Knowledge & Insights

MORNEAU SHEPELL

News & Views

Volume 14 | Issue 3
March 2017

In this issue

Ontario adopts Multilateral Agreement on PRPPs

On February 17, 2017, the Ontario government adopted a regulation that will allow Ontario to join the Multilateral Agreement Respecting Pooled Registered Pension Plans and Voluntary Retirement Savings Plans (the "Multilateral PRPP Agreement"). Effective March 31, 2017, Ontario will join British Columbia, Nova Scotia, Quebec, Saskatchewan and the federal government in signing the Multilateral PRPP Agreement (see our *News and Views* of July 2016).

The Multilateral PRPP Agreement will permit Pooled Registered Pension Plans ("PRPP") to be registered only with the federal Office of the Superintendent of Financial Institutions ("OSFI") in order to be effective across all jurisdictions that have signed the Multilateral PRPP Agreement. The process for registering and administering a PRPP that is also a Quebec Voluntary Retirement Savings Plan ("VRSP") will also be simplified.

The adoption of the Multilateral PRPP Agreement was the final regulatory step required to allow financial institutions to offer PRPPs in Ontario.

British Columbia budget includes 50% cut to MSP premiums

In the 2017 budget tabled on February 21, 2017, the British Columbia government announced that Medical Services Plan ("MSP") premiums will be reduced by 50% for residents with a net annual household income below $120,000. This change could result in savings of $450 per year for individuals and $900 per year for families currently paying full premiums directly to the government.

Many employers in BC pay at least a portion of MSP premiums on behalf of their employees. In these cases, employees will receive a lower taxable benefit while employers stand to benefit from the reduction in premium cost. Employers should review employment contracts and collective agreements to determine the specific impact of this change.

The government indicated that in order to receive the premium reduction, individuals and families whose premiums are paid by a group plan (i.e. their employer or a multi-employer health care plan) will need to register through their group plan administrator. Those who are currently receiving premium assistance will automatically be registered for the reduction. More specific information on the registration process is expected soon.

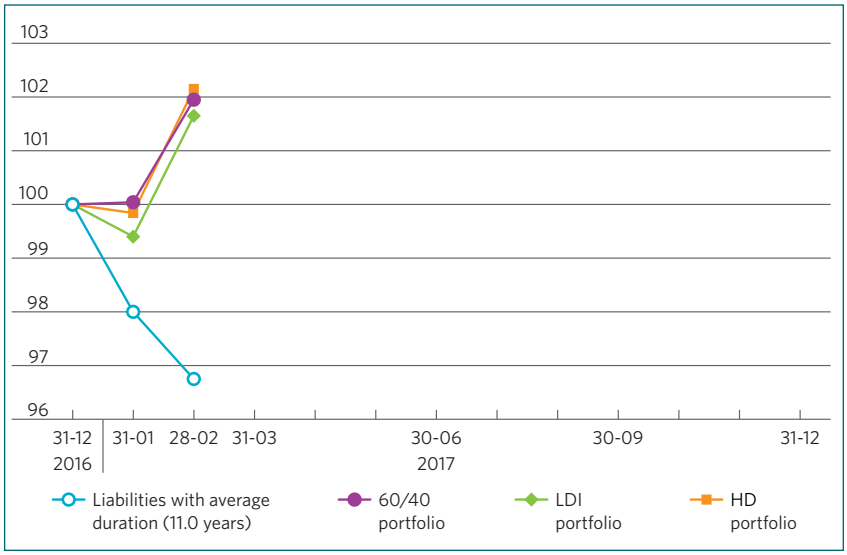
In addition to the above noted cuts, effective January 1, 2018, the net income threshold at which individuals are fully exempt from paying MSP premiums will increase from $24,000 to $26,000, while couples with two children and family net income below $35,000 will also be exempt.

These and other budget measures are contingent on the outcome of the provincial election on May 9, 2017. The MSP premium reduction is characterized as the first step in eliminating MSP premiums altogether. BC is unique in collecting monthly premiums from individuals to fund health care. MSP premiums have increased by 4% annually for the last number of years, with the exception of January 1, 2017 when the premium structure was revised to no longer consider children and the 4% increase was cancelled. The budget document indicates that the future elimination of MSP premiums will be "influenced by the Province's fiscal capacity". While MSP premiums in their current format may be eliminated at some point in the future, it is unclear how this source of revenue for government will be replaced.

