duration</th>
<th>December 2014*</th>
<th>May 2015</th>
<th>Change in 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>3.78%</td>
<td>3.51%</td>
<td>-27 pdp</td>
</tr>
<tr>
<td>14</td>
<td>3.99%</td>
<td>3.75%</td>
<td>-24 pdb</td>
</tr>
<tr>
<td>17</td>
<td>4.15%</td>
<td>3.93%</td>
<td>-22 pdb</td>
</tr>
<tr>
<td>20</td>
<td>4.25%</td>
<td>4.05%</td>
<td>-20 pdb</td>
</tr>
</tbody>
</table>

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

Due to the decrease in the discount rate, the pension expense has increased by 7% (for a contributory plan) since the beginning of the 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.
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 more than 20,000 clients, ranging from small businesses to some of the largest corporations and associations in North America. With approximately 3,600 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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