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Quebec announces Quebec Pension Plan consultation

On December 8, 2016, the Quebec Minister of Finance announced the public consultation on the Quebec Pension Plan (QPP). The purpose of the consultation is to address potential QPP enhancements and to strengthen QPP sustainability, with controlling the contribution rate a necessary constraint. A Consultation Paper titled *Strengthening the Plan to Promote Greater Intergenerational Fairness* was released for public discussion.

The three proposals that have been put forth for public discussion are the following:

1. Matching the enhancement of the Canada Pension Plan (CPP);
2. Increasing QPP benefits for individuals whose employment income exceeds $27,450; and
3. No change.

The second of the three proposals would be similar to the CPP enhancement, except that nothing would change on earnings below $27,450. Specifically, that proposal would do the following:

- increase the income replacement rate of retirement pensions under the QPP from 25% to 33.3% in respect of pensionable earnings above half the YMPE;
- increase the maximum employment earnings on which contributions can be made by 14% from $54,900 to $62,600;
- increase the contribution rate to the QPP from 2019 to 2025 on earnings above $27,450; and
- provide an additional income exemption for the purpose of calculating the Guaranteed Income Supplement (GIS) in order to immediately increase the income of low-income seniors.

Comment

Obviously, it would be simpler to have full uniformity of benefits and contributions across Canada. That would not quite be possible, however, given that the QPP already requires higher contribution rates than the CPP and will continue to do so because of demographic factors. Recent public pronouncements suggest that Quebec's preferred approach is proposal number 2 above. There are at least two reasons for this: (a) various public statements suggest that Quebec disagrees in principle with the notion that low-income workers need to contribute more because they might someday be high-income workers, while Ontario felt strongly about this, which is why the CPP enhancement affects low-income workers and (b) Quebec already has higher contribution rates and needs to find ways to contain further increases in order to avoid a public backlash.

If Quebec does proceed with proposal number 2, it will make pension administration a little more difficult for national employers with earnings-related pension plans, but not insurmountable. One element that is not clear is how the Quebec government could implement changes to GIS since it is a federal program. This consultation should generate a lot of discussions in early 2017.

Quebec: Bill 92 a game-changer for prescription drugs

Last November, Quebec Health Minister Gaétan Barrette tabled amendments to Bill 92 with the aim of boosting competition and improving drug price transparency in Quebec.

Among the changes proposed is the obligation on pharmacists to provide more details on drug receipts, in particular the price of the drug, the wholesaler's margin, and the pharmacist's professional fees. Quebec is currently the only province where pharmacists are not required to disclose their fees.

This change will effectively lead to greater transparency around pharmacy fees and thus promote competition among pharmacists, which will help reduce costs for insurance plans and their policyholders. It will also allow insurers to implement innovative measures to control the level of these fees.

The Minister's amendments, however, also make provision for insureds to exercise full freedom of choice in the selection of a pharmacist. This addition aims to prohibit insurers from favouring one pharmacy over another. Such a measure will remain specific to Quebec, since it is common practice in every other province for insurers to enter into procurement agreements with pharmacies.

Bill 92, including its amendments, will also enhance the competitiveness of pharmaceutical industry stakeholders, as well as protect the professional independence of pharmacists from manufacturers and wholesalers. However, these measures are limited to drugs specified on the List of Medications covered by the Quebec health insurance plan, effectively leaving the door slightly open for drugs not appearing on this List.

Another amendment put forward by Minister Barrette that has attracted much less media attention, but which will definitely have a significant impact on plan costs, is the fact that no manufacturer, wholesaler, or intermediary shall be allowed to pay or reimburse,

in whole or in part, the price of a drug or supplies. This amendment is aimed specifically at loyalty cards and other incentives used by pharmaceutical companies to promote the sale of their drugs over less expensive versions.

These measures, if adopted, are good news for Quebec insureds and plan sponsors. Once the measures are in place, sponsors would do well to make changes to their existing plans in order to adapt to the situation.

