MORNEAU SHEPELL

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Quebec: Details on QPP expansion and other rules for supplemental plans

On November 2, 2017, Quebec's Minister of Finance tabled Bill 149, "*An Act to enhance the Quebec Pension Plan and to amend various retirement-related legislative provisions*."

This bill amends the *Act respecting the Quebec Pension Plan* mainly to enhance the Quebec Pension Plan by creating an additional component.

The bill also amends the *Supplemental Pension Plans Act* ("SPP Act") to revise certain rules covering the use of surplus assets from private-sector defined benefit plans, notably changing the "banker's clause" calculation to include amounts paid by an employer to reduce a letter of credit or as special contributions for annuity purchases. Finally, the bill includes some administrative streamlining.

Quebec Pension Plan (QPP)

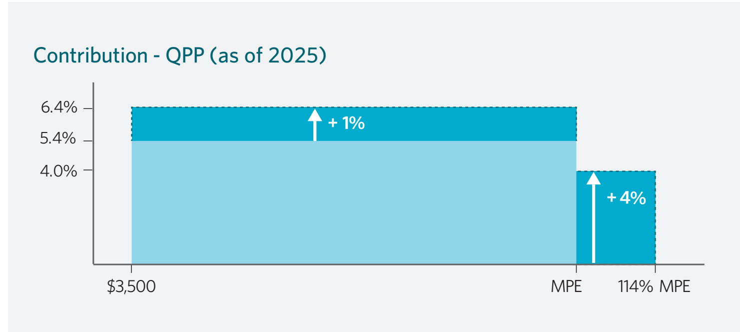
The bill creates an additional component of the QPP that is practically identical to the one that the Canada Pension Plan (CPP) adopted last year for the other provinces (see our *News and Views* of July 2016), although the government had looked at the possibility of taking a different approach (see our *News and Views* of December 2016). Keep in mind that the QPP applies to all Quebec workers employed by businesses located in Quebec, even if the business is under federal jurisdiction.

Contributions and pension benefits

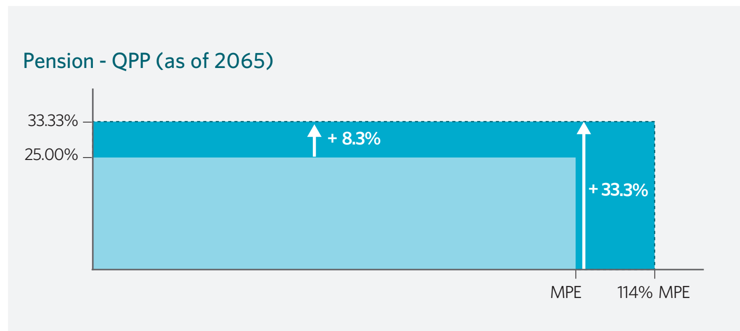
The additional component under the QPP provides for contributions and pension benefits that are exactly the same as for the CPP, i.e.:

1. Contributions
   - 2% (1% employee/1% employer) between $3,500 and the maximum pensionable earnings ("MPE," which will be $55,900 in 2018), introduced progressively from 2019 to 2023;
   - 8% (4% employee/4% employer) between the MPE and the additional maximum pensionable earnings ("AMPE"), which will equal 107% of MPE in 2024 and 114% of MPE as of 2025.
2. Pension benefits – **for participation as of January 1, 2019, only**
   - 8.33% of MPE, introduced progressively from 2019 to 2023;
   - 33.33% between the MPE and the AMPE, as of 2024.

Represented graphically:



The maximum contribution increases by about 30% as of 2025.



The maximum pension benefit increases by about 50% after a contribution period of 40 years.

Note that the surviving spouse's pension payable under the QPP's additional component is different from the base component. For a spouse aged 65 or older, it is 50% instead of 60%, while for a spouse who is younger than 65, it is 50% instead of 37.5% plus a flat benefit. These differences do not exist in the CPP.

