Knowledge & Insights

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FSRA sets out pension priorities

The Financial Services Regulatory Authority of Ontario (FSRA) has published a draft FSRA Priorities and Budget Consultation Document for 2020-2021, describing its priorities as it sets out to strengthen its oversight activities in the pension sector. FSRA also released its proposed Pension Sector Guiding Principles, identifying the proposed principles that will guide its activities in the pensions industry. These documents provide some early insight into what Ontario pension administrators can expect in terms of FSRA's approach to pension regulation.

FSRA's priorities for the 2020-2021 fiscal year

FSRA's priorities reflect a heightened focus on burden reduction and regulatory effectiveness. For example, FSRA aims to reduce the quantity of guidance to its sectors by as much as 40%.

FSRA states that its priorities with respect to pensions are to support pension plan evolution, develop a prudential supervisions framework and focus on burden reduction.

Pension plan evolution

FSRA aims to ensure that the regulatory framework facilitates asset transfers, consolidation, plan flexibility and other sector evolution to support the pension sector. Over the coming year, FSRA intends to adjust its organizational structure and relationship model to gear more towards large and jointly-sponsored pension plans. It also intends to review and consult on inherited guidance and develop a plan to update, retire or merge inherited guidance.

Prudential supervision framework

FSRA plans to consult on a plan to enhance its oversight of pension matters and begin implementation over the next year. This will include consideration of plan governance, a financial and risk assessment of the Pension Benefit Guarantee Fund (PBGF), and improved pension risk analysis. FSRA also intends to enhance its expertise in key areas such as credit analysis and pension risk analysis.

FSRA also intends to focus on certain types of pension plans. It intends to focus on standards and best practices in the use of leverage and illiquid assets in jointly-sponsored pension plans, as well as develop best practices in terms of funding, governance and investments for multi-employer pension plans (MEPPs). FSRA also intends to begin development and documentation of a risk-based supervisory approach for defined contribution (DC) pension plans in areas such as member behaviour and engagement, decumulation options, investments and fees. FSRA promises consultation and collaboration with pension plans in these areas, including through technical advisory committees.

Regulatory burden reduction

FSRA will continue to focus on high-value regulatory activity and reduce unnecessary regulatory burdens by updating its guidance framework, describing regulatory approaches, improving processes and modernizing information management and technology.

FSRA established technical advisory committees for missing members and asset transfers in fall 2019, and intends to create a new technical advisory committee for family law matters. It also intends to create a technical advisory committee, as well as work with the Ministry of Finance to reduce regulatory burden and improve regulatory effectiveness for DC pension plans.

Guiding principles for the pension sector

FSRA has also released its Proposed Pension Sector Guiding Principles, identifying the following seven principles that would guide its activities in the pensions industry: (1) risk-based, (2) reasonable, (3) aware, (4) adaptable, (5) facilitative, (6) effective and efficient, and (7) collaborative and transparent.

Comment

Ontario pension plan administrators will be interested to follow FSRA's progress in reforming its pension supervisory approach and reducing regulatory burdens on plan administrators. Developments in the regulation of MEPPs and DC pension plans will also be of interest to those particular sectors, while the risk analysis of the PBGF will be of interest to single employer defined benefit pension plan sponsors.

Ontario permits statutory discharge for buy-out annuities in respect of surviving spouses

On October 15, 2019, the Ontario government filed Ontario Regulation (O. Reg.) 335/19, which sets out the rules for a statutory discharge to be provided for a buy-out annuity in respect of a pension for a surviving spouse. This means that it is now possible for a plan sponsor to discharge its responsibilities in respect of a surviving spouse, in addition to former and retired members for whom such discharges were already available. Also, the Financial Services Regulatory Authority of Ontario (FSRA) has published a proposed approach that would reduce the regulatory burden for defined benefit (DB) pension plans that have previously purchased annuities that are not subject to statutory discharges.

