Knowledge & Insights

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In this issue

Make way for the bigger CPP

The agreement to expand the CPP reached by the country's finance ministers on June 20, 2016 is a major step in the right direction (see our *Special Communiqué*). Given the economy and the role of Pillar 3 (workplace pension plans and personal savings), a bigger expansion would not have been appropriate while a smaller expansion would likely have led to the balkanization of Pillar 2 (government-led contributory pension plans). We still might not have complete uniformity, however, as Quebec has yet to decide what will happen to its Quebec Pension Plan.

The deal very possibly ends ten years of national debate on pension reform and allows governments and pension plan sponsors to get on with needed changes to workplace pension plans, such as facilitating Target Benefit Plans and revamping solvency rules.

Once it is fully phased in, the enhanced CPP benefit will be up to 50 per cent bigger than the current maximum benefit. This will have a number of implications in the mid- to long-term:

a) Workplace pension plans will likely be revamped to integrate appropriately with the bigger CPP, even if they are not currently integrated. A bigger CPP makes this process a virtual must. Integration will not be easy in some cases and it is important to gain agreement among all stakeholders sooner rather than later. If the slow phase-in of the new CPP contributions and benefits is replicated in the adjustments made to workplace pension plans, it may produce smooth integration but also administrative complexities.

b) The bigger CPP eventually helps to close the pension income gap that currently exists for middle-income Canadians. While there will still be room for Pillar 3, workers without Pillar 3 coverage will at least find their retirement situation to be tolerable.

c) Bigger defined benefit pensions from government sources make it more palatable to take risk in Pillar 3. For instance, Target Benefit Plans (in lieu of DB plans) may become more attractive.

d) For the same reason, employees in DC plans (or RRSPs) may be inclined to take more risk by increasing their equity weighting. The structure of Target Date Funds might change accordingly.

These and other considerations will be explored in a special Morneau Shepell report that will be released in **September**.

While there is merit in the CPP expansion that was adopted, it is far from perfect. Adding new contributions and benefits on earnings below about $25,000 is problematic, as low income workers are more in need of the money while they are still working than after retirement. While this drawback was mitigated by increasing refundable tax credits for low-income workers, it was an unnecessary complication. Most of the extra CPP pension they will accrue will be clawed back in the form of a smaller Guaranteed Income Supplement. The net effect of these two measures is equivalent to governments contributing indirectly into CPP in the near term and then paying out less GIS later on.

The contribution formula will also be more complicated than is desirable. It will be 5.95 per cent (for both employees and employers) on earnings up to the current earnings ceiling plus another 4 per cent (approximately) on a new tranche of pensionable earnings that will be created by 2025 by increasing the earnings ceiling by 14 per cent. It would have been simpler to have one blended rate - say 5.6 per cent - on all pensionable earnings and thereby dispense with the need to track both the current and the new earnings ceiling on an ongoing basis. It seems that the legislated requirement for CPP improvements to be fully funded led decision-makers to keep this new layer separate.

Finally, it is unfortunate (though understandable) that the ministers avoided discussion of retirement age. Canada is fast becoming an anomaly as one of the few developed countries in the world that has not increased the age for full pension under public pension schemes to 67 or 68. In fact, the matter has barely been considered yet, other than reversing a planned increase in the OAS and GIS starting age from 65 to 67. The ultimate resolution may be to stop referring to retirement at 65 as 'normal' and simply allow retirement any time between 60 and 75, with appropriate adjustment to pension benefits for earlier or later retirement. This may well be the next big pension discussion, though perhaps not for several years yet. Now that a deal has been struck on the CPP, the country could use a break.

It remains to be seen, most likely in the coming months, whether Quebec will follow the rest of Canada for its QPP or follow a distinct path. Its finance minister has stated that the CPP deal is not targeted enough, which seems to indicate that he might propose to address the problem for low earners explained above. Quebec legislation requires a public consultation on QPP changes. Given that its demographics make the current design more costly

than in other provinces, and that its recent proposal for an innovative longevity pension was shelved mostly in order to wait and see what the CPP expansion would look like, it will be interesting to see whether pressures for cross-country harmonization will prevail.

