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Canadian actuaries recommend increasing retirement age

The Canadian Institute of Actuaries (CIA) issued a public statement on April 18, 2019 recommending that the federal government, with the consent of provincial governments, increase the target retirement ages under the Canada and Quebec Pension Plans (CPP and QPP) and Old Age Security (OAS) to 67 from the current 65. According to the CIA, its public statement is intended to engage all Canadians in a discussion of changing societal needs and the best retirement program designs to support those needs.

Background

The CIA makes clear that current retirement programs are sustainable for the next 40 to 75 years, but states that altering the timing of when benefits are collected should increase the financial security of Canadians in later retirement without affecting the stability of these programs.

According to the CIA, many Canadians do not need to draw retirement benefits as early as is currently permitted. It encourages Canadians to consider starting their pension income later and to recognize that these programs are an excellent method for ensuring income security in later retirement.

These proposals are prompted by both the recognition that people are living much longer than when these programs were first introduced and the anticipation of worker shortages in the Canadian economy as the baby boom generation continues to retire. Since 1966, life expectancy at age 65 has increased by about 6 years, or approximately 33% for women and 46% for men.

Proposal details

As stated above, the target retirement age under public pension plans such as CPP, QPP and OAS would increase from 65 to 67. The changes would be phased-in in 3 month increases each year over a 10 year period starting January 1, 2021. However, the changes are not intended to result in a reduction in benefits. Canadians would receive the same amounts at age 67 that they currently receive, but this would become the standard target retirement age.

In addition, the earliest age for benefits under the CPP and QPP would increase from 60 to 62. The latest retirement age would increase from 70 to 75 under the CPP, QPP and OAS.

The CIA recommends allowing employer-sponsored Registered Pension Plans (RPPs) to raise their normal retirement age from 65 to 67 for future benefits, with an adjustment for pensions already earned under the age 65 normal retirement age. It recommends raising the latest retirement age in an RPP or a Registered Retirement Savings Plan (RRSP) to 75 from the current latest retirement age of 71.

The CIA also states that the retirement age for these programs should continue to be reviewed every 5 to 10 years, with adjustments based on changes in life expectancy and needs of Canadians.

Dealing with concerns for low income groups

The CIA acknowledges that a later retirement age is a concern for low income seniors and they urge governments to consider other means for addressing the needs of these seniors, rather than through the pension system.

The CIA suggests that more targeted approaches to supporting low income seniors could include:

- enhancing income programs like Ontario's GAINS (Ontario's income supplement for low-income seniors),
- providing additional drug coverage for seniors,
- decoupling eligibility for the Guaranteed Income Supplement (GIS) from OAS eligibility, and
- increasing the $3,500 exemption on CPP/QPP contributions.

Comment

The CIA proposals, which have been reported in the media, will be of interest to policy makers, although most Canadians will not necessarily want to retire later. The previous federal government had implemented an increase in the OAS eligibility age to 67, but that change was undone after the most recent federal election.

Unlike previous proposals for raising retirement ages, with their effective decreases to benefits, the CIA proposal maintains the same higher benefits at later ages in an attempt to encourage Canadians to retire later. Such proposals are intended to benefit both the individual and society as a whole. It remains to be seen as to whether the Canadian government is willing to take up some or any of these proposals.

2019 Ontario Budget includes pension and benefits related matters

The 2019 Ontario Budget, which was presented on April 11, 2019, includes a number of items relating to pensions, benefits, executive compensation in the public sector and the funding of mental health initiatives. A number of these Budget announcements were reflected in Bill 100, *Protecting What Matters Most Act (Budget Measures), 2019*, which implements certain measures proposed in the 2019 Ontario budget.

Target benefit pension Plans

The government intends to move forward with a target benefit framework which would allow more multi-employer pension plans, including those in the non-unionized not-for-profit sector to participate in the framework. As a first step, legislative changes are being proposed in Bill 100 which, if passed, would expand the eligibility criteria for the target benefit framework to include non-unionized multi-employer pension plans, in addition to collectively bargained multi-employer pension plans. Bill 100 states that a target benefit plan can be based on documents where employer contribution obligations are limited to a fixed amount set out in documents other than a collective agreement. Further details will be set out in the regulations.

Treatment of excess contributions

Bill 100 adds a provision to the *Pension Benefits Act* (PBA) clarifying that restrictions on contribution holidays do not restrict a prior year credit balance (PYCB) from being used to pay for normal cost contributions and the associated provision for adverse deviations (PfAD).