Ontario Pension Bill: Restructuring of pension regulator and portability after age 65

On November 16, 2016, the Ontario government introduced Bill 70, the *Building Ontario Up for Everyone Act (Budget Measures), 2016*. Bill 70 will make several changes to the *Pension Benefits Act* (the PBA). Also, in the Fall 2016 Economic Outlook, Ontario stated that it will encourage innovative retirement savings tools and review the DC policy framework.

Establishment of the Financial Services Regulatory Authority

Bill 70 will create the Financial Services Regulatory Authority (FSRA) to replace FSCO, along with other financial regulators in Ontario. The establishment of the FSRA was proposed by an Expert Review Panel in November 2015 (see our *News and Views* of December 2015).

Administrative penalties

FSCO and FSRA will be permitted to impose administrative penalties on pension plan administrators and others who do not comply with the PBA or other regulatory requirements. Administrative penalties can be imposed in a summary process without going to court, as opposed to requiring a full prosecution and court-imposed fine. A person or company who receives an administrative penalty can still appeal it to the Financial Services Tribunal. The maximum possible administrative penalty will be $25,000 for a company and $10,000 for an individual. Additional rules governing administrative penalties will be prescribed by regulation.

Prior to this change, FSCO could impose fines only after a successful prosecution for a provincial offence under the PBA and its regulations. This was a relatively expensive and cumbersome process for the regulator. Administrative penalties are a much easier way for the regulator to impose financial penalties. Alberta, British Columbia and Manitoba pension legislation already provides for administrative penalties to be imposed by the regulator.

Portability after age 65

Ontario will once again permit defined benefit (DB) pension plans to allow former members to transfer the commuted value of their pension benefits to a locked-in vehicle, pension plan or annuity after age 65.

Because of amendments to the *Pension Benefits Act* in 2012, the Financial Services Commission of Ontario (FSCO) took the position that DB plans could not offer this option to Ontario members. It did not attempt to apply this restriction to defined contribution (DC) plans. This change was problematic for some members and plan sponsors, because of the previous belief and practice in their pension plan allowing for portability for former members eligible to retire, including those who have reached age 65. Only Ontario applied this restriction on portability after age 65. Bill 70 will once again permit portability after age 65 and permit DB plans to offer this option to Ontario members, but it will depend on the plan provisions.

Fall 2016 Economic Outlook

In the Fall 2016 Economic Outlook, released on November 14, 2016, Ontario stated that it will pursue the following workplace pension plan initiatives:

- Continuing the ongoing review of the current solvency funding framework for defined benefit (DB) plans;

- Reforms to encourage innovative and flexible retirement savings tools;
- Regulations to allow the payment of variable benefits directly from defined contribution (DC) plans;
- Considering the strengths and weaknesses of the existing DC policy and legislative framework.

Conclusion

Revisions to the PBA to permit portability after age 65 for Ontario DB members will be welcome to those DB pension plan sponsors who wish to offer this option to their Ontario members. The creation of a new financial regulator and the potential imposition of administrative penalties will increase the onus on plan administrators to comply with the PBA and all applicable regulatory requirements, including deadlines. Finally, the government's intention to encourage innovative and flexible retirement savings tools and to review the DC pension plan policy framework is to be followed closely.

Employment Insurance: Changes effective January 1, 2017

The last federal budget in March 2016 announced changes to Employment Insurance rules (see our *News & Views* of April 2016), including a reduction in the waiting period for benefits from two weeks to one week effective January 1, 2017. At the same date, the premiums will be reduced.

The decrease in the waiting period will also apply to special EI benefits which include: maternity, parental, compassionate care, parents of critically ill children and sickness benefits. The government has clarified that the total number of weeks of EI benefit entitlement, related to regular or particular special benefits, will not change.

The *Budget Implementation Act* has been passed and proposed regulations were released by the federal government this fall.

