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CAPSA releases revised multi-jurisdictional pension plan agreement

On June 2, 2020, the Canadian Association of Pension Supervisory Authorities (CAPSA) announced that representatives of the governments of Alberta, British Columbia, New Brunswick, Nova Scotia, Ontario, Quebec and Saskatchewan and the federal government have signed a new interim Agreement Respecting Multi-Jurisdictional Pension Plans (the MJPP Agreement). The new MJPP Agreement comes into effect on July 1, 2020.

Background

The 2020 MJPP Agreement replaces the previous MJPP Agreement adopted by British Columbia, Nova Scotia, Ontario, Quebec and Saskatchewan effective July 1, 2016 (and whose introduction was discussed in the June 2016 *News & Views*). The other provinces and the federal government did not sign the 2016 version of the MJPP Agreement. The 1968 Memorandum of Reciprocal Agreement, which was signed by all provinces except for Prince Edward Island (which has no pension legislation in force), remains in effect for Manitoba and Newfoundland and Labrador, which have not yet signed the 2020 MJPP Agreement.

According to CAPSA, the 2020 MJPP Agreement was developed to serve as a practical solution to coordinate and harmonize pension regulation across Canada. The revised agreement extends the legal framework established by the 2016 MJPP Agreement to the vast majority of multi-jurisdictional pension plans in Canada.

The 2020 MJPP Agreement is broadly similar to the 2016 MJPP Agreement it replaces, with the following differences.

Major authority's funding rules

The 2016 MJPP Agreement was adopted at a time when pension legislation generally required that defined benefit pension plans be funded on both a going concern basis and a solvency basis. Since then, jurisdictions such as British Columbia, Nova Scotia, Ontario and Quebec have eliminated or reduced solvency requirements. Under the 2016 MJPP Agreement, if a benefit was not required to be funded under the legislation of the jurisdiction of pension plan registration (i.e., the major authority), but was required to be funded under the legislation of the jurisdiction of a pension plan member (i.e., the minor authority), additional funding was required for that benefit.

Under the 2020 MJPP Agreement, that additional funding requirement has been eliminated and a defined benefit pension plan is only required to be funded based on the major authority's funding rules.

Asset allocation requirements

The 2020 MJPP Agreement alters the requirements governing the allocation of the assets of a multi-jurisdictional pension plan upon wind up as an underfunded pension plan or certain other major plan events.

The asset allocation requirements have been amended to accommodate recent changes in the legislation of participating jurisdictions to eliminate traditional solvency funding requirements for some pension plans.

Section 15 of the 2016 MJPP Agreement, which provided a methodology for reducing amounts related to benefits arising from a legislative or plan provision that came into effect less than five years before the date of allocation, has been revoked in the 2020 MJPP Agreement.

Annuity purchase rules

Given that an increasing number of plan sponsors are employing de-risking strategies such as buy-out annuities, some jurisdictions have granted statutory discharges to pension plan administrators that have purchased buy-out annuities, subject to conditions. The 2020 MJPP Agreement acknowledges this trend and provides that the rules for providing statutory discharges upon annuity purchase from the minor authority will generally apply in respect of a member. However, the 2020 MJPP Agreement also provides that the major authority's rules will apply in respect of three areas:

1. Requirements for contributions to the pension fund;
2. Minimum plan funding and solvency levels; and
3. Requirements pertaining to actuarial valuation reports, including the form and content of such reports, filing deadlines and actuarial standards to be applied in preparing such reports.

This development will simplify and clarify the process for obtaining statutory discharges.

Loss of "major authority" status

The MJPP Agreement distinguishes between the "major authority" or jurisdiction of registration and "minor authorities" where other plan members are located. A regulator loses its status as the major authority for a plan if, according to the plan's most recent periodic information returns, the number of active members employed in the major authority's jurisdiction fell below a prescribed threshold over a one or three year period, depending on the size of the plurality.

The 2020 MJPP provides that an upcoming change of major authority can be cancelled and a major authority can retain its status if the existing majority authority regains a plurality of active members before the effective date of the upcoming change to the major authority.

Administrative monetary penalties

The 2020 MJPP Agreement clarifies that the imposition of administrative monetary penalties is a matter within the jurisdiction of the applicable major authority.