Tracking the funded status of pension plans as at February 28, 2017

This graph shows the changes in the financial position of a typical defined benefit plan with an average duration since December 31, 2016. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2016. The estimate of the solvency liabilities reflects the new CIA guidance published in March 2017 for valuations effective December 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, 2016



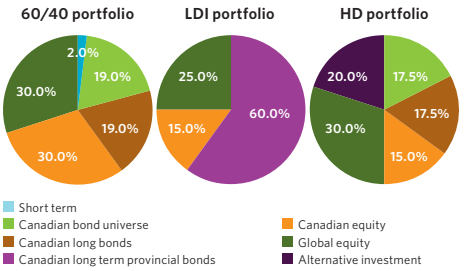
During the month of February, Canadian universe bonds, Canadian long term bonds, Canadian long-term provincial bonds, alternative investments as well as Canadian and global equity markets (CA $) showed positive returns. With a return of 2.3%, the highly diversified portfolio (HD) and the low volatility portfolio (LDI[1]) outperformed the 60/40 portfolio (1.9%). The outperformance of the HD and LDI portfolios in comparison to the 60/40 portfolio is explained by the allocation in alternative assets and Canadian long-term provincial bonds. The prescribed CIA rates used in the calculation of solvency liabilities increased during the month, decreasing the solvency liabilities by 1.3% 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.

Initial solvency ratio as at December 31, 2016	Evolution of the solvency ratio as at February 28, 2017 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	105.4%	105.1%	105.6%
90%	94.8%	94.6%	95.0%
80%	84.3%	84.0%	84.5%
70%	73.8%	73.5%	73.9%
60%	63.2%	63.0%	63.3%

[1] Liability driven investment

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.



The table 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, 2016 as well as the asset allocation of the three typical portfolios. Since the beginning of the year, driven by strong returns in the global equity markets, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 1.9%, 1.6% and 2.1% respectively. The solvency liabilities decreased over that same period between 3.2% and 3.3% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at February 28, 2017 stands between 3.0% and 5.6%.

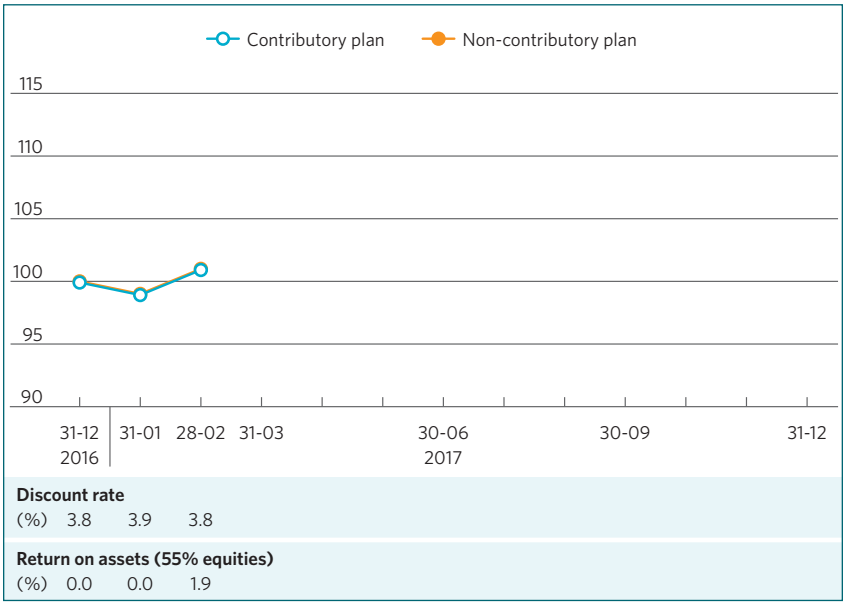
Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Impact on pension expense under international accounting as at February 28, 2017

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, 2016



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 2016	February 2017	Change in 2017
11	3.66%	3.56%	-10 bps
14	3.81%	3.74%	-7 bps
17	3.90%	3.85%	-5 bps
20	3.96%	3.92%	-4 bps

Since the beginning of the year, the pension expense has increased by 1% (for a contributory plan) due to the decrease in the discount rates.

Comments

1. The expense is established as at December 31, 2016, based on the average financial position of the pension plans used in our *2016 Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits report* (i.e. a ratio of assets to obligation value of 94% as at December 31, 2015).
2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (55% equities and 45% fixed income), which reflects the average asset mix in our 2016 Survey.
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

Contributing editors

David White, CEBS
Benefits Consulting

Andrew Zur, LL.B.
Pension Legislation

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)

morneaushepell.com

@Morneau_Shepell

Morneau Shepell

MENTAL HEALTH PARTNER