Survey: Canadians nearing retirement need help for the future

The labour force is rapidly aging and increasing numbers of Canadians are preparing for retirement. At the same time, unprecedented changes are on the horizon for workplaces and the healthcare system, which introduces a cloud of uncertainty over retirement planning. A recent Morneau Shepell survey was conducted to understand how employees approaching retirement (all respondents were 50 years or older) were planning for their health and wealth in retirement. We also surveyed employers to understand what they were doing to help employees in their retirement journey.

Key findings and commentary

Employee assessment of health conflicts with self-reported health conditions, so employees may not be well prepared for health costs in retirement.

Many employee respondents (61%) suffer from chronic health conditions. However, 86% believe that they will be in good health when they choose to retire.

Employee respondents are concerned about health-related financial impacts in retirement (72%), but claim to be prepared to deal with their current (81%) and expected issues (78%).

Respondents' positive assessment of their own health in combination with reports of existing chronic health issues highlights a troubling reality: employees may have difficulty assessing objectively their current health status. In turn, the discrepancy between subjective assessment of health status and objective measures of health may indicate trouble in forecasting future health needs.

It is possible that the discrepancy is due to one of two things (or both):

- A general acceptance that having a chronic health condition is normal.
- The chronic health condition does not result in unreasonable costs due to coverage provided by employer sponsored health benefit plans.

The reality is that chronic health conditions develop more often with advancing age. Furthermore, prescription medication costs are projected to rise as increasingly expensive medication is made available to treat common and uncommon health conditions.

Greater medical need and increased medical costs in combination with less extensive health benefit coverage provided by government plans (compared to the typical employer sponsored benefit plan) clearly indicate that retiree health and the associated financial impact should be a priority. With these factors, the costs of current and future health conditions are expected to increase in retirement for individuals without adequate post-retirement health coverage.

Personal health and wealth in retirement are clearly connected, so lacking good health or sufficient wealth can have negative consequences on the other.

Physical and psychological health is deeply intertwined with financial health. In fact, it is a self-perpetuating cycle: lower financial security leads to lifestyle choices that may hinder future health. Poor health then leads to increased costs. For example, retirees may need to work part-time in order to secure day-to-day financial security, which leaves them with less time for healthy activities.

Reinforcing the relationship between health and wealth, 6 out of 10 respondents (59%) who reported not being likely to meet their financial retirement goal stated that they don't expect to be physically active after retirement. This 59% is almost double the percentage of respondents who expect to be physically inactive among those who report being likely to meet their retirement goal.

Retirement readiness and financial knowledge remain a concern.

The average employee respondent reports saving an appropriate amount of income but plans to withdraw an inappropriate amount of their savings after they have retired. A wide variety of factors could be contributing to this discrepancy but it is clear that education relating to proper savings decumulation is needed.

Employees reported saving, on average, 20% of their current income for retirement at present, and believe their retirement savings will need to last them for 21 years. However, respondents plan to withdraw, on average, 15% of their retirement savings annually – three to four times the rate that is typically recommended. These plans to withdraw a significant proportion of savings annually conflicts greatly with the average expected lifespan for those who reach age 65, which, as of 2012, was between 83.5 (for men) and 86.6 (for women) (Statistics Canada, CANSIM, table 102-0512).

Here are additional indications of inadequate savings or decumulation intentions:

- Seventeen percent (17%) plan to withdraw more than 20% annually, and another 21% plan to withdraw between 11-20% annually.
- Over 1 in 3 employees (35%) report that they are saving only 10% of their income or less for retirement through any means.
- Furthermore, 67% of those saving 10% or less report household incomes of $60,000 or more, meaning that near-retirees who should not rely on government pension plans as the major source of income are saving inadequately.

What can employers do?