Comment

The 2020 MJPP Agreement will extend the reach of the agreement to three new jurisdictions, including the federal government. Furthermore, it clarifies a number of issues and also better accommodates ongoing defined benefit funding reform initiatives. As such, it will simplify and clarify a number of issues faced by employers who sponsor multi-jurisdictional pension plans.

FSRA sets out rules and procedures for approval of commuted value transfers

Effective May 22, 2020, the Financial Services Regulatory Authority of Ontario (FSRA) issued Approach No. PE0202APP (the Approach), which provides new guidance on commuted value transfers and annuity purchases for Ontario-registered defined benefit pension plans. The Approach sets out two processes for approval of commuted value payouts once plan administrators have determined that the restrictions on commuted value transfers apply, as well as FSRA's expectations if the plan administrator chooses not to apply for permission to make such transfers. The Approach replaces the prior Policy T800-402 on transfer restrictions.

FSRA's expectations if Form 10 is not filed

FSRA requests that it be notified if an administrator determines that its preferred course of action is not to apply for approval to continue making commuted value transfers until plan stability has improved. The administrator should explain the reasons for taking this approach and the factors that were considered. In addition, the administrator should indicate: (i) how long the cessation of commuted value transfers is expected to continue, (ii) what communication is being made to plan beneficiaries, and (iii) what steps are being taken to return to a situation where commuted value transfers can be made.

Expedited review process

Under its new approach, FSRA will consider applying an expedited review process for qualifying plans that wish to continue making commuted value transfers. FSRA will generally consider applications to continue making commuted value transfers on an expedited basis in the following circumstances:

- The full transfer deficiency with respect to each commuted value to be transferred has been remitted to the plan;
- The plan's updated transfer ratio is at least 0.85 and the administrator proposes to transfer out

full commuted values, so long as the aggregate of all transfer deficiencies since the last valuation date does not exceed 5% of the plan's assets at that time; or

- The updated transfer ratio is less than 0.85 and the administrator proposes to transfer out only a portion of the commuted value at the updated transfer ratio.

FSRA will make the ultimate determination as to whether the expedited review process is appropriate, or whether an in-depth review is required. Under its expedited process, FSRA aims to respond to applicants within five business days of receiving a completed Form 10, provided no additional information is required.

In-depth review process

If FSRA determines that the expedited review process is not appropriate, its in-depth review process may take the following additional items into consideration:

- The plan's financial position, including the plan's funded level based on the most recent valuation, the estimated drop in the plan's transfer ratio, and an estimate of the plan's funded status (at year 5 from the date of application);
- Liquidity concerns (or lack thereof);
- The expected frequency of terminations and the average size of their commuted values;
- A description of the impact of transfer deficiencies on the plan's assets and transfer ratio (i.e., the size of the transfer deficiencies relative to the plan's assets), and the potential impact of transfers on the benefit security of remaining plan beneficiaries;
- The impact of continued market uncertainty and further events;
- Any concern over the plan's investment portfolio;
- Any concern over the employer's ability to absorb fluctuations in plan costs or to fund wind up deficiencies; and
- For multi-employer pension plans (MEPPs), existing benefit reduction practices and how they will be applied when there are temporary reductions to commuted values.

FSRA encourages administrators to include relevant information addressing the aforementioned considerations with their Form 10 applications. If FSRA determines that an in-depth review is required or additional information is to be provided, FSRA will strive to respond to an application within 15 to 20 business days, or longer in some cases.

Resuming unreduced commuted value transfers

An administrator that has filed a Form 10 and been approved only to make reduced commuted value transfers may resume making unreduced commuted value transfers once any of the following have taken place:

- A new valuation report is filed and the regular rules for making unreduced commuted value transfers have been met;
- The employer fully funds all commuted value transfer deficiencies; or
- In accordance with the approval granted by FSRA, a statement signed by the plan's actuary is filed showing an estimated updated transfer ratio of at least 0.9.

Other issues

FSRA has stipulated that, after an administrator has submitted a Form 10 and FSRA has approved the transfer of commuted values, if the plan's transfer ratio declines by an additional 5% from the level identified in the original Form 10, the administrator must again cease transferring commuted values. In such a case, the administrator may decide to file another Form 10 reflecting the updated transfer ratio.

Option statements provided to eligible terminating and retiring beneficiaries should inform the recipients if all or a portion of the commuted values must remain in the plan, as well as the time frame within which the remainder is expected to be transferred out.

FSRA indicates it plans to revisit the Approach by December 31, 2020.

