Knowledge & Insights

MORNEAU SHEPELL

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In this issue

Ontario offers conditional deferral of defined benefit employer contributions

On September 21, 2020, the Ontario government filed O. Reg. 520/20, amending Ontario Regulation 909 under the *Pension Benefits Act*. The new regulation permits Ontario employers to defer their defined benefit (DB) pension contributions due from October 1, 2020, to March 31, 2021, to be made up with interest from April 2021 to March 2022. Employers who make this election will be subject to a number of prohibitions and restrictions until the deferred contributions are made to the pension fund.

The Financial Services Regulatory Authority of Ontario (FSRA) has updated its guidance document to include a number of questions and answers clarifying the application of O. Reg. 520/20 and the new contribution deferral scheme.

An employer wishing to defer contributions is required to file an election and payment schedule with FSRA specifying which payments will be deferred. FSRA will be providing an electronic filing form shortly. The election and schedule must be filed no later than the date the contributions for the first deferred month are due.

FSRA cautions that actuaries should take care in creating their payment schedules since, once filed, they cannot be amended unless a new valuation report dated before March 31, 2021 is filed.

Required updates

The plan administrator must file updates including prescribed information throughout the deferral period. The first update must be prepared by the plan actuary as of the last day of the third month following the first deferred payment. The updated must be provided to FSRA within 30 days after the end of the third month. Updates must continue be made every three months thereafter.

Plan administrators may stop filing updates once they have informed FSRA that all the deferred payments have been repaid with interest.

An update must also include a statutory declaration made by an officer of the employer in the prescribed form. FSRA has drafted a template for the required statutory declaration as an appendix to Information No. PE0206INF. FSRA asks that administrators or employers contact it before filing the declaration if they need to deviate from the template or wish to propose alternative wording. Employers are required to provide the statutory declaration to the pension plan administrator at least 15 days before the update is due to be filed.

Prohibition on compensation increases

In order to ensure that the funds made available as a result of contribution deferrals are used to facilitate the continuation of the employer's business during a time of financial stress, employers that elect to defer contributions are prohibited from doing any the following:

- Declaring or paying any amount on a capital share, whether as a dividend or a return of capital;
- Buying-back or otherwise purchasing or redeeming any issued and outstanding shares;
- Paying a bonus, whether non-discretionary or discretionary, in cash or otherwise, to any executive;
- Increasing the compensation of any executive;
- Repaying the principal amount of any debt or other obligation in excess of amounts previously scheduled and agreed to before September 21, 2020;
- Paying or crediting any amount as a loan or advance to or for the benefit of,
  - Any person or entity that owns a beneficial interest in any issued and outstanding capital share of the employer or of any related person or entity of the beneficial owner, or
  - Any executive of the employer and any related person or entity of the executive.
- Entering into any transaction with a related person or entity in the normal course of business under terms and conditions that are less favourable to the employer than market terms and conditions would dictate.

FSRA provides an example stating that companies should not pay any short-term incentives, award long-term incentives (such as stock options) or increase benefits to executives during the deferral period.

Employers are also restricted from making pension plan amendments to increase benefits or ancillary benefits, unless the amendment confers a benefit improvement that is required by law or the amendment implements an improvement that was agreed to in a collective agreement before September 21, 2020.

Early repayment of deferred contributions

A deferred payment schedule cannot be amended once an election is made and a payment schedule has been filed with FSRA, except upon the filing of a new valuation dated before March 31, 2021. Upon such a filing, the contributions set out in the new valuation report become the plan's new required contributions. An employer may also repay the full amount of any outstanding deferred payments with interest at any time. Employers should update FSRA once they have repaid the full amount owing.

Annual and biennial statements

If an employer elects to defer contributions, the annual and biennial statements to active, former and retired members must include a statement that the employer has elected to defer the payment of certain contributions and the date by which all the deferred payments will be made by the employer. This wording must continue to be included on statements until all deferred contributions are repaid.

Catch-up contributions

The Regulation also makes a temporary change to the rules for catch-up contributions when an actuarial report is filed after September 21, 2020 and on or before April 1, 2021. The usual 60-day deadline for making catch-up contributions has been extended to 120 days. This extension applies to all valuation reports filed between September 21, 2020, and April 1, 2021.

Comment

The deferral of DB contributions will be of interest to certain DB employers in Ontario who need to conserve funds for their business in late 2020 and early 2021. Given the conditions and requirements, it is likely that most Ontario DB plan sponsors will not take advantage of the deferral.