This will effectively overturn a recent interpretation of the Financial Services Commission of Ontario (FSCO) stating that the normal cost and its PfAD can only be reduced if the contribution holiday restrictions in section 55.1 are met.

The amendment will come into force immediately.

Electronic communications for pension plans

The Ontario government is considering future legislative changes to the PBA to permit pension plans to use electronic communication as the default method, with appropriate safeguards, to provide pension plan information to their members. Members would be given the option to continue to receive paper documents if desired.

Financial Services Regulatory Authority

The government will be moving forward with launching the new Financial Services Regulatory Authority (FSRA), targeted for June 2019. The government is considering legislative and regulatory changes that would provide the FSRA with additional rule-making authority in the pension sector.

FSRA will tackle key priorities in its first year of operation that will reduce regulatory burden for regulated sectors, such as reviewing inherited guidance, in addition to data collection and filling requirements, and establishing meaningful service standards.

Bill 100 makes a number of legislative amendments to the legislation that created FSRA. Among the changes, FSRA will be required to prepare an annual business plan to be provided to the finance minister and released publicly.

In order to make a rule, Bill 100 will require FSRA to post a notice that contains a qualitative and quantitative analysis of the anticipated costs and benefits of the proposed rule.

Bill 100 will require FSRA to provide the Minister of Finance with records and information related to a pension plan or pension fund, as well as the Pension Benefits Guarantee Fund, upon request. Notice is not required to be given to an individual in respect of personal information that may be collected by the Minister.

Executive compensation in the public sector

The Ontario government will end automatic pay increases for public sector leaders. Under the new framework, compensation adjustments would be controlled, and only executives who deliver on priority-driven outcomes would be eligible.

To move ahead with this approach, the government is proposing amendments in Bill 100 to the *Broader Public Sector Executive Compensation Act, 2014*, and is consulting with employers to set sector-specific priorities that all leaders must work towards.

Retirement age in universities

The government of Ontario reports that the average retirement age of university faculty has been increasing, suggesting that employees are remaining in their positions longer and limiting turnover. Such employees tend to receive the high salaries and large benefits packages and, in some cases, draw a salary and a pension simultaneously. The government proposes to address this issue through amendments to the *Ministry of Training, Colleges and Universities Act*. The Ministry of Training, Colleges and Universities will consult with the university sector on how best to address this issue.

Bill 100 authorizes regulations governing the reduction, limitation and alteration of compensation due to an individual who is working and in receipt of a pension or who has transferred the commuted value of their pension to a locked-in retirement vehicle that was earned while working in post-secondary institutions.

Ontario drug benefit

Effective April 1, 2019, the Ontario government removed drug coverage for children and youth who are under the age of 25 and who have access to private drug plans. The government will consider ways to redesign the Ontario Drug Benefit Program to make its programs more efficient, including:

- Providing timely access to new clinically proven medicines while continuing efforts to lower drug costs;
- Modernizing and strengthening oversight of payments to pharmacies; and
- Reducing the administrative burden on clinicians and red tape for the industry wherever possible.

Dental benefits for low income seniors

The government will introduce a new dental program for low-income Ontario seniors with an annual investment of approximately $90 million once fully implemented. By late summer 2019, single seniors age 65 and older with incomes of $19,300 or less (or senior couples with combined incomes of less than $32,300) and without existing dental benefits will be able to receive dental services at public health units, community health centres and Aboriginal Health Access Centres located throughout the province. The program will later be expanded by investing in new dental services in underserviced areas, including through mobile dental buses and an increased number of dental suites in public health units.

Scope of practice for health care professionals

The Ontario government will expand the scope of practice for certain regulated health professionals, such as pharmacists, nurse practitioners, dental specialists and optometrists.

According to the government, these changes will improve convenience for patients by reducing the time spent travelling between providers for multiple visits for diagnostic tests and alleviate the need to make referrals to other providers.

Mental health funding

The 2019 Ontario budget pledges $3.8 billion in support for mental health and addictions services and housing support over 10 years, beginning with building a mental health and addictions system focused on core services embedded in a stepped-care model, and a robust data and measurement framework.

$174 million of the new funding is to be distributed in 2019-2020 to support community mental health and addictions services, mental health and justice services, supportive housing, and acute mental health inpatient beds. Services will also target priority populations, such as Indigenous peoples and Francophones.

Comment

The most noteworthy pension-related change in the budget would be the introduction of electronic communications with pension plan members as a default option, potentially resulting in cost savings for pension plans. The amendment in Bill 100 that permits the use of PYCB to cover normal cost and PfAD without dealing with the restrictions on contribution holidays will be of relief to DB plan sponsors in Ontario who have accumulated PYCB in their pension plans.