Comment

The new Approach sets out detailed expectations and processes for dealing with commuted value transfer requests. Ontario defined benefit pension plan administrators who have not yet reviewed their transfer ratios in light of recent market volatility should refer to the new Approach for guidance on how to do so. Plan administrators who have already made such applications should review their approval letters from FSRA for the precise conditions applicable to their situations.

Any transfer deficiencies that are not paid immediately must be paid within five years. FSRA may set out conditions for such payments in its approval letters.

Federal government implements moratorium on solvency special payments

Following up on the April 15, 2020 announcement of a federal solvency funding moratorium as discussed in the May 2020 *News & Views*, the federal government has adopted a regulation to provide temporary, short-term solvency funding relief for federally regulated defined benefit pension plans. The new regulations became effective on May 27, 2020.

Solvency special payments moratorium

Under the new regulation, no solvency special payment instalments are required from May 27, 2020 until December 30, 2020. Therefore, federally regulated defined benefit pension plan sponsors are not required to make solvency special payments that are due from April 1, 2020 until December 30, 2020.

If a plan sponsor has made solvency special payments between April 1, 2020 and May 27, 2020, the amount of any such payments can be deducted from future normal cost contributions and going concern special payment requirements due from now until December 30, 2020.

The new regulation also provides that, from the date the new regulation comes into force, no interest will be payable in respect of solvency special payments that became due after March 31, 2020 and before the day on which the regulation comes into force.

Plan sponsors that use letters of credit to meet their solvency funding requirements may reduce the face values of letters of credit that have been obtained to cover solvency special payments in respect of the moratorium period by the amount of payments that would otherwise have been due.

All normal cost contributions and going concern special payments will continue to be required through the moratorium period. Plan sponsors can continue making contributions in respect of their plans' solvency deficiencies if they choose to do so. Any such contributions, to the extent that they exceed the solvency special payments that would ordinarily have been required in the absence of the new regulations, will be considered additional payments and applied to subsequent plan years.

Following the moratorium period, sponsors of federally regulated defined benefit pension plans will be required to resume making monthly solvency special payments, beginning with the December 2020 payment due January 30, 2021. Plan sponsors will not be required to repay the 2020 solvency special payments under a separate amortization schedule. Rather, the usual solvency funding requirements will apply.

Threshold for void amendments

Between May 27, 2020 and November 30, 2020, any plan amendment that would reduce a plan's solvency ratio to below 1.05 will require approval from the Office of the Superintendent of Financial Institutions (OSFI). Any plan whose solvency ratio

is already below 1.05 will also require OSFI's approval for any plan amendment that would increase benefits or pension benefit credits. The usual threshold for void amendments is 0.85 in most cases and 1.0 in certain cases.

Disclosure requirements

The new regulation also introduces new disclosure requirements aimed at informing beneficiaries of the impact of the solvency special payment moratorium on their pension plans. In respect of a plan year in which solvency special payments are reduced under the new regulation, members' and former members' annual statements must indicate (a) the amount of reduced solvency special payments for the plan year and (b) what payments would have normally been required for the plan year to members and former members. This would affect annual statements covering any part of 2020 in which the solvency moratorium is taken, but not annual statements in respect of prior years.

OSFI provides automatic consent for portability transfers for retirement eligible members

On May 7, 2020, the Office of the Superintendent of Financial Institutions (OSFI) announced that it has revised its Directives of the Superintendent pursuant to the *Pension Benefits Standards Act, 1985* (the Directives) to ease the restrictions on portability transfers for members who are retirement eligible.

OSFI has also clarified some other matters related to the portability freeze in a revision to its *COVID-19 Measures – FAQs for Federally Regulated Private Pension Plans* (FAQ) publication, which was discussed in the April 2020 *News & Views*.

Automatic consent for retirement eligible members

The revised Directives provide for automatic consent to portability transfers to locked-in vehicles for members who are retirement eligible (i.e., at least eligible for early retirement). The new automatic consent provision applies to transfers to prescribed retirement savings plans, such as locked-in registered retirement savings plans (RRSPs), life income funds and restricted life income funds. Transfers to other pension plans or transfers used to fund an annuity purchase still require OSFI's consent.

