Knowledge & Insights

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Ontario: Draft legislation on new solvency funding framework

On November 14, 2017, the Ontario government introduced Bill 177, the *Stronger, Fairer Ontario Act (Budget Measures), 2017* (Bill 177). Schedule 33 of Bill 177 contains several proposed amendments to the Ontario Pension Benefits Act (PBA), which will help implement the new solvency funding framework and other proposed reforms announced on May 19, 2017 (see our *Special Communiqué* of May 2017).

Solvency funding

Bill 177 includes technical amendments that are required to implement the proposed solvency funding framework, such as new definitions of the "provision for adverse deviations", the "available actuarial surplus" and the "reduced solvency deficiency". The amount of surplus available for distribution from a defined benefit pension plan is restricted to the surplus over and above the sum of twice the normal cost of the pension plan and twice the provision for adverse deviations in respect of the normal cost of the pension plan. However, many of the details of the framework will be found in the regulations that have yet to be released.

Funding and governance policies

Bill 177 would require administrators of Ontario-registered pension plans to establish funding and governance policies for the pension plan; and these policies would have to be filed with the Financial Services Commission of Ontario (FSCO).

Details concerning the requirements for the content of governance and funding policies will be prescribed by regulation.

Registry for missing beneficiaries

A new provision of the PBA would require FSCO to establish, maintain and operate an electronic registry relating to missing pension plan beneficiaries. The registry would help beneficiaries locate benefits or payments owing to them under pension plans.

Plan administrators would be required to notify FSCO, within a reasonable timeframe, if a beneficiary cannot be located. If satisfied that there are reasonable and probable grounds to believe that the beneficiary is missing, FSCO would add the beneficiary to the registry. The administrator would have a duty to notify FSCO if a missing beneficiary is located after the person has been added to the registry.

The registry would not be publically searchable. A person would be able to request confirmation from FSCO as to whether the person is listed in the registry. If FSCO is satisfied that the person is in fact on the registry, it would release the information recorded in the registry to that person.

Purchase of pension, deferred pension or ancillary benefit from insurance company

A single employer defined benefit pension plan would be able to provide a pension to a former or retired member by purchasing an annuity that meets prescribed conditions. The former or retired member would need to receive notice of the annuity purchase and the annuity would need to provide the same benefit that would have been provided under the plan.

Upon purchase, the plan administrator would receive a full discharge and have no further obligations to these members, except possibly with respect to surplus sharing upon plan wind-up. Such members would retain an entitlement to surplus sharing on plan wind-up if they would have had a right to surplus if the pension plan had wound up on the date of the annuity purchase.

Plan administrators who purchased annuities prior to the date of this new provision of the PBA would also be able to obtain a full discharge in respect of such members. In order to obtain the full discharge upon an annuity purchase, the plan administrator would be required to provide a certificate from an actuary stating that the purchase meets the prescribed requirements. The administrator would also need to provide a prescribed notice to the affected members.

Target benefits

Bill 177 would also prescribe requirements for multi-employer target benefit plans, and set out the requirements for conversions into such plans. Only a unionized multi-employer pension plan to which employer contributions are limited by collective agreement would be able to convert to a target benefit plan. Notice of the proposed conversion would have to be given to the members, former members, retired members and other persons entitled to benefits under the plan, as well as to the

applicable trade unions, and the administrator would have to consult in good faith with the applicable trade unions. FSCO consent would be required, and FSCO would be required to grant consent if the statutory requirements are met.

Pension Benefits Guarantee Fund

Bill 177 increases the maximum coverage available to an Ontario member upon wind-up of a defined benefit plan from $1,000 to $1,500 per month, if the date of the wind up is on or after the day the amendments come into force.

The requirements regarding the age and years of employment or membership that members and former members must meet for their benefits to be guaranteed by the Pension Benefits Guarantee Fund would be removed, if the date of the wind up of the pension plan is on or after the day the amendments come into force.

Other provisions

Bill 177 also includes further amendments to facilitate the payment of variable benefits from a defined contribution pension plan.

Conclusion

The release of the PBA related provisions of Bill 177 demonstrates that the government of Ontario is moving forward with the proposed solvency funding framework. However, further details will only be available when draft regulations are released. It is expected that some of the draft regulations will be released near the end of 2017, with other draft regulations likely to be released in 2018. It remains to be seen whether the new rules will be implemented in time to be considered for valuations at December 31, 2017.