Funding

The contributions and benefits under the plan as it now exists ("base component") will be accounted for separately from those to be added as of January 1, 2019 ("additional component").

The additional component will be fully funded (the base component is partially funded) and each component will have its own investment policy.

Stabilization measures have been introduced, notably:

- *Base component:* obligation to fund improvements by increasing contributions (like the CPP)
- *Additional component:* adjustment of contributions and/or benefits in the event of underfunding or overfunding (like a target benefit plan and like the CPP)

SPP Act

Here is a brief list of the main amendments proposed for the SPP Act (respecting private sector plans, although the last two administrative matters on the list below also apply to plans in the municipal and university sectors).

- The conditions with respect to the banker's clause are revised to include contributions paid by an employer to reduce a letter of credit (effective January 1st, 2016) or to purchase an insured annuity.
- Specifications are made concerning the use of the surplus assets during the life of the plan and concerning the application of the provisions in force as at December 31, 2015, for appropriating and allocating surplus assets.
- The requirements for financial reporting are revised and the report need not include a statement of the obligations relating to benefits.
- The notice of the annual meeting must be sent within 9 months (instead of 6 months) after the end of the fiscal year.
- The notice regarding the solvency financial position must be submitted within 9 months (instead of 4 months) after the end of the fiscal year and will no longer be required when a complete actuarial valuation at the same date is sent to Retraite Québec.
- The transfer value paid in proportion to the plan's solvency ratio reflects the solvency ratio applicable on the calculation date (instead of the settlement date).

Comments

Even though Quebec's demographics mean that the QPP contribution rate for the base component is now higher for the CPP, the initial contribution rate for the additional component is the same for the QPP and the CPP. Unless there are future demographic changes or better returns on investments, the QPP thus runs a higher risk of having to increase contributions and/or decrease benefits.

Now that it is clear how public plan contributions are going to increase in just over 12 months, this change provides a good opportunity to consider the impact of this expansion and whether to review supplemental pension plans.

Note that the QPP consultation held last winter also included proposals to change existing benefits under the base component ("Axis 2"), but the present bill does not mention this.

Ontario: New policies on missing plan beneficiaries

On September 30, 2017, the Financial Services Commission of Ontario ("FSCO") issued two new policies related to missing beneficiaries: Policy A300-900: Searching for Plan Beneficiaries (the "Search Policy") and Policy A300-901 (the "Waiver Policy"). The Search Policy sets out steps a pension plan administrator should consider when searching for plan beneficiaries. The Waiver Policy sets out FSCO's requirements for granting a waiver from the requirement to provide statements to missing former members and retired members.

The Search Policy

Section 22 of the *Pension Benefits Act* (the "PBA") imposes a standard of care on plan administrators. According to the Search Policy, this duty includes the obligation to maintain accurate and current member records, including contact information.

The Search Policy states that:

- prudent administrators should establish processes and procedures to update member records in order to provide information and notifications required under the PBA and Regulations;
- a number of methods may be used, individually or in combination, to search for current addresses or other contact information;
- administrators should choose search methods in the context of their particular pension plan. Factors for consideration include the following:
  - nature and location of the employer;
  - plan's size and demographics;
  - magnitude of the pension and/or commuted value entitlements;
  - cost of the search; and
  - likely effectiveness of the approach;
- administrators should document the date(s) and the type of methods used to search for an individual's current contact information;
- termination and retirement packages should include a statement about the importance of keeping the administrator informed of any future changes to their contact information, and administrators should follow up immediately when mail is returned.

The Waiver Policy

The Waiver Policy sets out FSCO's requirements to grant administrators a waiver from the requirement to provide statements to missing former members and retired members. The PBA and Regulations require that the biennial statements be sent to the last known address of a former member or retired member, unless FSCO provides a waiver of this requirement.