The automatic consent for members who are eligible to retire are subject to three criteria, which OSFI says are designed to ensure that the plan's financial position is considered in determining the amount of the transfer. The criteria are as follows:

1. The amount of the initial transfer cannot exceed the "transfer value" (i.e. the commuted value of the pension benefit multiplied by the plan's "transfer ratio"). The transfer ratio is the lesser of (1) the solvency ratio, as determined in the plan's most recent actuarial report and (2) the solvency ratio projected to a date no earlier than March 31, 2020.

2. If the plan's transfer ratio is less than one, the full commuted value can only be transferred if the plan sponsor remits to the fund an amount equal to the "transfer deficiency" (i.e. the amount by which the commuted value exceeds the transfer value).

3. If the full amount of the commuted value is not transferred to an individual, the transfer deficiency shall be transferred on the earlier of:

   - Five years from the date the commuted value of the pension benefit was calculated; and

   - The date on which the solvency ratio of the plan is determined to be one (based on an actuarial report with a valuation date no earlier than March 31, 2020).

   The transfer deficiency must also include interest at the same rate as that used to determine the commuted value, calculated from the date the commuted value was calculated to the date of the transfer.

The automatic consent would also apply to pre-retirement death benefits where the member was retirement eligible.

Where the member or survivor has a transfer subject to automatic consent, the plan administrator is required to comply.

Projected solvency ratio

OSFI explains that, under the Directives, a plan's projected solvency ratio, being the solvency ratio projected to a calculation date no earlier than March 31, 2020, as determined by an actuary, must take the following into account between the valuation date of the plan's most recent actuarial report and the calculation date of the projected solvency ratio:

- Changes in interest rates on a solvency basis;
- The fund's actual investment return;
- Contributions made; and
- Benefits paid.

It is not necessary to file the estimate with OSFI unless OSFI requests it.

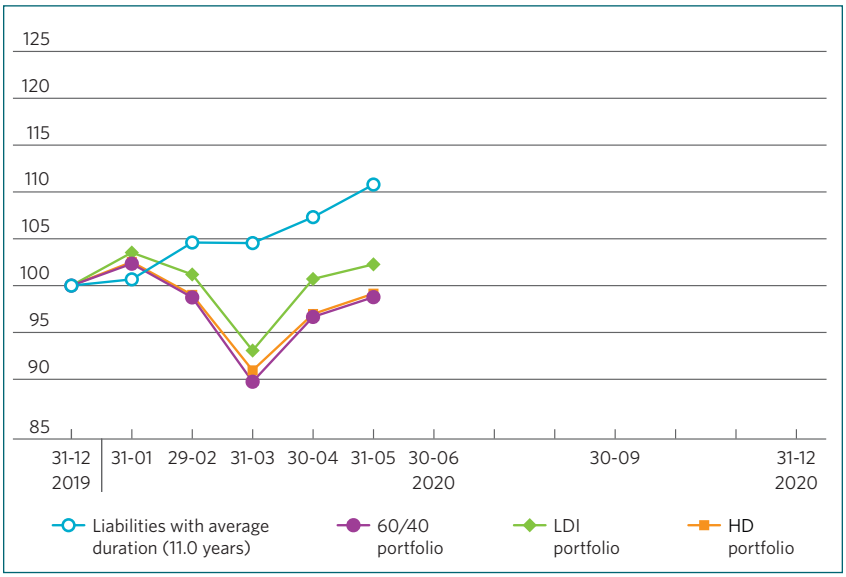
Comment

OSFI has indicated that, although the financial and economic environment remains uncertain, it believes easing portability in a limited way will help accommodate plan members who were counting on being able to access funds for their retirement, while still safeguarding plan solvency.

Tracking the funded status of pension plans as at May 31, 2020

This graph shows the changes in the financial position of a typical defined benefit plan with an average duration since December 31, 2019. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2019. The estimate of the solvency liabilities reflects the CIA guidance for valuations effective April 30, 2020 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, 2019