1. **Assess and improve employee retirement-related knowledge.**
   Our employer survey results demonstrated that employers believe that employees are more knowledgeable than reality suggests. According to employers, providing education or access to financial advisors and other resources is not widely implemented.
2. **Maintain appropriate health benefits for retirees and ensure the benefit plan's workings and limitations are known and understood.**
   Employers could do more to provide retirees with access to private health benefits and ensure that retirees are knowledgeable regarding the benefit plan's coverage. The healthcare landscape is changing dramatically and retirees will be in increasing need of health benefits above and beyond those provided under government plans. Products, such as benefit exchanges, currently allow employers the ability to offer cost effective options for their employees without risk to the organization's future bottom line.
3. **Provide money management tools to employees before and after they retire.**
   A large proportion of retirees remain unaware of expert recommended money management guidelines in retirement. Helping employees gain the knowledge necessary to effectively manage their money after retirement is just as important as helping them accumulate sufficient savings before retirement. Decumulation tools and advice are an invaluable part of the retirement process.

Conclusion

Results from the survey "*Forgotten Decisions: The disconnect between the plan and reality of Canadians regarding health and finances in retirement*" indicate that many soon-to-retire employees need more information and better planning in terms of health issues, possible expenses and the financial management of their savings to complement safety nets of Canadians in retirement. With our public health care system becoming increasingly overburdened, it would be useful for employers to better equip their retiring employees.

Quebec: Final regulation on the stabilization provision for private sector pension plans

The final regulation on the stabilization provision (SP) was published on July 13, 2016. It comes into force on July 28, 2016 (the 15th day after publication in the Gazette officielle du Québec) and has effect from January 1, 2016. For more details, see the April 2016 issue of *News & Views*.

The final version of the regulation differs in several ways from the draft regulation of April 6, 2016, namely:

- A change has been made to the scale establishing the target level of the SP, i.e., "5%" instead of "4%" for duration of the assets/duration of the liabilities (%) of 100 and no assets allocated to variable-yield investments.
- Derivatives may not be considered assets for the purpose of establishing the target level of the SP. However, derivatives that increase the pension fund's exposure to stock market risks shall be added to assets allocated to variable-yield investments. Furthermore, derivatives may be taken into consideration for the purpose of establishing the duration of the assets.
- Up to 50% of the assets invested in infrastructure or in immovables (real estate) can be considered fixed-income investments. The final regulation states that investments in stock market securities are excluded.
- It states that "money market or bond market securities" (as opposed to just "investments") can also be considered as fixed-income investments if they have a rating at least equal to those indicated in the table prescribed in the regulation (this table has not been changed).
- The duration of each investment is established according to the benchmark index provided in the investment policy for the investment. The duration of an investment for which no index is provided in the investment policy is calculated by the person or body who invests any part of the plan's assets.
- Where no target is set out in the investment policy of the plan in effect on December 31, 2015, the target provided for in the investment policy in effect on the date on which the actuarial valuation report referred to under section 318.2 of the Act (valuation as at December 31, 2015) is produced shall be used.

Now that the final regulation has been adopted, sponsors of defined benefit (DB) pension plans will be able to assess the impact of the SP on plan funding more accurately. It may also be necessary to make adjustments to the investment policy. The final regulation does not specify how to account for buy-in annuities, e.g., whether they can be considered fixed-income investments. It remains to be seen if and how Retraite Québec addresses this issue.

Quebec: Bill 75 is adopted, affecting pension plans in the university and municipal sectors

On June 8, 2016, the Quebec government passed Bill 75, *An Act respecting the restructuring of university-sector defined benefit pension plans and amending various legislative provisions*, including amendments added after the February hearings of the Committee on Labour and the Economy (Law 13 in 2016). Bill 75 was introduced in the National Assembly on November 11, 2015 (see November 2015 *News & Views*).