Quebec: Proposals regarding disparity clauses

In December 2016, the Quebec government set up a working group to study disparity in treatment clauses based on the date of hire in pension plans (also known as "orphan clauses"). During its investigations, the committee broadened its mandate to also include group insurance plans.

At the time, the Quebec government was responding to criticisms raised by union groups and groups promoting rights of young workers, who want such clauses to be eliminated. They argue that disparity in treatment clauses in pension and group insurance plans should be prohibited, just like they are for other aspects of employee working conditions. In effect, in Quebec, disparity clauses based on date of hire that have an impact on, among other things, salary, work duration and statutory holidays, as well as annual paid holidays or vacations, have been prohibited since the early 2000s. Quebec is the only province to prohibit disparity in treatment with respect to certain working conditions.

One type of disparity that currently exists is that some employers offer a defined contribution plan to new employees, while employees hired previously participate in a defined benefit plan. Another common disparity is to offer post-retirement benefits only to employees who were hired before a certain date.

The working group released its report on November 23, 2017. The main recommendations are as follows:

Recommandation	Comment
Act quickly to prohibit "orphan" clauses in pension, group insurance and other employee benefit plans	The law could take effect by June 2018. The National Assembly recently unanimously passed a motion asking the government to table a bill to that effect for adoption by June 2018.
That legal provisions **not take effect as long as the other provinces have not enacted similar legislation** so as not to harm the competitiveness of Quebec companies	Based on statements by the Minister of Labour and the Premier, it seems Quebec would not wait for other provinces before going ahead with this reform.
Not require retroactive measures with respect to past service	It would not be necessary to convert past years accrued under a defined contribution component to years of credited service under the defined benefit component. Members who have already retired would not be affected either.
Eliminate disparities in treatment for the future even for existing clauses	So it seems that it wouldn't be possible to maintain separate plans or components based on hiring date, even if they have been in place for many years.

The recommendations apply to both pension and group insurance plans, including post-retirement benefit plans. It may be impossible to maintain separate plans based on hiring date. For example:

- It would not be possible to maintain a defined benefit pension plan for employees hired before a certain date and a defined contribution plan for those hired as of that date.[1]
- It would not be possible to maintain post-retirement medical coverage for employees hired before a certain date and have no coverage or reduced coverage for those hired as of that date.

The report also presents **two options for reaching the objective** of eliminating treatment disparities: the **same plan for everyone or an equivalent plan for everyone:**

Options	Comment
Same plan for everyone	This option offers very little flexibility
Equivalent plan for everyone	This option offers more flexibility, but it may be hard to establish equivalency between two plans

If such legislation is actually passed, a number of questions remain and will need to be answered in 2018:

- Will the bill be enacted by June 2018? If not, could the Fall 2018 elections influence the adoption of the new bill?
- How much time will employers be given to comply with the new law?
- Will the concept of equivalent plan be permitted and how will the equivalency be determined?
- How will plans that cover employees in several different provinces be treated?

The stakeholders affected by the issue will make their respective points of view known before the bill on disparity in treatment clauses is tabled and passed. To date, we know that the bill is supported by unions and groups representing young workers, who defend the principle of intergenerational equity. Employer organizations oppose it, out of concern that it would harm the competitiveness of Quebec companies.

1 Unless the plan is deemed equivalent and that option is permitted under the new legislation

Quebec: Change in VRSP rules

The rules for Voluntary Retirement Savings Plans (VRSP) are about to change, as originally planned. Quebec employers who have 10 to 19 employees must set up a VRSP or an equivalent group retirement savings plan for employees by December 31, 2017. Prior to this, only employers who had 20 or more employees were required to do so. Penalties may be imposed on employers who do not fulfill their obligation.

For employers with 5 to 9 employees, the VRSP Act has not yet been amended to specify the date by which they also must offer a VRSP. A number of companies with fewer than 10 employees have decided to offer the VRSP even though there is no legal obligation to do so.

Note that as of January 1, 2018, the default VRSP contribution rate will rise from 2% to 3% of gross salary. The default VRSP contribution rate applies to employees who are participating in a VRSP offered by an employer, but who have not determined their contribution rate by the deadline.