The changes to executive compensation for public sector executives and potential changes to encourage earlier retirement for university faculty will be of interest to employers and employees in those sectors. The expansion of the scope of practice for health care professionals could potentially result in more efficient patient care. The increased funding for mental health services is also noteworthy.

Ontario proposes draft variable benefit, annuity purchase regulations

On April 11, 2019, the Ontario Ministry of Finance posted two proposed regulations affecting pension plans. One draft regulation sets out rules for the payment of variable benefits to Ontario retired members from the defined contribution (DC) provision of a pension plan. The other draft regulation amends the rules for obtaining a discharge upon purchase of an annuity to satisfy a defined benefit (DB) pension plan's obligation to pay a pension to an Ontario retired member or surviving spouse.

Variable benefits

The draft variable benefit regulations follow a 2018 public consultation on the proposed content of the future variable benefit regulations.

The draft regulations set out rules regarding the minimum and maximum annual payments from a variable benefit account, transfers to other retirement arrangements, statements, and death benefits payable from a variable benefit account.

They also permit the retired member to withdraw or transfer from the variable benefit account up to 50% of the initial account balance to an unlocked registered retirement savings arrangement within 60 days of the establishment of the variable benefit account. This 50% unlocking option for variable benefit accounts is the same option available upon establishment of a Life Income Fund. The extension of the 50% unlocking option to variable benefit accounts was recommended by Morneau Shepell in its submission during the 2018 public consultation.

The draft regulations also require the administrator to provide the retired member with information on how to designate his or her spouse as a specified beneficiary for the purpose of the *Income Tax Regulations*, in order for the spouse to receive continuing benefit payments after the retired member's death.

Discharge upon annuity purchase

In the fall of 2018, the Ontario *Pension Benefits Act* (the Act) was amended to clarify the annuity discharge provisions and to extend the discharge provisions to surviving spouses entitled to a pre-retirement or post-retirement death benefit.

The draft regulations support these amendments to the Act by:

- Aligning the definition of "solvency ratio" in the annuity purchase and discharge regulations with the general definition of "solvency ratio" used elsewhere in the pension regulations;
- Setting out conditions under which a discharge will be provided for annuities purchased for surviving spouses; and
- Specifying the funding requirements under which a discharge will be provided for previously purchased annuities that are adjusted to meet the requirements for a discharge at a later date.

Comment

Upon adoption, the new variable benefit regulations and accompanying amendments to the Act will permit a DC plan to offer variable benefit accounts to Ontario DC members who wish to retire and receive payments directly from the DC pension plan. By offering this option, DC plan sponsors can assist their former DC members in obtaining retirement income directly from a DC plan, instead of requiring them to transfer funds to a financial institution or purchase an annuity.

The amended annuity purchase rules will facilitate discharges upon purchase of buy-out annuities for surviving spouses in Ontario. In addition, they will also facilitate discharges for previously purchased annuities for which the administrator wishes to obtain a discharge from liability.

Public comments on the draft regulations were permitted until May 3, 2019.

Recent case highlights risk of predatory marriages

Our increasingly aging population raises questions about marriages for persons with a degree of incapacity. A recent case in which an Ontario court voided a couple's marriage based on a claim of incapacity highlights the risk that predatory marriages can pose to families and the complexities they can raise for pension and benefit plan administrators.

Ontario court applies revised test for void marriages

In *Hunt v. Worrod*, the court heard the claim of a 50-year-old applicant who had suffered a traumatic brain injury as the result of an ATV accident. After recovering from a coma, he was released to the care of his two sons, as he still suffered significant cognitive and physical impairment.

Prior to sustaining the injury, the applicant had been involved in what the court described as an "on again, off again" relationship with the respondent. Three days after returning home from the hospital, he was picked up outside his home by the respondent's uncle. The applicant's sons were able to trace his whereabouts to a hotel in another town. When they found their father that evening, they discovered that he had married the respondent earlier on the same day.

The court declared the marriage void from the beginning, finding that the applicant did not have the mental capacity to consent to a marriage. The court stated that capacity to marry requires the capacity to understand the nature of the contract and the duties and responsibilities it creates. A capacity assessment will be informed in part by the person's ability to manage themselves and their affairs.

The court relied on extensive medical evidence supporting the applicant's claim of physical and cognitive incapacity, including the evidence of several expert witnesses. In the period between the applicant's injury and the marriage, the applicant showed significant impairments in his executive functioning, including his ability to make decisions, solve problems, plan, organize and execute tasks. Further, his hospital treatment team observed that the injury had affected his ability to recognize his own cognitive impairments. His driver's license was revoked and his caregivers advised he should not be left alone.