The extended time frame for making catch-up contributions will be helpful to Ontario DB employers filing valuation reports from September 21, 2020, to April 1, 2021.

FSRA releases draft supervisory approach to asset transfer applications

The Financial Services Regulatory Authority of Ontario (FSRA) published a draft of its new guidance document on asset transfer applications, Approach No. PE0205APP – Supervisory Approach to Asset Transfers Under the *Pension Benefits Act* (the Supervisory Approach). The draft Supervisory Approach sets out FSRA's expectations with respect to applications to transfer defined benefit (DB) entitlements between pension plans under sections 80, 81 and 80.4 of the Ontario *Pension Benefits Act* (the PBA). These sections apply to DB asset transfers between pension plans upon the sale of a business, between pension plans sponsored by the same or affiliated employers, and from a single employer pension plan to a jointly sponsored pension plan, respectively. FRSA has also released new information disclosure forms to accompany asset transfer applications.

Principles for FSRA's review

FSRA will act consistent with its statutory objectives to promote good administration of pension plans and protect and safeguard the pension benefits and rights of pension plan beneficiaries. Where a proposed asset transfer transaction may raise concerns regarding the security of benefits or the administration of the plan, FSRA may undertake a more detailed review of the application.

FSRA says that, depending on the outcome of a detailed review, it may withhold its consent and ask further questions of the applicant. These questions may focus on the following:

- Member complaints;
- Changes to previously accrued benefits;
- Issues relating to member or union consent, where applicable;
- Complexity (i.e. where a transfer affects benefits subject to pension legislation of another jurisdiction or where an asset transfer application includes multiple pension plans);

- Impact on the plans' financial positions; and
- Sustainability of the plans and their sponsors.

Due diligence expectation

Applications should reflect that administrators and their advisors are familiar and comply with applicable fiduciary duties and regulatory requirements for asset transfer transactions and related professional obligations for their advisors. FSRA expects asset transfer applications to demonstrate that administrators have performed sufficient due diligence in advance of the asset transfer, including with respect to the following:

- Whether any amendment to plan documentation is required;
- Whether any plan investments require special treatment;
- Whether additional funding is required;
- Whether any unresolved regulatory issues remain.

Prior consultation

FSRA asks administrators contemplating large or complex transactions to engage proactively with FSRA in order to explain the unique features of the asset transfer and the rationale for any variances or waivers sought with respect to specific regulatory requirements.

Any unresolved regulatory issues should be raised with FSRA prior to an application's submission and, if they are not resolved beforehand, identified in the application together with an explanation for how they will be resolved and how benefits will be impacted.

Plan amendments

FSRA indicates that, if an amendment associated with the asset transfer has been filed through the Pension Services Portal rather than being attached to the application, this should be noted in the application.

FSRA also suggests that it considers any amendment to the original plan that ceases benefit accruals or contributions to be adverse, and must therefore comply with the PBA requirements respecting adverse amendments.

Letters of credit

FSRA indicates that administrators should take care to consider the role of letters of credit in original and successor plans, given that they are provided to particular employers and cannot be included among the transferred assets. The implications of any letters of credit and how they will be addressed should be explained in the asset transfer application.

Waiver or variance of regulatory requirements

The PBA allows FSRA to vary or waive some of the requirements for assets transfers. This includes the requirements for the content and timing of notices. Applicants should inform FSRA if they intend to request a waiver or variance early in the asset transfer process (i.e., before notices are issued).

FSRA provides a number of examples of types of variances to regulatory requirements that it would consider approving:

- Using the most recent annual pension statement rather than duplicating the information in the asset transfer notice where the information is the same or substantially similar, even if the date of the annual pension statement does not align with the effective date of the proposed asset transfer;
- Using an existing summary of benefits or employee booklet where the transferred benefits are not being changed, rather than reproducing the information in the notice;
- Summarizing information for members, and directing them to where they may receive further detailed information;
- Extending deadlines for notices to members; and
- Variation of notice content, where content is technically non-compliant in a way that is not material to the transfer and could not reasonably be expected to affect a decision to consent to the transfer, if consent is required.

Applications to FSRA

FSRA has developed optional information disclosure forms to be included with an asset transfer application. In order to facilitate FSRA's review of such an application, forms are provided for two components of the asset transfer application process:

- The Application Summary, which must be certified by the plan administrator; and
- The Actuary's Certification (for defined benefit or hybrid plans only).

If an applicant provides an Information Disclosure form, FSRA will endeavour to respond within 150 days of its receipt. FSRA may simply approve applications or it may make additional requests for information.