Surviving spouses

The Ontario *Pension Benefits Act* allows the administrator of a single-employer pension plan to discharge its responsibility to provide a pension or ancillary benefit to former members or retired members by purchasing a buy-out annuity, provided that certain notice and funding requirements are met. Bill 57, the *Restoring Trust, Transparency and Accountability Act, 2018*, extended that provision to surviving spouses.

The new regulation sets out the notice and funding rules applicable to annuities for purchases for surviving spouses. These are similar to the requirements applicable to former members.

With the adoption of the regulation, these provisions of Bill 57 became effective October 15, 2019 and it is now possible to receive a statutory discharge from liabilities by purchasing annuities for surviving spouses.

Easing reporting requirements for frozen, annuitized DB plan components

As part of its effort to focus on burden reduction for pension administrators, FSRA has published Approach No. PE0195APP (the Approach), a new guidance document setting out FSRA's approach to reducing the regulatory burden on pension plans with frozen DB components where annuities have been purchased in respect of members' defined benefits. This Approach can apply where annuities have been purchased for active members with frozen benefits, but a statutory discharge is not available because active members are still employed and earning benefits in a defined contribution provision.

FSRA says it will re-evaluate the ongoing requirements to submit actuarial valuation reports and Actuarial Information Summaries, Pension Benefits Guarantee Fund Assessment Certificates and Investment Information Summaries for such plans on a case-by-case basis. FSRA has also indicated that Annual Information Returns will no longer need to include information on members with annuitized benefits unless they continue to accrue benefits under a defined contribution provision in the same plan.

Plan administrators for plans must first contact FSRA to determine if the guidance under this Approach applies to their plan. In the absence of written confirmation from FSRA that this Approach guidance is applicable in advance of the relevant filing deadline, all required statutory filings required will be expected to be filed on time.

Comment

The new regulation will allow sponsors who have previously purchased annuities in respect of surviving spouses to obtain a statutory discharge for such past purchases, provided that the notice and funding rules are met. It will also increase the appeal of purchasing annuities for the purpose of receiving a statutory discharge by including surviving spouses in the groups that are covered by the statutory discharge.

The new Approach will be of value to plan administrators with frozen DB benefits, provided they can demonstrate that their particular circumstances meet FSRA's requirements.

New British Columbia pension regulator in place

Effective November 1, 2019, the existing pension plan regulator in British Columbia, the Financial Institutions Commission (FICOM), was replaced by the BC Financial Services Authority (BCFSA). The BCFSA is a new Crown corporation that will be self-funded and will work at arm's length from the Ministry of Finance, with greater independence than FICOM enjoyed.

There are currently no plans to change the priorities or powers of FICOM relating to pension plans after the transition to the BCFSA. As a result of the change, the BCFSA's public website, e-filing website and email addresses have been updated. Telephone numbers were unchanged.

Payments made to the new entity should be issued to the BC Financial Services Authority and no longer to the Ministry of Finance.

Updates to government benefit plans in Ontario, Quebec and Alberta

There have been several recent announcements of changes to provincial government health care benefits that are summarized below.

OHIP Out-of-Country Coverage to Terminate

Effective January 1, 2020, the Ontario Health Insurance Plan (OHIP) will no longer cover any emergency medical costs for Ontarians travelling outside of Canada. Currently, coverage is limited to a maximum of $400 per day for inpatient care, and $50 per day for outpatient care or physician costs. It should be noted that most private extended health care plans include emergency out-of-country coverage that reimburses expenses well beyond the limits of provincial government plans.

FreeStyle Libre flash glucose monitors now covered under the Ontario Drug Benefit

Effective September 16, 2019, FreeStyle Libre flash glucose monitors have been added for reimbursement under the Ontario Drug Benefit. Flash glucose monitors are a newer blood glucose monitoring system that use a sensor worn on the upper arm. Patients use a reader or a phone app, waved over the sensor, to take an immediate reading of their blood glucose level. Such devices increase convenience for diabetics and have become popular.