The court also heard that, immediately prior to his sustaining the injury, the couple had not been cohabiting and the applicant had made the decision not to marry the respondent.

While the applicant was ultimately able to nullify the marriage, he and his family were first required to undertake a costly and lengthy legal process that lasted for six years. The court recognized the toll this proceeding took on the applicant and his family, noting that the applicant had funded his litigation using insurance money intended for his care and rehabilitation, and decided to order the alleged spouse to pay a significant portion of the applicant's legal costs. However, since the alleged spouse did not appear to have any assets, Legal Aid Ontario was required to pay a portion of the cost award.

Comment

While marriage is not primarily about property rights, marriage has a dramatic effect on an individual's financial circumstances and estate planning. A marriage voids prior wills in most Canadian provinces, although prior beneficiary designations remain in place. Furthermore, pension legislation provides for pre- and post-retirement death benefits for both married and common law spouses of plan members. A married spouse also has rights to a member's estate if there is a death without a will and has claims to property earned during a marriage.

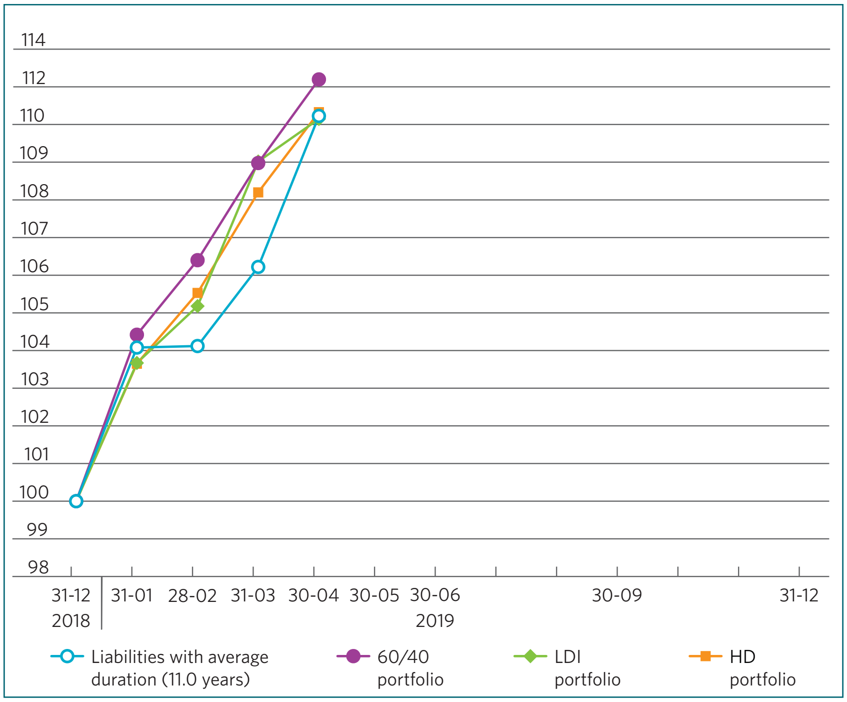
Employees who have access to an Employee Assistance Program like the one offered through LifeWorks by Morneau Shepell can obtain support and referrals to deal with family members who require support upon incapacity, as well as those who find themselves in predatory marriages or victims of other forms of elder abuse.

While family members may be diligent in their attempts to protect their loved ones from predatory marriages and other forms of elder abuse, it may be impossible to fully protect them. These situations may also raise dilemmas for plan administrators and others who face suspicious circumstances and dubious claims for benefits. In such circumstances, legal advice is appropriate.

Tracking the funded status of pension plans as at April 30, 2019

This graph shows the changes in the financial position of a typical defined benefit plan with an average duration since December 31, 2018. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2018. The estimate of the solvency liabilities reflects the new CIA guidance for valuations effective March 31, 2019 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, 2018