Key implications for plan sponsors:

- **Short term disability (STD) plans –** Sponsors of STD plans with two week waiting periods for benefits may wish to reduce the waiting period to one week in light of the change to the EI program. Most plan sponsors with STD waiting periods of one week or less do not need to make any changes.
- **Supplementary unemployment benefit (SUB) plans –** Sponsors of SUB type plans (including EI carve-out, maternity leave, leave for care of a child, and compassionate care leave) may see a reduction in plan costs as employees will be able to access EI benefits earlier in their leave period. SUB plan designs may need to be modified to wrap around the reduced waiting period. There is a transitional provision (in place until January 3, 2021) included in the proposed regulations that allows combined EI and employer wage replacement benefits to exceed the typical 95% limit during the second week of a disability.
- **EI premium reduction program (PRP) –** The proposed regulations include a transitional provision to provide existing plans participating in the PRP with a four year period to update their plans while continuing to qualify for participation in the PRP. This transitional provision will apply to plans that are in place before the reduction of the waiting period, and expires on January 3, 2021.
- **Long term disability (LTD) plans –** Plan sponsors may consider adjusting their LTD elimination period to coordinate with changes to other programs.
- **Salary continuance or other wage replacement arrangements –** Plan sponsors with other arrangements should consider the impact of any potential changes on expected costs, disability management best practices, and other factors.

The considerations required in light of the changes to the EI program will vary for each plan sponsor.

EI premium rate change

The Canada Employment Insurance Commission has recently confirmed the 2017 EI premium rates. The employee premium rate will decrease to $1.63 (from $1.88) per $100 of insurance earnings. The maximum employee contribution will decrease to $836.19 from $955.04 in 2016. The employer premium rate is 1.4X the employee rate and the maximum employer contribution will decrease accordingly.

The 2017 rate change is the first under a new rate-setting mechanism that will set the EI premium rate annually at a seven-year break-even level, as forecasted by the EI Chief Actuary. Annual rate adjustments after 2017 will be subject to a limit of 5 cents.

The Quebec Employment Insurance rate effective January 1, 2017 will be $1.27 (from $1.52) per $100 of insurance earnings.

Maximum insurable earnings (MIE) for 2017 will increase to $51,300 from $50,800 in 2016.

Prince Edward Island: Changes to premium taxes

Changes to premium taxes were announced by the Prince Edward Island government in October 2016. Effective January 1, 2017, the tax rate on life, accident and sickness insurance (which affects individual and group insurance premiums for insured benefits) will increase from 3.50% to 3.75%.

This change affects employers with employees in Prince Edward Island, even if the organization is headquartered in another province. Premium taxes vary provincially so it is important to have correct information regarding employees' province of residence when administering benefits.

British Columbia: Temporary solvency funding relief announced

On October 24, 2016, the British Columbia government amended its regulations to implement two new solvency funding relief measures for pension plans with a defined benefit ("DB") component: 1) an extension of the regular solvency amortization period from 5 to 10 years, and 2) a consolidation of all prior solvency deficiencies into a single new deficiency.

BC's new temporary solvency funding relief measures are similar to Ontario's temporary solvency funding relief measures adopted earlier in 2016, with the exception that member consent is not required for the extension.

In 2009, the Financial Institutions Commission of British Columbia (FICOM) issued a bulletin stating that it would consider extending solvency funding amortization schedules for up to 15 years. The 2009 bulletin has been removed from the FICOM website and is no longer in effect.

Summary of new solvency funding relief measures

The two new measures are:

1. Solvency deficiency payments may be made over a 10-year period commencing on the review date, rather than the regular 5-year amortization period.
2. All existing solvency deficiencies may be consolidated into one new solvency deficiency as at the review date.

It is important to note that this change does not affect the transfer deficiency provisions of the B.C. pension legislation, which require transfer deficiencies created when commuted values are transferred from the plan to be paid within five years.

Election for solvency funding relief

A plan administrator may make an election for solvency funding relief for a defined benefit component with a specified review date between December 31, 2015 and December 31, 2017 inclusive. It is important to note that election can be made only once. Certain conditions must be met to allow the exemption:

- During each fiscal year that includes any portion of the exemption period, annual statements to active and retired members or their beneficiaries must disclose that the pension plan has elected to amortize the solvency deficiency over the 10-year period; and
- The administrator must provide an updated Schedule of Expected Contributions (Form SOP-004) to the fund holder.

Plan administrators who have already filed an actuarial valuation with FICOM with a specified review date prior to the enactment of the regulation may take advantage of temporary solvency funding relief by:

- Providing written notice of the election to FICOM before December 31 2016;
- Specifying in the written notice of election a review date falling between December 31, 2015 and December 31, 2017; and
- Submitting to FICOM a revised amortization schedule prepared by the plan's actuary before December 31, 2016.