Some of the amendments adopted expand the scope of the legislation to municipal-sector defined benefit plans. The following is a summary of the main amendments:

- **Amendments affecting the university sector only:**
  - The restructuring will affect service before and after December 31, 2015 based on a complete actuarial valuation as at December 31, 2015 (instead of December 31, 2014).
  - Contribution holidays are no longer permitted unless required by income tax legislation.

- When the total plan cost is less than 21% of payroll it does not have to be restructured and the plan is no longer required to create a stabilization fund for service after December 31, 2015. However, a stabilization contribution must be paid into the plan's general account, beginning at the latest on January 1, 2018. The stabilization contribution must be paid until the provision for adverse deviation has reached the level stipulated in the *Regulation respecting supplemental pension plans*.
- When a plan must be restructured because the total plan cost is greater than 21% of payroll, and where the impact of the restructuring on active members is more than 7.5% of active member liabilities, the employer and active members may agree to limit the restructuring to 7.5%, or a higher percentage, of those liabilities.

- **Amendments affecting both the university and municipal sectors:**
  - As is the case for the private sector, when a terminated member has the option of keeping benefits in the plan, benefits may be paid out based on the plan's solvency ratio. When the plan is not required to produce a full actuarial valuation, an actuarial certificate must be produced to establish the solvency ratio that will apply in the coming year.
  - Excess contributions must be calculated for the plan as a whole without reference to pre- and post-structuring components. Also, the stabilization contributions paid by employees are included in the total contribution amount considered in the calculation of excess contributions.
  - Plans with a defined contribution provision may pay variable benefits in a manner similar to a life income fund.
- **Amendments affecting the municipal sector only:**
  - Actuarial gains established in the following actuarial valuations are not transferred to the reserve and cannot be used to buy back municipal bonds:
    - Post-restructuring from December 31, 2013 (2014 if postponed)
    - Valuation as at December 31, 2014, as applicable
    - Pre- and post-restructuring valuation as at December 31, 2015 if indexing is eliminated

Final thoughts

To meet the deadlines in Bill 75, the parties must promptly obtain the results of an actuarial valuation as at December 31, 2015, since these results will have a direct impact on the level of restructuring required and on the subsequent negotiation process. In every case, the new provisions must be in force by January 1, 2018.

Although certain rules were harmonized with the new private sector rules in effect since January 1, 2016, some of the mandatory risk-management measures for the private sector do not yet apply to the municipal and university sectors, as follows:

- Quantification in the internal by-laws of the plan's risk exposure
- Possibility of implementing an annuity purchasing policy
- Investment policy in line with the funding policy

However, all plans will have to have a written funding policy that will comply with the requirements to be prescribed in an upcoming regulation.

Saskatchewan: Consultation on negotiated cost pension plans

On May 2, 2016, the Financial and Consumer Affairs Authority ("FCAA"), the Saskatchewan pension regulator, released a consultation paper titled *Proposed Regime for Negotiated Cost Pension Plans* (the "consultation paper"). Negotiated cost pension plans ("NCPPs") are currently not defined in the

Saskatchewan Pension Benefits Act, but are considered to be pension plans where funding obligations are limited by a collective agreement or by the plan documents. Currently there are six NCPPs in Saskatchewan, all of which are multi-employer pension plans.

Funding requirements

Under the proposed regime, an NCPP would not be required to fund on a solvency basis. The solvency position of an NCPP would still have to be measured and reported in each actuarial valuation report. According to the Consultation Paper, solvency information would be used to calculate the transfer ratio to be applied when a commuted value is transferred from the plan.

An NCPP would be required to continue to fund an unfunded going concern liability over a period not greater than 15 years. There would be a requirement to calculate provisions for adverse deviation ("PfAD") in the going concern valuation, but the PfAD would not have to be funded other than for current service cost.

The actuary would be required to perform stress testing to analyze elements considered to pose a material risk to the plan's ability to meet its funding requirements. While the stress testing results would have to be reported in the valuation report, there would be no requirement to fund the plan in accordance with these results. A funding policy would not be required, but it would be considered best practice.