Both the reader and the disposable sensors will be covered with a valid prescription for patients on insulin therapy.

Quebec launches vision care coverage for children under 18

Effective September 1, 2019, the Quebec government has launched the "See Better to Succeed" program. This program provides a reimbursement of $250 (which does not vary with the cost of the purchase) every 2 years for glasses or contact lenses for all children under the age of 18.

Alberta Budget includes biosimilar initiative and mental health investments

The 2019 Alberta Budget, released on October 24, 2019, included an announcement regarding prescription drug coverage changes and new funding for other areas of health care.

The budget noted that Alberta's prescription drug costs are higher than other provinces partially due to program design. It announced that program changes will include a biosimilars initiative, as well as Maximum Allowable Cost pricing rules to limit drug benefit coverage to lower-cost alternatives that are clinically appropriate. The Alberta Senior Drug Benefit Program will discontinue coverage for non-senior dependents and the government will explore applying an income test for seniors' drug coverage.

Commentary

The loss of OHIP travel coverage will mean private travel insurance plans will cover all costs for emergency out of country claims, and will likely result in travel premium increases for plans with plan members in Ontario. The quantitative impact of this change to private plans is not yet clear; however, given the provincial plan reimbursed a small portion of the total average cost of such claims, premium increases are expected to be minor.

Private plans providing coverage for vision care for individuals under 18 in Québec should encourage members to seek reimbursement under the See Better to Succeed Program prior to private plan reimbursement. Insurance companies will not be coordinating reimbursement under the program.

Though very little information is available regarding the Alberta change to utilize biosimilar drugs, it may be similar to the changes implemented earlier in 2019 by the British Columbia provincial drug plan. (See the September 2019 *News & Views* for further details.) Most private plan insurers are following suit to reimburse the biosimilar versions rather than the brand name biologic drugs for BC plan members. It remains to be seen if other government plans embrace forced switching of patients to biosimilars, since increased use of biosimilars will support the sustainability of both private and government drug plans.

Pension and benefits developments from the 2019 federal election

The Liberal Party of Canada has won a plurality of seats in the House of Commons in the recent 2019 federal election and is expected to form a minority government. The party's 2019 election platform contained a number of promises that, if enacted, would affect pensions and benefits in Canada.

Old Age Security and Canada Pension Plan

The platform promised to increase the Old Age Security Benefit by 10% for seniors when they turn 75, and to continue to increase the benefit with inflation. According to the platform, this change will add $729 to the annual retirement income of most seniors who are 75 or over.

The platform also promised to work towards increasing the survivor benefits available under Canada Pension Plan and Quebec Pension Plan by 25%, which would provide up to an additional $2,080 per year for qualifying seniors. The consent of the provinces is required for changes to the Canada Pension Plan.

Pharmacare

In June 2019, the Advisory Council on the Implementation of National Pharmacare produced a report recommending the adoption of a universal public, single-payer pharmacare system (as discussed in the April 2019 and July 2019 *News & Views*). The Liberals' election victory means the government will likely continue to push for a national universal pharmacare program, particularly as the New Democratic Party, which now holds a balance of power, has also indicated it regards pharmacare as a priority issue. However, significant involvement from provincial and territorial governments would be required to implement national pharmacare.

Healthcare

The Liberals have promised to introduce "distinctions-based" health legislation for indigenous Canadians to ensure indigenous control over the development and delivery of healthcare services.