- Before submitting a waiver application, the administrator must ensure an individual-directed search has been undertaken for all individuals who are part of the waiver application. The Search Policy provides guidance on the search process.
- The application for a waiver must:
  - include a description of the search conducted for each missing member;
  - identify the party that conducted the search (e.g. employer, third-party administrator, professional search company); and
  - identify the date(s) the search was conducted.
- If FSCO considers a waiver application incomplete and/or non-compliant with the Waiver Policy, they will advise the applicant in writing, specifying the period within which the applicant must provide a written response. The applicant then has the opportunity to provide additional information and/or comply with the Waiver Policy.
- If the application is acceptable, FSCO will send a letter to the applicant granting the waiver. The applicant must keep a record of the application and supporting documents indefinitely.
- If the application is not acceptable, the applicant will be advised by letter of the Superintendent's decision not to grant the waiver. The Superintendent's decision cannot be appealed to the Financial Services Tribunal.
- FSCO will publish information concerning the waiver application on its website in accordance with the policy on disclosure by the Superintendent of decisions made under the PBA.
- Each waiver application approved by the Superintendent is applicable to a specific biennial statement, and not to all biennial statements required to be distributed in the future.

- If the administrator cannot send a required biennial statement, a separate waiver application must be made each time, but the administrator is not required to conduct another individual-based search for each missing member for whom a waiver was previously granted.

Conclusion

The Search and Waiver Policies provide a comprehensive scheme by which administrators can exempt themselves from the requirement to provide biennial statements to the last known address of missing former and retired members. Additionally, the Search Policy provides good general guidance for administrators in searching for missing former and retired members and keeping current contact information for such persons.

Manitoba now allows PRPPs

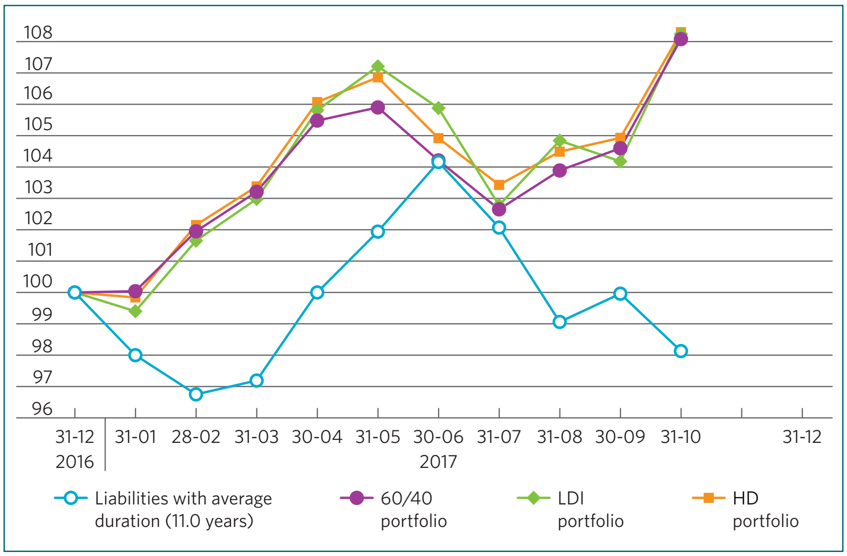
Manitoba proclaimed into force its legislation permitting pooled registered pension plans (PRPPs) on August 1, 2017. On October 5, 2017, the federal government amended its regulations to permit Manitoba to join the multi-lateral pooled registered pension plans agreement.

Together, the changes make Manitoba the newest province where PRPPs can be offered. The current jurisdictions where PRPPs can be offered are British Columbia, Manitoba, Nova Scotia, Ontario, Quebec (where they are termed Voluntary Retirement Savings Plans), Saskatchewan and the federal jurisdiction. Alberta has passed a law to enable PRPPs, but it has not adopted accompanying regulations and its legislation has not yet been proclaimed into force.