The use of surplus for contribution holidays or surplus withdrawal would be prohibited, subject to *Income Tax Act* requirements. Surplus could be left in the plan or used for benefit improvements.

Benefit reductions or improvements

If the NCPP were unable to cover the cost of benefits, namely the current service cost plus PfAD on current service cost and special payments, past or future benefits could be reduced by plan amendment. Alternately, contribution increases could be negotiated.

Benefit improvements would only be permitted if the plan has accessible going concern excess ("AGCE"), as per the last filed actuarial valuation report. AGCE is described as "the value by which the going concern assets exceed the sum of the going concern actuarial liabilities and the PfAD less a PfAD offset" – this offset applies if negotiated contributions exceed the current service cost plus PfAD or if the actuarial value of assets is less than the market value.

Commuted value transfers

An NCPP would be able to continue the current regime of holding back transfer deficiencies from the commuted value calculated using the Canadian Institute of Actuaries ("CIA") standards of practice. The member would receive the funded portion of the commuted value at termination and the remainder within the next five years.

Under the proposed regime an NCPP could be amended to provide for the calculation of commuted values by using the discount rate in the most recently filed actuarial valuation report. Furthermore, this "going concern" commuted value would be reduced based on the funded ratio of the plan. This means that, if the plan were underfunded at the time of transfer, the amount of the underfunding would be permanently lost to the former member. An NCPP that decided to use this going concern methodology could only apply it on a go-forward basis and not to benefits already accrued.

Communication to members

The proposed regime contemplates that additional disclosures would be required in annual statements and other plan statements, including a reminder that benefits may be reduced in the event of adverse plan experience.

Alternative regime: "enhanced going concern"

The consultation paper also outlines an alternative funding regime which is described as "enhanced going concern". The main components of the enhanced going concern are described as the elimination of solvency funding, a decreased period

of amortization for newly established going concern deficiencies from 15 years to 10 years, and the restriction of benefit improvements based on a 90% solvency ratio test. It should be noted that this alternative regime would not permit NCPPs to permanently reduce benefits upon transfer of a commuted value.

Multi-jurisdictional NCPPs with Saskatchewan members

The consultation paper states that funding rules are based on the jurisdiction where the plan is registered. Accordingly, the plan funding rules in the proposed regime and the rules on "hold backs" where a plan is underfunded would not apply to NCPPs registered outside of Saskatchewan.

The rules for calculating a commuted value are based on the individual member's jurisdiction of employment and, accordingly, the going concern commuted value calculation could apply to a non-Saskatchewan NCPP. The consultation paper asks for feedback on how the proposed regime would affect multi-jurisdictional NCPP.

Conclusion

The consultation paper proposes a new regime for Saskatchewan NCPPs, but some of the proposals will be of interest to audiences interested in both NCPPs in other provinces as well as target benefit pension plans. Variants of many of the proposed measures could find their way into new regulatory regimes in other provinces.

Interested parties may provide comments on the proposed regime by **July 31, 2016**.

British Columbia: Guideline on administrative penalties for non-compliance

In June 2016, the British Columbia Superintendent of Pensions issued its *Non-Compliant Filing Administrative Penalty Guideline*. The Guideline sets out the Superintendent's process for ordering administrative penalties in case a pension plan administrator fails to make a statutory filing or file a return within legislated deadlines. The Superintendent is not bound to follow the Guideline, but the Guideline is likely to be followed in most cases.

Applicable filings

Administrative penalties will be applied to the following filings and deadlines:

- Annual Information Return (AIR), due 180 days after end of fiscal year
- Actuarial report and cost certificate, due 270 days of the review date (only applicable to benefit formula plans)
- Audited financial statements, due 180 days after end of fiscal year (only applicable to benefit formula plans with assets of at least $10 million or collectively bargained multi-employer pension plans).