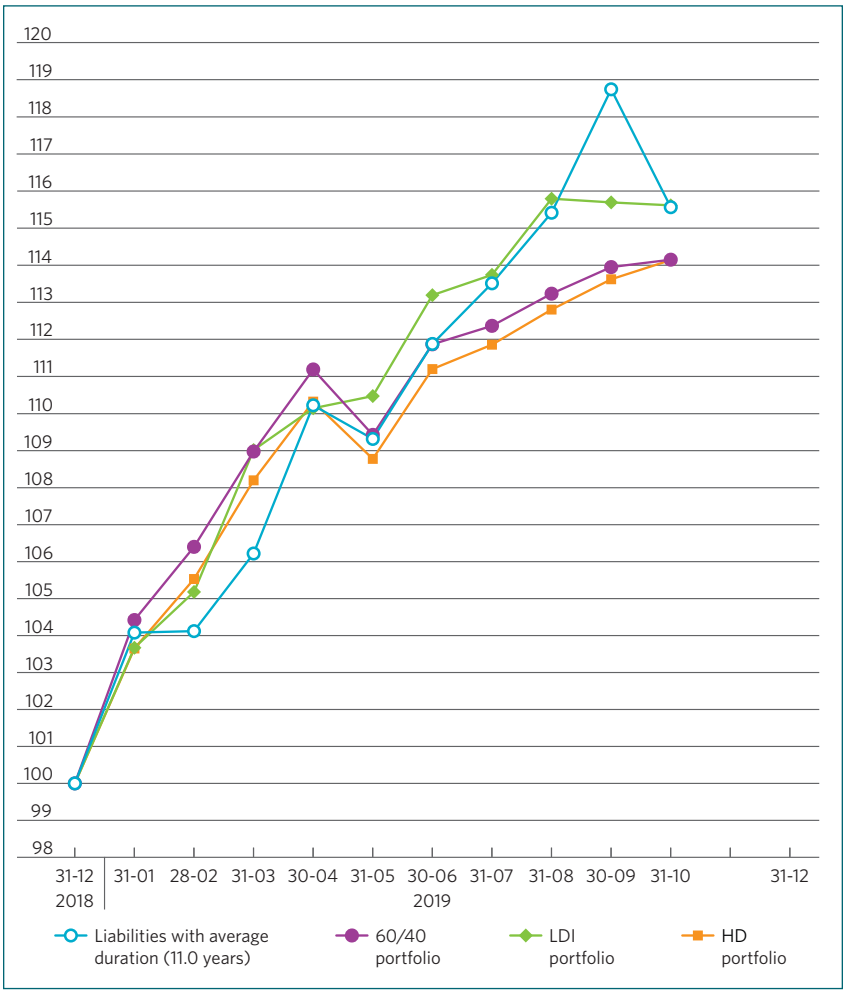
The 2019 platform promises up to $3,000 in free counselling services for veterans through Veterans Affairs Canada or one of its service partners before they are required to make a disability claim. The Liberals also promised to create a new rapid-response service for veterans staffed by social workers, case management counsellors and peer support workers, and to provide automatic approval for the most common disability applications such as depression, post-traumatic stress disorder and arthritis.

The platform proposed to set clear national standards for access to mental health services. It plans to include mental health as a specific element of occupational health and safety rules for federally regulated employees, while requiring federally regulated employers to take preventative steps to address workplace stress and injury.

Tracking the funded status of pension plans as at October 31, 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 September 30, 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



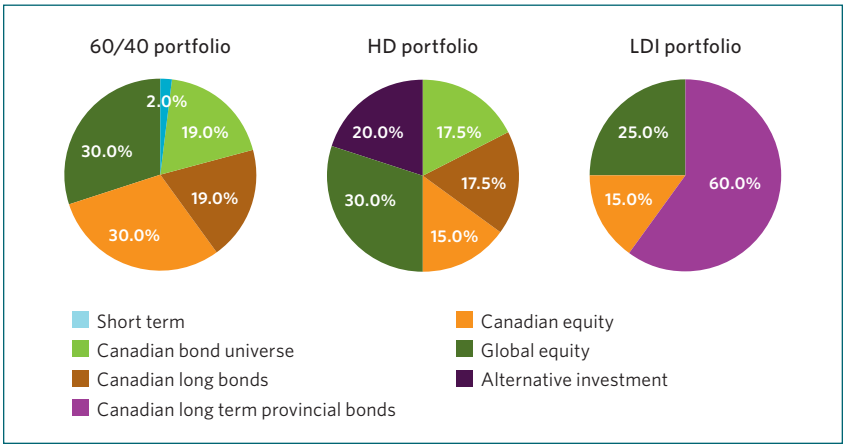
During the month of October, global equity markets (CAD) and alternative investments showed positive returns. However, Canadian equity markets, Canadian universe bonds, Canadian long-term bonds and Canadian long-term provincial bonds showed negative returns. With a return of 0.5%, the highly diversified portfolio (HD) outperformed the 60/40 portfolio (0.2%) and the low volatility portfolio (LDI[1]) (-0.1%).