Quebec is the only province to require employers to offer a VRSP if they do not have other types of plans – in other provinces, providing such plans, called "Pooled Registered Pension Plans" (PRPP), is optional.

According to Retraite Québec, nearly 8,000 companies had set up a VRSP by September 30, 2017. To that can be added a large number of employers who have an equivalent group retirement savings plan, such as a group RRSP. Based on our informal information, we believe that a majority of employers will have complied with the VRSP Act by the end of 2017. It is recommended that all employers who do not have other plans set up a VRSP (or PPRP), whether they are required to or not.

Alberta: New rule on commuted value payments

On November 21, 2017, the Government of Alberta amended the *Employment Pension Plans Regulation* (the "Regulation") to establish a new commuted value payout option for Collectively Bargained Multi-Employer Plans (CBMEPs) that are under a solvency moratorium.

Prior to the amendment to the Regulation, CBMEPs were required to pay commuted values of defined benefit pensions on a solvency basis, by reference to the current standards of the Canadian Institute of Actuaries. However, with the amendment to the Regulation, CBMEPs now have the option to calculate and pay commuted values on a going concern basis. However, it should be noted that CBMEPs still have the option to continue to calculate and pay out commuted values on a solvency basis.

A CBMEP that would like to exercise the option to calculate and pay commuted values on a going concern basis must currently be under or apply for a moratorium on solvency funding. In addition, any CBMEP that wishes to exercise the option must:

1. Submit an application to the Alberta Superintendent of Pensions for approval;
2. Develop a communication plan to inform plan members of the change to commuted value calculations; and
3. Provide the communication plan to the Superintendent.

Trend allowing for different commuted value calculations depending on plan design

The approach of permitting or requiring the use of a pension plan's going concern funded ratio for the calculation of commuted values has already been adopted for certain types of pension plans in several jurisdictions. It is also under discussion as part of funding reform measures in other provinces.

Alberta and British Columbia: Target benefit pension plans

In both Alberta and British Columbia, target benefit pension plans are required to pay commuted values that are calculated based on going concern assumptions.

Saskatchewan: Limited liability plans

Saskatchewan permits limited liability plans, which are also commonly referred to as negotiated cost plans, to pay out commuted values based on going concern assumptions. Limited liability plans that exercise the option to pay commuted values based on going concern assumptions are required to disclose the calculation methodology in disclosure statements to members.

Proposals in other provinces

In addition, Ontario has proposed using going concern assumptions in its framework for collectively bargained target benefit plans. A similar change has also been suggested in Quebec but is still under discussion.

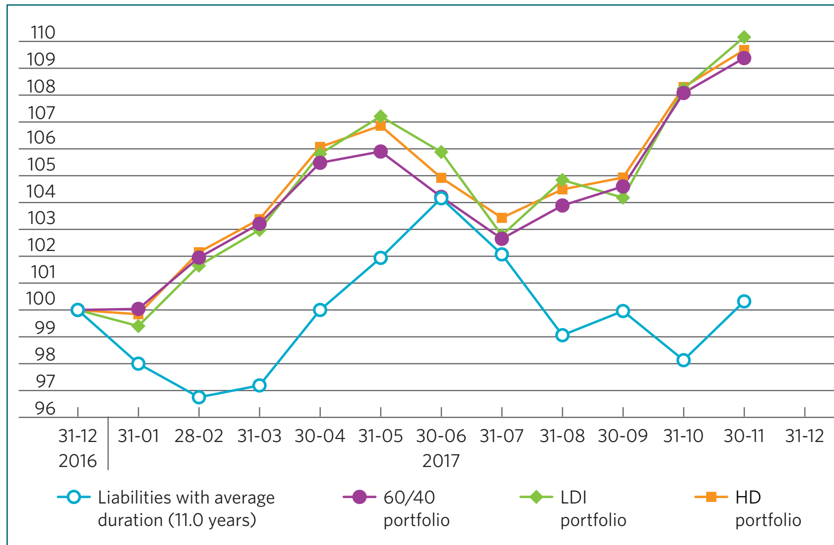
Conclusion

In the jurisdictions referenced above, which permit or require the commuted value to be calculated and paid based on the going concern basis, there is a link to the design and funding of the plan. In the situations described above, the pension plans that are allowed to calculate and pay out commuted values on a going concern basis are not funded on a solvency basis. It will be useful to follow the development of this trend as other jurisdictions such as Ontario develop regulations to support new solvency funding frameworks for pension plans.