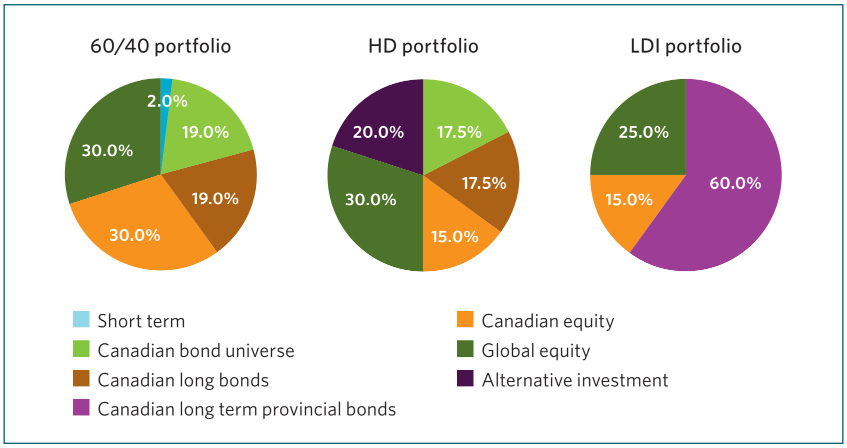
During the month of April, Canadian equity markets, global equity markets (CAD) and alternative investments showed positive returns while Canadian universe bonds, Canadian long-term bonds as well as Canadian long-term provincial bonds showed negative returns. With a return of 2.0%, both the highly diversified portfolio (HD) and the 60/40 portfolio outperformed the low volatility portfolio (LDI[1]) (1.0%).

The prescribed CIA Annuity purchase rates increased while the commuted value rates used in the calculation of solvency liabilities decreased during the month. As a result, the solvency liabilities increased by 3.8% for a medium duration plan. For this type of plan, an investment in the 60/40, in the HD or in the LDI portfolio resulted in a decrease of the solvency ratio.

[1] Liability driven investment

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, 2018. The graph shows the asset allocation of the three typical portfolios.

Initial solvency ratio as at December 31, 2018	Evolution of the solvency ratio as at April 30, 2019 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	100.9%	99.9%	100.1%
90%	90.8%	89.9%	90.1%
80%	80.7%	79.9%	80.1%
70%	70.6%	69.9%	70.1%
60%	60.5%	60.0%	60.1%



Since the beginning of the year, driven by strong positive returns in the Canadian equity markets, global equity markets as well as the alternative investments, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 11.2%, 10.1% and 10.3% respectively. The solvency liabilities fluctuated over that same period from 10.0% to 10.5% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at April 30, 2019 stands between -0.1% and 0.9%.

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

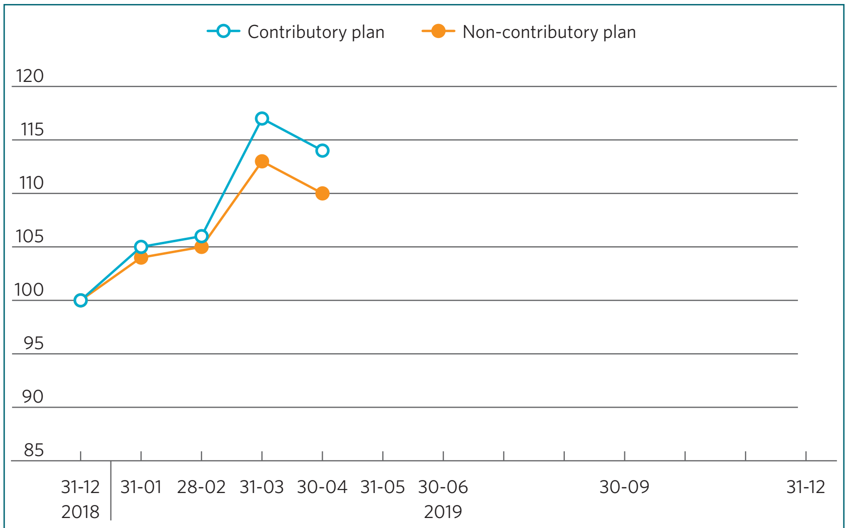
Comments

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 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.

Impact on pension expense under international accounting as at April 30, 2019

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, 2018



Discount rate
(%) 3.8% 3.6% 3.6% 3.3% 3.4%

Return on assets (55% equities)
(%) 0.0% 4.2% 1.8% 2.5% 1.8%

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 2018	April 2019	Change in 2019
11	3.72%	3.23%	-49 bps
14	3.81%	3.33%	-48 bps
17	3.87%	3.40%	-47 bps
20	3.90%	3.45%	-45 bps

Since the beginning of the year, the pension expense has increased by 14% (for a contributory plan) due to the decrease in the discount rates, despite the good returns on assets (relative to the discount rate).

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

Comments

1. The expense is established as at December 31, 2018, based on the average financial position of the pension plans used in our 2018 *Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits report* (i.e. a ratio of assets to obligation value of 95% as at December 31, 2017).
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 2018 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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