While completing the Information Disclosure forms is not a regulatory requirement, FSRA indicates applicants who do not submit an Information Disclosure form should expect much longer review times.

Comment

The draft Supervisory Guidance will be welcome to pension plan sponsors and administrators making DB asset transfer applications, in that it will clarify FSRA's expectations and set out cases where exceptions may be granted. In addition, the new Information Disclosure forms may speed up FSRA's review process and provides a timeline within which pension plan administrators may expect a response from FSRA.

Update: Ontario extends the COVID-19 deemed leave of absence period

On September 3, 2020, the Government of Ontario filed a regulation extending until January 2, 2021 the job-protected Infectious Disease Emergency Leave that was originally scheduled to end on September 4, 2020. Non-unionized employees whose hours of work are temporarily reduced or eliminated by their employer due to COVID-19 prior to January 1, 2021 are automatically placed on Infectious Disease Emergency Leave.

The primary reason for the extension is to permit businesses to delay automatic terminations and severance payments due to lay-offs exceeding the maximum period permitted under the *Employment Standards Act*, 2000. As stated in the August 2020 *News & Views*, the deemed leave may also require employers to offer pension and benefit coverage during the leave period, unless pension and benefit coverage ceased prior to May 29, 2020.

Alberta requires amendments and other documents to be filed online

On September 30, 2020, the Alberta Superintendent of Pensions (the Superintendent) published EPPA Update 20-06, which describes revisions to its online filing system.

Effective October 1, 2020, all audited financial statements, plan texts and amendments, and fund holder documents that are required to be filed under the *Employment Pension Plans Act* and *Employment Pension Plans Regulation* must be filed online through the Pensions Online Filing System website. Any associated forms, summaries and redlined versions that accompany the filing of such documents must be submitted online as well. These documents will no longer be accepted by email or regular mail.

The Superintendent has required annual information returns (AIRs), cost certificates and actuarial valuations to be filed online since October 1, 2014.

The Superintendent has also published an Online Filing User Manual to guide plan administrators through the online filing process.

Highlights of Morneau Shepell's Annual Salary Projection Survey for 2021

Morneau Shepell recently released the results of its 38th annual survey on salary projections for 2021 (the Survey). The Survey results reflect input from 889 organizations employing non-unionized employees.

Highlights from the Survey results include the following:

- Base salaries in Canada are expected to increase by an average of 2.5% in 2021 if salary freezes are excluded or 1.9% if salary freezes are included. This represents a slight decrease over the actual average increase in 2020 of 2.6% with salary freezes excluded, and a slight increase over the 1.6% average rate of increase when freezes are included.
- In 2020, 36% of organizations froze salaries, after only 2% originally planned to do so. Thirteen per cent of organizations plan to freeze salaries in 2021. In addition, 46% of organizations remain undecided.
- Employers in British Columbia and Quebec are expecting increases in salaries at the national weighted average of 2.5%, excluding salary freezes. British Columbia and Quebec were also the provinces with the highest actual salary increases in 2020 at 2.6%.
- The highest projected average salary increases in 2021 in Canada, excluding freezes, are expected to be in the Administrative and Support, Waste Management and Remediation Services at 3.0% and in the Professional, Scientific and Technical Services at 2.8%. Lower than average increases are expected in the Educational Services and Health Care and Social Assistance industries at 1.8%.

The Survey also reports on the financial impacts of the COVID-19 pandemic on Canadian employers. 22% of organizations indicated they suffered a severe decline in revenues (i.e., a reduction of over 30%). Another 34% of organization indicated a decline in revenues of 10-30%, and another 20% indicated a decline of less than 10%. The rest reported no impact or growth in revenues.

2020 Survey – Economic assumptions in accounting for pension and other post-retirement benefits

Recently, Morneau Shepell issued its 20th annual survey on the economic assumptions used by Canadian public companies to account for the costs of their defined benefit plans. The data was gathered from audited financial statements as at December 31, 2019.

Here are a few highlights of the survey:

- Discount rates at December 31, 2019 decreased when compared to the prior year. The median discount rate was 3.10% as at December 31, 2019 compared to 3.80% a year earlier. The discount rates used for non-pension benefits are similar to those used for pension benefits.
- More than three quarters of the companies surveyed used a compensation increase assumption between 2.50% and 3.50% (median of 3.00%, which is identical to last year's median).
- Companies surveyed showed a 94% overall ratio of pension assets to defined benefit obligation for accounting purposes.