Until the administrator submits the revised schedule, the employer is required to continue making payments in accordance with the schedule on file with FICOM. Once a revised schedule is submitted, the employer may reduce future solvency deficiency payments or cease future required solvency deficiency payments by using previously made payments.

Plan administrators who have not yet filed an actuarial valuation with FICOM are not required to file a separate notice of election to FICOM. However, the actuarial valuation report must include an amortization schedule that reflects the election to amortize the plan's consolidated solvency deficiency in accordance with the solvency funding relief measures.

FICOM has also released Bulletin PENS 16-009, titled "Extension of Solvency Deficiency Payment Period", which summarizes the regulation and outlines FICOM's expectations concerning its implementation.

Ontario and Manitoba move to adopt Pooled Registered Pension Plans

Both Ontario and Manitoba took steps to allow for the introduction of Pooled Registered Pension Plans (PRPPs) in those provinces. PRPPs are an optional form of pension plan for employers who wish to offer a low-cost, defined contribution plan to their employees. The PRPP is sponsored and administered by a financial institution, while the employer sets the contribution rates for employees and, if applicable, the employer.

Ontario adopts PRPP regulations

On November 4, 2016, Ontario adopted regulations to implement PRPPs. The regulations implement the draft regulations that were released in July 2016 and discussed in the July 2016 *News and Views*.

PRPPs will become effective in Ontario upon proclamation by the government. It is not specified when that will happen.

Manitoba introduces PRPP legislation

On November 23, 2016, the government of Manitoba presented legislation to allow for the introduction of PRPPs in the province. As with other provinces, Manitoba's legislation will incorporate existing federal legislation, with some modifications.

Conclusion

Ontario and Manitoba will join a growing list of provinces implementing PRPPs. British Columbia, Nova Scotia, Saskatchewan and the federal jurisdiction currently permit PRPPs to be offered, while Alberta has passed its statute and is awaiting regulations. Quebec has implemented similar plans, termed Voluntary Retirement Saving Plans or VRSPs. Only the provinces of New Brunswick, Prince Edward Island and Newfoundland and Labrador have yet to take legislative steps towards the introduction of PRPPs.

Ontario revises Form 7: Summary of contributions

In November 2016, the Financial Services Commission of Ontario (FSCO) released a revised Form 7: Summary of Contributions, along with a User Guide.

Form 7 is used by Ontario plan administrators to notify the pension fund trustee of the contributions that are to be remitted to the trustee. The pension fund trustee is required to notify FSCO if Form 7 is not received or if the required contributions are not received.

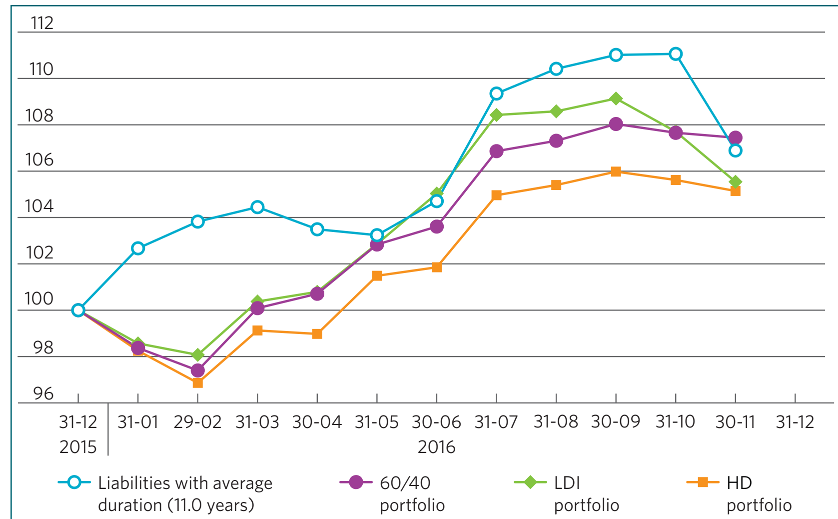
Form 7 only applies to pension plans registered in Ontario. Although employers with pension plans registered in other provinces may have received notice from FSCO regarding this change, they are not required to fill out Form 7.