Tracking the funded status of pension plans as at October 31, 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



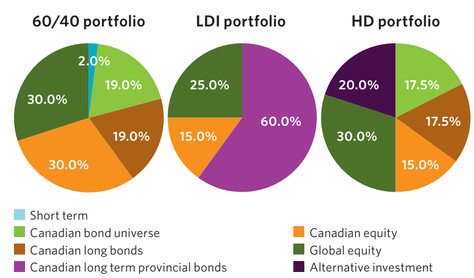
During the month of October, Canadian universe bonds, Canadian long term bonds, Canadian long-term provincial bonds, Canadian and global equity markets (CAD) as well as alternative investments showed positive returns. With a return of 3.9%, the low volatility portfolio (LDI1) outperformed the 60/40 portfolio (3.3%) and the highly diversified portfolio (HD) (3.2%). The relative outperformance of the LDI portfolio is mainly due to its bigger allocation to Canadian long-term provincial bonds. The prescribed CIA Annuity purchase rates **decreased** during the month, however, the commuted value rates used in the calculation of solvency liabilities **increased**. As a result, the solvency liabilities decreased by 1.8% 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 solvency ratio increase.

Initial solvency ratio as at December 31, 2016	Evolution of the solvency ratio as at October 31, 2017 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	105.1%	104.6%	105.4%
90%	94.6%	94.2%	94.9%
80%	84.0%	83.7%	84.3%
70%	73.5%	73.3%	73.8%
60%	63.0%	62.8%	63.2%

[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 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, 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 provincial bonds as well as the alternative investments, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 8.1%, 8.2% and 8.3% respectively. The solvency liabilities decreased over that same period from 1.6% to 2.4% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at October 31, 2017 stands between 6.1% and 10.4%.

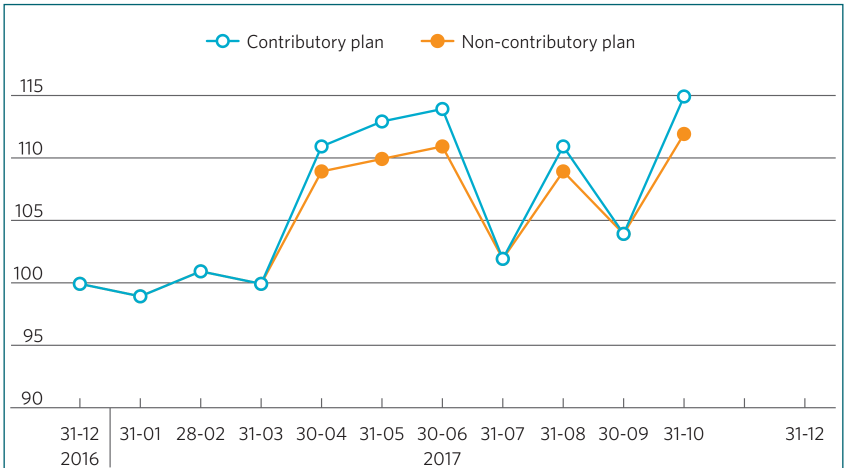
Please contact your Morneau Shepell consultant for a customized analysis of your pension plan.

Impact on pension expense under international accounting as at October 31, 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



	31-12 2016	31-01	28-02	31-03	30-04	31-05	30-06 2017	31-07	31-08	30-09	31-10	31-12
Discount rate (%)	3.8	3.9	3.8	3.8	3.5	3.5	3.5	3.9	3.7	3.8	3.6	
Return on assets (55% equities) (%)	0.0	0.0	1.9	1.2	2.2	0.5	-1.5	-1.	1.3	0.5	3.3	

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	October 2017	Change in 2017
11	3.66 %	3.41 %	-25 bps
14	3.81 %	3.53 %	-28 bps
17	3.90 %	3.60 %	-30 bps
20	3.96 %	3.65 %	-31 bps

Since the beginning of the year, the pension expense has increased by 15% (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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