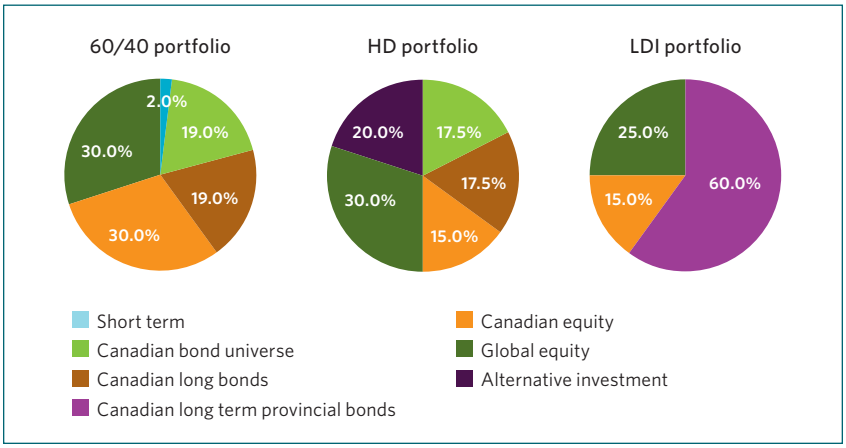
During the month of May, Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian equity markets, global equity markets (CAD) as well as alternative investments showed positive returns. With a return of 2.24%, the highly diversified portfolio (HD) outperformed the 60/40 portfolio (2.18%) and the low volatility portfolio (LDI[1]) (1.55%).

The prescribed CIA Annuity purchase rates as well as the commuted value rates used in the calculation of solvency liabilities decreased during the month. As a result, the solvency liabilities increased for a medium duration plan. For this type of plan, an investment in the HD, in the 60/40 and 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, 2019.
The graph shows the asset allocation of the three typical portfolios.

Initial solvency ratio as at December 31, 2019	Evolution of the solvency ratio as at May 31, 2020 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	89.2%	92.3%	89.5%
90%	80.2%	83.1%	80.5%
80%	71.3%	73.8%	71.6%
70%	62.4%	64.6%	62.6%
60%	53.5%	55.4%	53.7%



Since the beginning of the year, driven by negative returns in the Canadian equity markets, global equity markets as well as alternative investments, the LDI portfolio, the HD portfolio and the 60/40 portfolio returned 2.3%, -0.9% and -1.2% respectively. The solvency liabilities fluctuated over that same period from 10.1% to 11.0% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at May 31, 2020 stands between -10.8% and -4.6%.

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

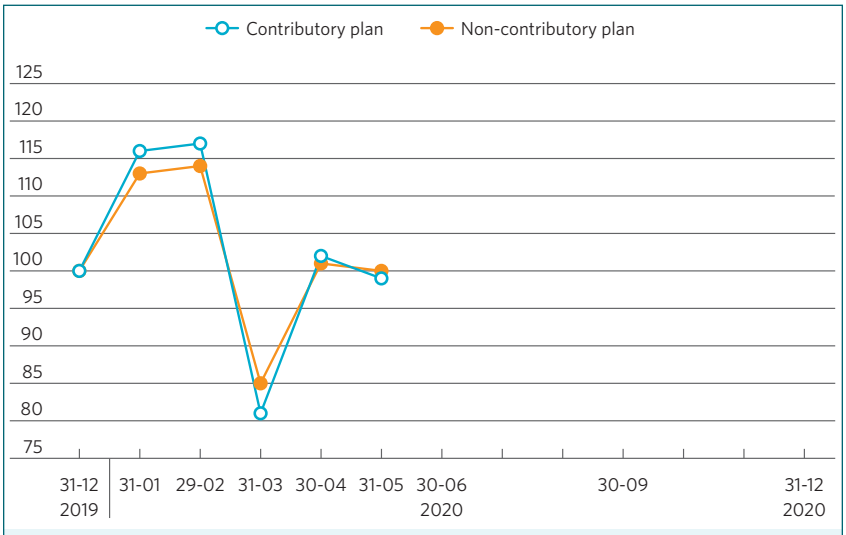
Comments

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 May 31, 2020

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, 2019



Discount rate (%)	3.2%	2.7%	2.7%	3.8%	3.1%	3.2%
Return on assets (50% equities) (%)	0.0%	2.6%	-2.8%	-8.2%	7.3%	1.9%

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 2019	May 2020	Change in 2020
11	3.06%	3.04%	-2 bps
14	3.13%	3.17%	+4 bps
17	3.17%	3.24%	+7 bps
20	3.20%	3.29%	+9 bps

Since the beginning of the year, the pension expense has remained quite stable, despite the financial markets turmoil.

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

Comments

1. The expense is established as at December 31, 2019, based on the average financial position of the pension plans used in our 2019 *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, 2018).
2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (50% equities and 50% fixed income), which reflects the average asset mix in our 2019 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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