Administrative penalty guidelines

Administrative penalties may be assessed based on the number of days the filing is late. The expectation for administrative penalties is as follows:

Type of return	Overdue 30 to 60 days	Overdue 61 to 90 days	Overdue 90+ days
Annual information return	$500	$1,000	$50,000
Audited financial statements	$500	$1,000	$50,000
Actuarial report and cost certificate	$5,000	$10,000	$50,000

Notwithstanding the above guidelines, the Superintendent has the discretion to vary the penalty, subject to legislative limits. In applying discretion, the Superintendent may consider the following factors:

- a review of previous enforcement actions for contraventions of a similar nature;
- the gravity and magnitude of the contravention;
- the extent of the harm to others resulting from the contravention;
- whether the contravention was repeated or continuous;
- whether the contravention was preventable; and
- the extent to which the plan administrator attempts to correct the cause of contravention.

Extension of deadlines for extenuating reasons

The Superintendent may, upon request from a pension plan administrator, extend a period of time within which or by which some act must be done. The request to extend time limits needs to be submitted in writing along with reasons the Superintendent should take into consideration.

Some examples of extenuating circumstances are:

- significant disruption to the computer system due to virus attacks, fire, or flood; and
- business disruption caused by an industrial action, natural disaster, state of emergency.

Situations that will not normally be considered as extenuating circumstances include:

- staff changes or absences;
- extraordinary work being undertaken by the external auditor or appointed actuary;
- minor computer problems, partial system disruption, lack of system backup or contingency plan; and
- office closure due to statutory holidays.

Direction for compliance letter, notice of objection and appeal

The first step of the process when a filing is identified as late is a direction for compliance letter from the Superintendent. Typically the decision on whether to order an administrative penalty will be made after a complete filing is received.

If an administrative penalty is imposed, the party subject to the penalty will receive a written notice. The recipient can then dispute the penalty by providing a notice of objection. The Superintendent will reconsider the decision and provide a final decision that rescinds, varies or confirms the original penalty.

The Superintendent's final decision can be appealed to the Financial Services Tribunal.

Conclusion

The Guideline is important for administrators of B.C.-registered pension plans. Such administrators will face an increased onus for making regulatory filings on time and, if extensions are sought, demonstrating that extenuating circumstances outside the administrator's control exist.

Administrative penalties permit a regulator to impose monetary penalties on individuals and businesses for regulatory breaches without requiring them to launch a prosecution and ask the court to impose a fine. They put the onus on the individual or business to either object to the penalty or to simply pay it.

It should be noted that the new Alberta pension legislation also provides for administrative penalties, but the Alberta Superintendent has not yet issued guidance on administrative penalties. The Canada Revenue Agency also imposes administrative penalties in certain circumstances. The recent review of the mandate of the Financial Services Commission of Ontario recommended that the Ontario Pension Benefits Act be amended to provide for administrative penalties.

Three more provinces introduce PRPPs; Ontario releases draft PRPP regulations

In May 2016, three new provinces adopted and proclaimed into force legislation permitting pooled registered pension plans ("PRPPs"): British Columbia, Nova Scotia and Saskatchewan.

PRPPs are an optional form of pension plan for employers who wish to offer a low-cost, defined contribution (DC) plan to their employees. The PRPP is sponsored and administered by a financial institution, while the employer sets the contribution rates without having the governance responsibilities associated with registered DC pension plans. The employer may choose to make contributions to the plan, or it can be funded solely by employee contributions.

Ontario releases draft PRPP regulations

On July 5, 2016, Ontario published draft regulations to facilitate PRPPs. The rules of the federal PRPP legislation would apply to PRPP design and administration, but Ontario rules would apply for marriage breakdowns and spousal rights upon death of a PRPP member. The Ontario *Pooled Registered Pension Plans Act, 2015*, permits Ontario to sign the Multilateral Agreement referenced below.

