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The biggest stories of the quarter with significant ongoing impact

Second quarter, 2015

Quebec to end solvency funding

Under Bill 57, DB plan sponsors in the private sector would no longer have to fund solvency deficits. They would, however, still have to perform a solvency valuation for disclosure and asset transfer purposes. Bill 57 may be part of a bigger trend as certain public sector and quasi-public sector plans (e.g. universities) have already been exempted from solvency funding. Moreover, a growing number of provinces have passed legislation enabling the establishment of target benefit plans, which also do not require solvency funding.

Why plan sponsors should care

Funding based on a going-concern valuation will probably result in lower employer contributions. DB pension plan funding has been solvency-driven for the past 20 years as opposed to going-concern driven which was the case in the 1970s and 1980s. The higher volatility of solvency-driven funding has been one of the main reasons for the long, slow decline in DB pension plan coverage. A move away from solvency funding might not lead to a resurgence of DB plans but it may slow down the closing down of remaining DB plans.

Decumulation comes into focus

In the quarter, there were many articles, presentations and conferences devoted to the subject of decumulation options under DC plans.

Why plan sponsors should care

The sponsors of DC pension plans have historically not worried too much about what happens to a DC participant's account balance after retirement since it became the responsibility of the retiring employee who had to transfer his or her monies out of the pension fund. As in-fund decumulation options become permitted in more jurisdictions, sponsors will need to consider whether they make these options available to retiring participants. The upside of providing a better decumulation solution to retirees is the distinct possibility of higher retirement incomes, but this has to be weighed against the possibly greater fiduciary liability if the employer continues to assume some responsibility for a retiree's assets.

DC plans continue to evolve

Decumulation options are not the only aspect of DC plans that is changing. During the quarter, a LIMRA study reported that only 28 percent of DC plan participants say they are "very confident" of their ability to make important financial decisions. A separate survey showed that 62 percent of DC plans are now using auto-enrollment (vs. 44 percent in 2010) to increase plan participation. Finally, the federal government announced the launch of a National Strategy for Financial Literacy.

Why plan sponsors should care

Much of the evolution of DC plans involves working around the natural human tendency to put off learning about investment basics or making long-term decisions involving participation or contribution limits. DC plan sponsors need to ensure that their plan design takes full advantage of the new tools, ideas and programs that are being made available to improve the DC participation experience.

The ESG trend

Environmental, social and governance factors (ESG) were by far the most-cited pension topic of the quarter, accounting for numerous articles, conferences and reports.

Why plan sponsors should care

Statements of Investment Policies and Procedures for both DB and DC pension plans registered in Ontario will have to be amended by January 1, 2016 to disclose whether they consider ESG factors in their decision-making and if so, how. Whether or not one agrees that ESG should be factored into a plan's investment strategy, it is important that all plan sponsors understand the potential significance of ESG with respect to their own pension plans and adapt to the changing environment.

De-risking strategies are put on hold but not forgotten

Nearly 25% of North American pension scheme professionals are still considering transferring DB risk to a third party insurer.

Why plan sponsors should care

De-risking activity may have slowed in the first half of this year as larger deficits as of year-end and the growing expectation that rates are rising gave plan sponsors pause about transferring risk to insurers at what may prove to be the bottom of the interest rate cycle. If rates do rise, however, we can expect de-risking activity such as the purchase of annuities to heat up again. Note that yields on 10-year US treasuries have increased from less than 2 percent to 2.40 percent in the last few months. A further rise, say to the 3 percent level, may trigger the purchase of many more group annuities.

Voluntary CPP contributions

The federal government proposed consultations on whether to allow voluntary individual contributions to the CPP. This initiative would not require employers to contribute more.

Why plan sponsors should care

Voluntary contributions to the CPP would have little effect on existing pension plans, but it might lead to the dismantling of some supplementary group RRSPs or group TFSAs that are currently offered in the workplace. This proposal suggests that the Conservative government is acknowledging that CPP enhancement would be popular among the majority of potential voters. While the federal government has rejected CPP enhancement thus far, the matter is far from dead, regardless of the outcome of the federal election later this year.