Tracking the funded status of pension plans as at November 30, 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 for valuations effective September 30, 2017 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



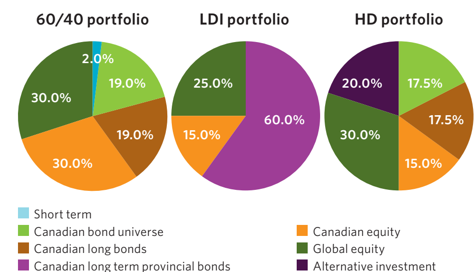
During the month of November, Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian and global equity markets (CAD) as well as alternative investments showed positive returns. With a return of 1.8%, the low volatility portfolio (LDI[1]) outperformed the highly diversified portfolio (HD) (1.3%) and the 60/40 portfolio (1.2%). The relative outperformance of the LDI portfolio is mainly due to its larger allocation to Canadian long-term provincial bonds. The prescribed CIA Annuity purchase rates and the commuted value rates used in the calculation of solvency liabilities decreased during the month. As a result, the solvency liabilities increased by 2.2% for a medium duration plan. For this type of plan, an investment in the 60/40, LDI portfolio or the HD portfolio resulted in a decrease of the solvency ratio.

Initial solvency ratio as at December 31, 2016	Evolution of the solvency ratio as at November 30, 2017 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	109.0%	109.8%	109.3%
90%	98.1%	98.8%	98.4%
80%	87.2%	87.8%	87.5%
70%	76.3%	76.9%	76.5%
60%	65.4%	65.9%	65.6%

[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 Canadian and global equity markets, Canadian long-term bonds, Canadian long-term provincial bonds as well as the alternative investments, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 9.4%, 10.2% and 9.7% respectively. The solvency liabilities fluctuated over that same period from -0.3% to 0.6% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at November 30, 2017 stands between 5.4% and 9.8%.

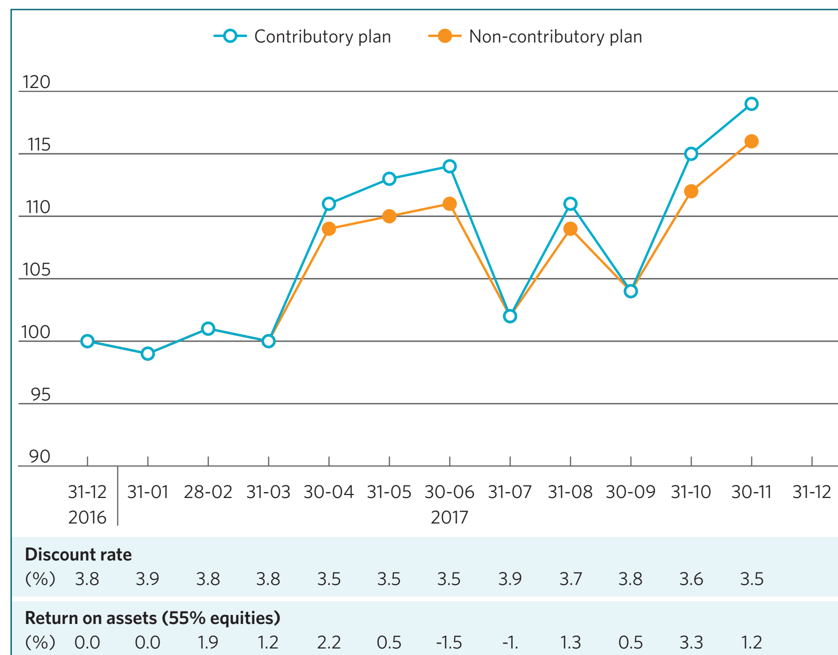
Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Impact on pension expense under international accounting as at November 30, 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	November 2017	Change in 2017
11	3.66%	3.33%	-33 bps
14	3.81%	3.44%	-37 bps
17	3.90%	3.51%	-39 bps
20	3.96%	3.55%	-41 bps

Since the beginning of the year, the pension expense has increased by 19% (for a contributory plan) due to the decrease in the discount rates, despite good returns (relative to the discount rate).

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).

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