Multilateral Agreement Respecting Pooled Registered Pension Plans and Voluntary Retirement Savings Plans

Effective June 7, 2016, the federal government adopted the new Multilateral Agreement Respecting Pooled Registered Pension Plans and Voluntary Retirement Savings Plans (the "Agreement"), and designated British Columbia, Nova Scotia, Quebec and Saskatchewan as provinces that will be part of the Agreement. For PRPPs with members outside Quebec, the Agreement streamlines supervision by ensuring that plan administrators only need to deal with one supervisor (i.e., the federal Office of the Superintendent of Financial Institutions, or "OSFI") for administrator licensing, plan registration and ongoing plan supervision. This would allow a multi-jurisdictional employer to offer the same PRPP across its workforce.

The Agreement also streamlines the licensing process for administrators that want to offer PRPPs and Voluntary Retirement Savings Plans ("VRSPs") by establishing that OSFI and the Quebec *Autorité des marchés financiers* ("AMF") recognize licences issued by each other (with a few conditions in the case of the AMF, i.e. that the applicant be a regulated financial institution, that they pay the licensing fee to the AMF, provide financial information and a business plan, and obtain liability insurance).

Conclusion

As a result of these recent developments, PRPPs and VRSPs are now available for federally regulated employers and employers in British Columbia, Nova Scotia, Quebec and Saskatchewan. Other provinces such as Ontario have already proposed or enacted PRPP legislation, and once they proclaim it into force and join the Agreement, PRPPs and VRSPs will become a more viable option for employers who wish to offer a defined contribution pension plan to their employees across the country.

Ontario establishes the Investment Management Corporation of Ontario

Effective July 1, 2016, Ontario has proclaimed the *Investment Management Corporation of Ontario Act, 2015*, into force. This will permit the creation of the Investment Management Corporation of Ontario ("IMCO"), which will provide investment management and advisory services to participating organizations in Ontario's Broader Public Sector ("BPS").

The creation of such a corporation was recommended in the 2012 report by Bill Morneau as the independent Pension Investment Advisor (see our *News & Views* of December 2012). The report advised that a pooling framework would achieve significant potential annual savings of $75 million to $100 million annually, which will help improve return on investments. Legislation to create the IMCO was included in the 2015 Ontario Budget (see our *News & Views* of May 2015).

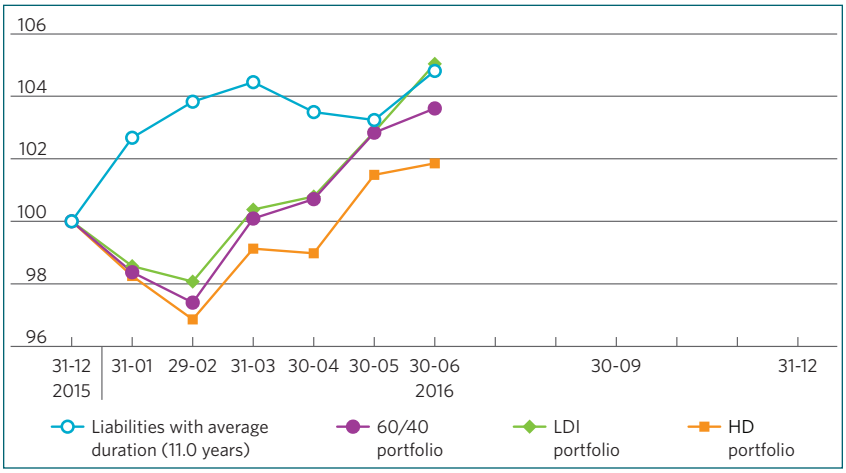
The founding members of the IMCO are the Ontario Pension Board and the Workplace Safety and Insurance Board, with combined investment assets of approximately $50 billion. IMCO is designed to accept, through a managed process on a voluntary basis, the membership application of any BPS organization that has an investment fund and that is interested in accessing its services.

IMCO will operate at arm's length from the Ontario government as a non-profit corporation. It is expected to be operational by spring 2017. Three of the IMCO's initial Board of Directors were appointed July 1, 2016.