- The median assumption for the short-term medical cost trend rate was 5.50% (a 0.20 % decrease over the previous year's median), while the median ultimate trend rate was 4.50% (identical to last year).

Consideration should be given to market movements since the end of 2019, particularly given the volatility seen so far this year in terms of bond yields and asset returns due to the COVID-19 pandemic. Therefore, these results should be interpreted and used with caution. As budget discussions begin for 2021, Morneau Shepell consultants would welcome the opportunity to discuss how the volatility in 2020 may affect your employee pension plan.

Morneau Shepell's *Pension Risk Bulletin* looks at benefit security

Morneau Shepell publishes a periodic *Pension Risk Bulletin* to provide updates and views on pension risk transfer and risk management to defined benefit (DB) pension plan sponsors in Canada. Given the significant volatility in financial markets this year, the September 2020 edition of the *Pension Risk Bulletin* titled "The benefit security conundrum" studies de-risking and risk transfer solutions from different angles and considers what can be done to maximize benefit security.

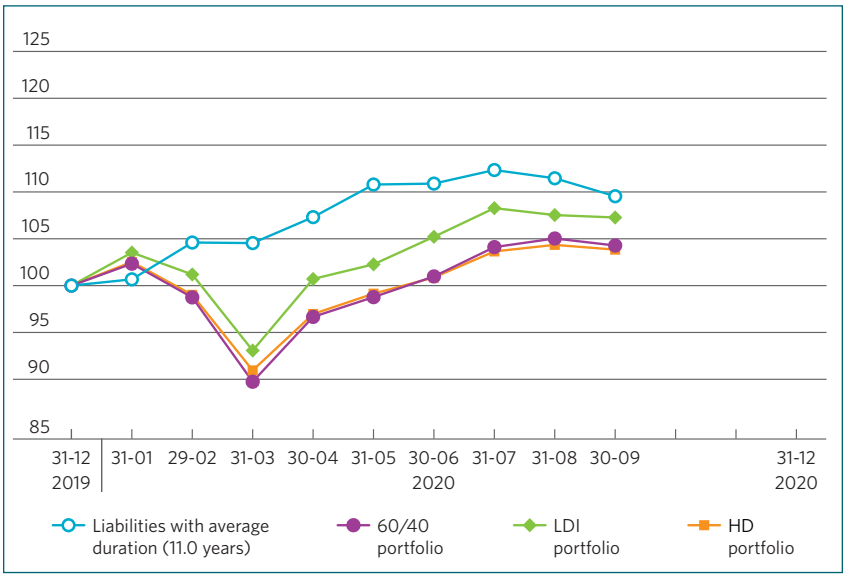
Key highlights

- The "guarantee" that members will receive their full pension comes from the assets held in trust and the sponsor's ability to make special contributions when required. Therefore, a participant's benefit security in a DB pension plan is only as strong as the plan's funded status and the plan sponsor's ability to make up any contribution shortfall.
- Canadian life insurance companies offering group annuities have to hold sufficient reserves to cover all contracted future benefit payments and to put capital aside in case of adverse deviations from their assumptions for calculating those reserves. In other words, insurers are required by the Office of the Superintendent of Financial Institutions (OSFI) to be fully solvent at all times and to maintain a buffer. Additionally, most insurers obtain independent opinions from credit rating agencies and all have ratings of A- or above.
- Every life insurance company in Canada must become a member of Assuris, an independent not-for-profit organization aimed at protecting policyholders if their life insurance company fails. Assuris will work with an insolvent insurer to restructure the impacted books of business and will provide a minimum benefit protection for annuity policyholders that is the greater of 85% of the monthly income or $2,000. The vast majority of policyholders affected by past insolvencies did not suffer any reduction in benefits.
- A group annuity contract can strengthen participants' benefit security, as the insurer's financial strength along with Assuris coverage provide significant protection against risks such as market risk and longevity risk.
- Studying de-risking or risk transfer opportunities from different angles and communicating the decisions effectively to all stakeholders is of paramount importance to ensure everyone understands their impact, especially with regard to the participants' benefit security.
- For plan sponsors and plan fiduciaries considering risk transfer opportunities:
  - Keep the long-term objectives of the plan in mind as you structure the transaction;
  - Define proactively the benefit security outcome you want to achieve; and
  - Broaden your criteria for insurer selection beyond the premium paid.