All administrators of pension plans registered in Ontario should be using the Form 7 effective immediately.

Tracking the funded status of pension plans as at November 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 November 2016 for valuations effective September 30, 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

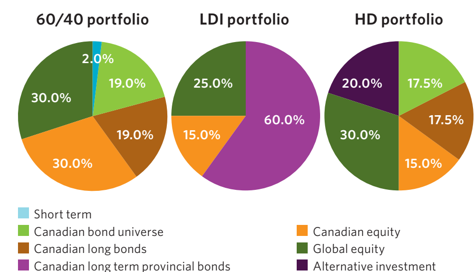


During the month of November, Canadian universe bonds, Canadian long term bonds, Canadian long-term provincial bonds as well as alternative investments showed negative returns, while Canadian and global equity markets showed positive returns. With a return of -0.2%, the 60/40 portfolio outperformed the highly diversified portfolio (HD) (-0.4%) and the low volatility portfolio (LDI) (-2.0%). The underperformance of the low volatility portfolio (LDI) is explained by higher allocation in Canadian bonds. Annuity purchase rates and the rates used in the calculation of solvency liabilities increased during the month, decreasing the solvency liabilities by 3.8% 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 increase. The tables below 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, 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 November 30, 2016 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	100.5%	98.7%	98.4%
90%	90.5%	88.9%	88.5%
80%	80.4%	79.0%	78.7%
70%	70.4%	69.1%	68.9%
60%	60.3%	59.2%	59.0%

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 in the Canadian equity market, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 7.4%, 5.5% and 5.1% respectively. The solvency liabilities increased over that same period between 6.5% and 6.9% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at November 30, 2016 stands between -1.6% and 0.5%.

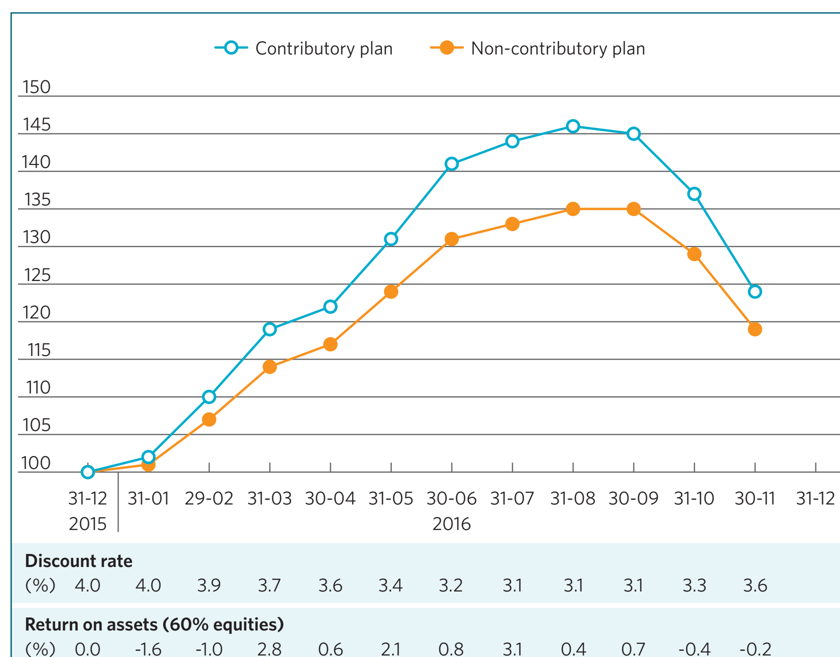
Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Impact on pension expense under international accounting as at November 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	November 2016	Change in 2016
11	3.71%	3.39%	-32 pdb
14	3.91%	3.53%	-38 pdb
17	4.04%	3.61%	-43 pdb
20	4.12%	3.65%	-47 pdb

Since the beginning of the year, the pension expense has increased by 24% (for a contributory plan) due to the decrease in the discount rate. However, the pension expense has decreased since the last couple of months due to the increase 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).

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