MORNEAU SHEPELL

News & Views

IN THIS ISSUE

1 Ontario Budget Announces Further Pension Reforms

2 Federal Budget 2011—Proposals on Hold

3 Quebec Budget 2011-2012

Update!
> Federally Regulated Plans—Final Version of Regulations and Effective Dates for Several Provisions of Bill C-9
> Small Benefit Unlocking Rule Amended for Federally Regulated Plans
> Ontario Pension Division on Marriage Breakdown

5 FSCO Consultation on Risk-Based Regulation

More Electronic Filing Options for Ontario Pension Plans

6 Pension Plan Financial Statements (Quebec)

7 CAPSA Releases New Guidelines

9 Investment Corner
> Strategies to Reduce Market Risk
> Draft Stress Testing Guideline

10 As at March 31, 2011
> Market Indices
> Tracking the Funded Status of Pension Plans
> Impact on Pension Expense Under International Accounting

Ontario Budget Announces Further Pension Reforms

The Ontario budget of March 29, 2011, confirmed previously announced measures on pension reform and included several new provisions.

The new provisions are as follows:

> Members who terminate employment will be permitted to use their lump-sum pension entitlement to purchase a life annuity, if allowed under the terms of their plan. This change supersedes a provision from Bill 135 (December 2010) which, effective June 30, 2011, would have eliminated the member option to use a lump-sum pension entitlement to purchase a life annuity upon termination of employment. This change has already been introduced as part of Bill 137, the budget implementation bill.

> Plan administrators will be required to file a plan's Statement of Investment Policies and Procedures with the Financial Services Commission of Ontario and disclose whether it addresses environmental, social or governance factors.

> The government promises that pension reform regulations will be posted on the Ontario Regulatory Registry for review by stakeholders, but does not provided an expected publication date.

> The government will explore options to handle the benefits of unlocated former members of plans that are wound up.

> Regulations will be amended to reflect new actuarial standards of practice and the recent adoption of International Financial Reporting Standards by Canada's Accounting Standards Board.

> The government has amended the Ontario regulations to adopt the changes to the federal investment rules implemented in 2010, effective March 25, 2011.

> The government will examine financial hardship unlocking rules and extend the application fee waiver while the economy recovers.

> The government will explore the introduction of single employer target benefit plans and is discussing this possibility with the federal Department of Finance and other stakeholders.

> Increases to PBGF assessments which were announced in August 2010 will come into effect in 2012. ■

Federal Budget 2011—Proposals on Hold

On March 22, 2011, before it fell and an election was called, the Federal Government delivered a budget that contained a few measures intended to affect retirement and savings plans, as described below.

Mandatory Retirement

The Government proposed to introduce amendments to the *Canadian Human Rights Act* and the *Canada Labour Code* to prohibit federally regulated employers from setting a mandatory retirement age unless there is a bona fide occupational requirement.

Government Assistance for Seniors

It was proposed that, effective July 1, 2011, seniors with little or no income other than Old Age Security and the Guaranteed Income Supplement receive additional benefits of up to $600 per annum for single seniors and $840 per annum for couples. Single recipients with an annual income (other than Old Age Security and the Guaranteed Income Supplement) of $2,000 or less, and couples with an annual income of $4,000 or less, would have received the full amount of the benefit. Above these income thresholds, the amount of the top-up would be gradually reduced and would be completely phased out at an income level of $4,400 for singles and $7,360 for couples.

Pooled Registered Pensions and CPP

The federal government announced that it would work with provincial and territorial governments to implement the Pooled Registered Pension Plan as soon as possible. Federal, provincial and territorial governments are continuing work on options for a modest enhancement to the Canada Pension Plan, which would require a consensus among governments.

Financial Literacy

The government announced its intention to appoint a Financial Literacy Leader to promote national efforts for the recommendations of the Task Force on Financial Literacy.

Employee Profit Sharing Plans (EPSPs)

The government announced that it will review the existing rules for EPSPs to determine whether technical improvements are required.

Pension Plan Wind-Ups

The government announced that the Canada Revenue Agency will clarify the application of the rules regarding the tax treatment of lump-sum amounts received by former employees or retirees in lieu of their right to health and dental coverage from employers who have become insolvent. These amounts will not be treated as income in relation to insolvencies arising before 2012.

RRSP/RRIF Anti-Avoidance Rules

New rules were announced to address self-dealing arrangements and schemes to withdraw amounts from RRSPs or RRIFs without paying tax.