Tracking the funded status of pension plans as at June 30, 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



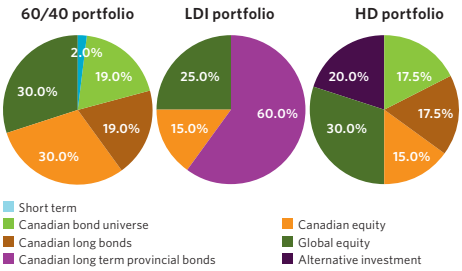
During the month of June, Canadian long term bonds, Canadian long-term provincial bonds, Canadian universe bonds and Canadian equity markets showed positive returns, while global equity markets and alternative investments showed negative returns. With a return of 2.1%, the low volatility portfolio (LDI) outperformed the 60/40 portfolio (0.8%) and the highly diversified portfolio (HD) (0.4%). 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 1.5% for a medium duration plan. For this type of plan, an investment in the 60/40 or the HD portfolio resulted in a solvency ratio decrease. On the other hand, the solvency ratio increased if the same plan was invested in the LDI portfolio.

The tables below shows the impact of past returns on plan assets and the effect of interest rate changes on solvency liabilities, based on the plan's initial solvency ratio as at December 31, 2015, as well as the asset allocation of the three typical portfolios.

Initial solvency ratio as at December 31, 2015	Evolution of the solvency ratio as at June 30, 2016 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	98.9%	100.2%	97.2%
90%	89.0%	90.2%	87.5%
80%	79.1%	80.2%	77.7%
70%	69.2%	70.2%	68.0%
60%	59.3%	60.1%	58.3%

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.



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 3.6%, 5.0% and 1.9% respectively. The solvency liabilities increased over that same period between 4.2% and 5.0% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at June 30, 2016 stands between -2.8% and 0.2%.

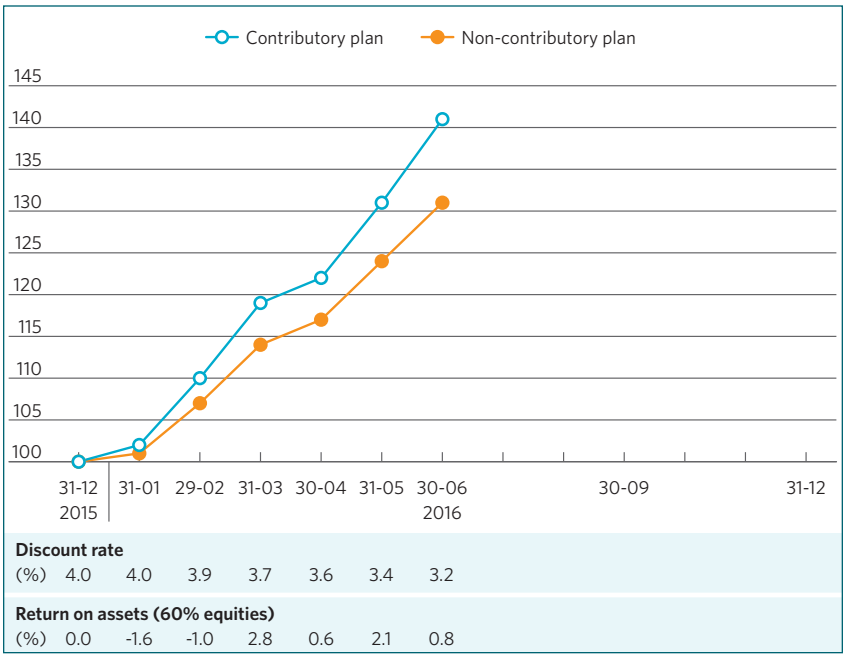
Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Impact on pension expense under international accounting as at June 30, 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



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 2015	June 2016	Change in 2016
11	3.71%	3.04%	-67 bps
14	3.91%	3.16%	-75 bps
17	4.04%	3.23%	-81 bps
20	4.12%	3.27%	-85 bps

Since the beginning of the year, the pension expense has increased by 41% (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.

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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)

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