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



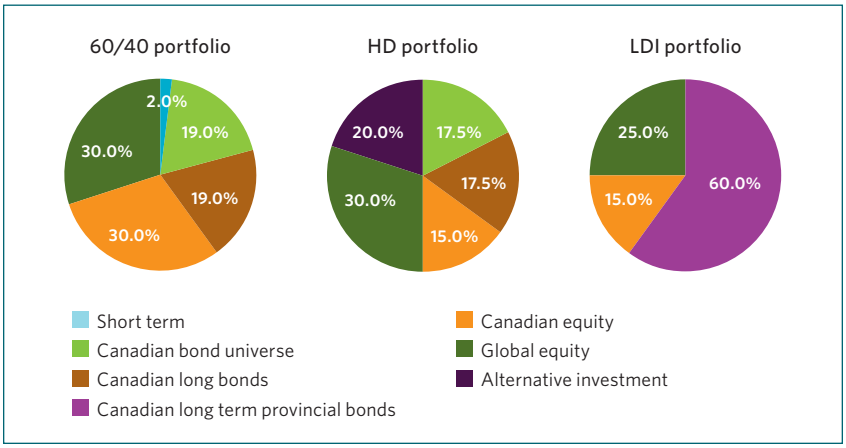
During the month of September, Canadian universe bonds, Canadian long-term bonds and Canadian long-term provincial bonds showed positive returns. However, Canadian equity markets and global equity markets (CAD) as well as alternative investments showed negative returns. With a return of -0.2%, the low volatility portfolio (LDI[1]) portfolio outperformed the highly diversified portfolio (HD) (-0.5%) and the 60/40 portfolio (-0.7%).

The prescribed CIA annuity purchase rates decreased while the commuted value rates used in the calculation of solvency liabilities increased during the month. As a result, the solvency liabilities decreased for a medium duration plan. For this type of plan, an investment in the LDI, in the HD and in the 60/40 portfolio resulted in an increase 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 September 30, 2020 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	95.2%	97.9%	94.8%
90%	85.7%	88.1%	85.3%
80%	76.2%	78.3%	75.8%
70%	66.6%	68.6%	66.4%
60%	57.1%	58.8%	56.9%



Since the beginning of the year, driven by positive returns in the Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds and global equities, the LDI portfolio, the 60/40 portfolio and the HD portfolio returned 7.3%, 4.3% and 3.8% respectively. The solvency liabilities fluctuated over that same period from 9.4% to 9.5% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at September 30, 2020 stands between -5.2% and -1.2%.

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

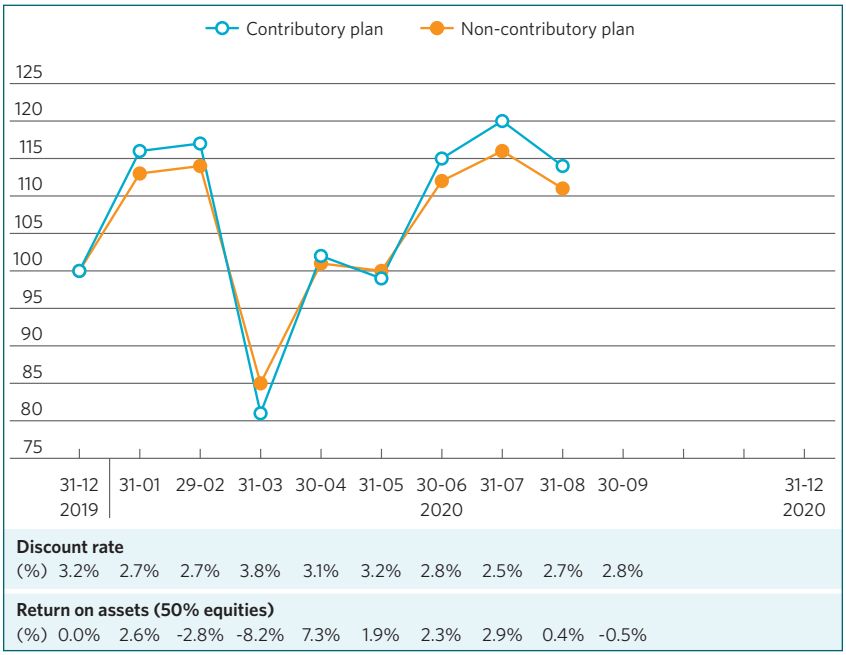
Comments

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 September 30, 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



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	September 2020	Change in 2020
11	3.06%	2.57%	-49 bps
14	3.13%	2.72%	-41 bps
17	3.17%	2.80%	-37 bps
20	3.20%	2.85%	-35 bps

Since the beginning of the year, the pension expense has increased by 12% (for a contributory plan) mainly due to the decrease in the discount rates.

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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