MORNEAU SHEPELL

30,000 Feet

The biggest stories of the quarter with significant ongoing impact

Fourth quarter, 2015

Most Canadians think they are on track

Interac reported that 73 percent of Canadians whom they surveyed feel they will be retirement-ready. A CIBC survey found that 69 percent of Canadians felt "positive" about their finances. In the US, research from Fidelity Investments found that 82 percent of retirees felt they retired at the right time and 85 percent of them feel that retirement is the most rewarding time of their lives.

Why Plan Sponsors should care

What lends credence to the Interac and CIBC surveys is that pre-retirees are usually less confident of their financial situation than existing retirees. Employers who are concerned about the state of retirement-readiness amongst their employees should therefore be encouraged by these findings. Nevertheless, employers may want to consider proactive measures to further promote their workplace plans. In particular, employees could be encouraged to join early (if participation is voluntary) and to take advantage of any employer matching of optional contributions.

Solvency funding eliminated in Quebec

In Bill 57, Quebec eliminated solvency funding and instead strengthened going-concern funding. Ontario is apparently considering doing the same.

Why Plan Sponsors should care

The exigencies of solvency funding present a major challenge to the sustainable funding of DB pension plans in this low-interest environment, a problem that primarily affects plans in the private sector. It is hoped that other jurisdictions follow suit.

CPP talks to start up again

The federal and provincial finance ministers will convene in mid-2016 to discuss enhancements to the CPP.

Why Plan Sponsors should care

While nothing is being promised, a majority Liberal government makes it more likely that the CPP will be enhanced. By the end of 2016, the future of Canada's retirement income system should be much clearer. The prevailing environment of uncertainty regarding the status of the CPP, the ORPP, PRPPs and TBPs has created a state of near-paralysis among sponsors in terms of the evolution of pension plan design.

Negative interest rates?

The governor of the Bank of Canada raised the possibility that its benchmark interest rate could dip below zero if the country suffers another major economic shock. This has already happened in Switzerland and Denmark.

Why Plan Sponsors should care

This is further evidence of the growing acceptance of the notion that both real and nominal interest rates will stay low for a long time to come. If so, the discount rates used to value DB plans may fall further which would increase pension costs (the median discount rate is currently 5.9 percent before subtracting the provision for adverse deviation). In the case of DC plans, contribution rates may have to rise if future retirement income is to be adequate. Plan sponsors and DC participants seeking higher investment returns may need to consider increasing their allocation to equities in spite of the increased risk this represents.

US Sponsor preparing to transfer risk

According to MetLife, 45 percent of US DB plan sponsors have already taken steps to prepare for an eventual risk transfer, such as an annuity buyout.

Why Plan Sponsors should care

We expect that many Canadian plan sponsors have a similar strategy in mind. An estimated 60 percent of DB plans in the Canadian private sector are now closed to new hires (and in many cases to all employees). Clearly, the end game is to wind these plans up when it becomes practical to do so. The trigger for a large-scale termination of such plans may be a rise in interest rates that makes annuities cheaper. Given the preceding story, however, that rise may be slow in coming.

Ontario allows plans to convert to JSPPs

The Ontario government filed regulations that would allow single-employer public sector plans to convert to JSPPs, which are DB plans in which the members and the employer(s) are jointly responsible for governance as well as for funding current service costs and deficits.

Why Plan Sponsors should care

In conjunction with some provinces recently allowing TBPs and PRPPs, this is another example of the migration away from traditional DB pension plans towards arrangements in which the risk is shared in some form between the members and employers. That migration needs to be accelerated, however.