[1] Liability driven investment

Annuity purchase rates increased along with the commuted value rates used in the calculation of solvency liabilities. As a result, the solvency liabilities decreased for a medium duration plan. For this type of plan, an investment in the 60/40, in the HD and the LDI portfolio resulted in an increase of the solvency ratio.

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 October 31, 2019 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	98.8%	100.0%	98.8%
90%	88.9%	90.0%	88.9%
80%	79.0%	80.0%	79.0%
70%	69.1%	70.0%	69.1%
60%	59.3%	60.0%	59.3%



Since the beginning of the year, driven by strong positive returns in the Canadian fixed income and equity markets, global equity markets and alternative investments, the 60/40 portfolio, the LDI portfolio and HD portfolio returned 14.2%, 15.6% and 14.2% respectively. The solvency liabilities fluctuated over that same period from 15.2% to 16.0% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at October 31, 2019 stands between -1.2% and 0.0%.

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

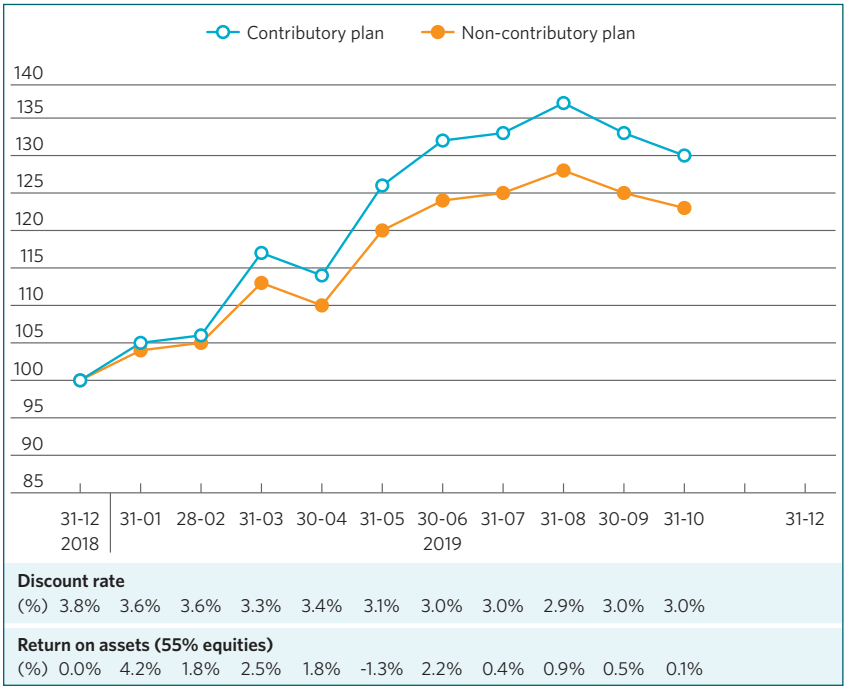
Comments

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 October 31, 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



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	October 2019	Change in 2019
11	3.72%	2.94%	-78 bps
14	3.81%	3.02%	-79 bps
17	3.87%	3.08%	-79 bps
20	3.90%	3.11%	-79 bps

Since the beginning of the year, the pension expense has increased by 30 % (for a contributory plan) due to the decrease in the discount rates, despite the good returns on assets (relative to the discount rate).

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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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