Registered Disability Savings Plans (RDSPs)

The government announced that it would increase flexibility to access RDSP assets for beneficiaries with shortened life expectancies.

Individual Pension Plans

The 2011 Budget proposed new tax measures that would apply to “individual pension plans” (IPPs). For this purpose, an IPP would be a defined benefit RPP with three or fewer members, if at least one member is “related” for tax purposes to an employer that participates under the pension plan; or that is a designated plan, if it is reasonable to conclude that the rights of one or more members under the plan exist primarily to avoid this new definition. As is the case for designated plans, the Minister of National Revenue would have the power to waive IPP status in appropriate circumstances.

The budget proposed that, commencing in 2012, annual minimum amounts would be required to be withdrawn each year after the member attains 71 years of age, equal to the greater of the regular annual pension payment and a new minimum amount calculated as if the member’s share of IPP assets were held in a Registered Retirement Income Fund (RRIF). This proposal could result in significant additional amounts required to be withdrawn and taxed in the year of payment for IPPs with large surpluses.

The budget also proposed that contributions made to an IPP that relate to past years of employment would be required to be funded first out of a plan member’s existing Registered Retirement Savings Plan (RRSP) assets or by reducing the individual’s accumulated RRSP contribution room before any new past service contributions may be made. This new requirement attempted to remove one of the advantages of IPPs by reducing the net past service contribution room available. Individuals with larger existing RRSP balances would be unfairly penalized compared to individuals

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with lower balances, given that their net past service contribution room would be lower or even eliminated.

Reduction in the member's accumulated RRSP contribution room before new past service contributions are permitted would apply to IPP past service contributions made after March 22, 2011, except that it would not apply to IPP past service contributions made in respect of past service that was credited to an IPP member before then under the terms of the IPP submitted for registration on or before then.

Conclusion

The winner of the election that forms the government will decide whether the proposals in the budget are reintroduced to become law. ■

Quebec Budget 2011-2012

On March 17, 2011, Quebec Finance Minister Raymond Bachand tabled Quebec's 2011-2012 budget, announcing a number of important measures. Please see our *Special Communiqué* (☝) dated March 21, 2011, for information on those measures related to the Quebec Pension Plan (QPP), Voluntary Retirement Savings Plans (VRSP), and the tax credit for experienced workers. ■

Update!

Federally Regulated Plans—Final Version of Regulations and Effective Dates for Several Provisions of Bill C-9

On March 25, 2011, the federal government published the final version of regulatory amendments to the regulation under the *Pension Benefits Standards Act, 1985* (the "PBSA"). The federal government also set the effective dates for various provisions of Bill C-9, which amended the PBSA and was passed in July 2010.

These measures are part of the federal pension reform announced on October 27, 2009. Please see our *News & Views* of February 10, 2011 (☝) and April 16, 2010 (☝) for more information about the federal regulation and Bill C-9, respectively.

Measures That Came Into Force on April 1, 2011

> Plan sponsors are authorized to use letters of credit in lieu of making solvency payments to the pension fund, up to a limit of 15% of assets.

> Annual statements must be issued to former plan members, retirees and their spouses. Note that no regulation has yet been published that specifies the content of these annual statements, so it is not possible at this point to determine when plan sponsors will be required to send out such annual statements.

> Employers must fully fund pension benefits upon plan termination.

> A workout scheme is provided for distressed pension plans.

> Pension plan amendments are voided if the effect of the amendments would be to lower the plan's solvency ratio to less than 85%, unless the Superintendent consents to the amendment.

Measures That Come Into Force on July 1, 2011

> Immediate vesting of benefits.

> Elimination of the special rules that provided a post-retirement survivor pension to a surviving spouse or common-law partner, instead of the regular pre-retirement death benefit, upon the death of a plan member eligible for early retirement.

With these actions by the federal government, we now know the effective date of most of the provisions of Bill C-9. Provisions of Bill C-9 that are not yet in effect include the option of making life-income fund payments directly from a defined contribution plan. ■

Small Benefit Unlocking Rule Amended for Federally Regulated Plans

Bill C-47, which amends the *Pension Benefits Standards Act, 1985*, received royal assent on December 15, 2010. For a summary of the bill, see our *News & Views* (☝) of November 12, 2010.

Some of the changes introduced by this bill came into force on the date of royal assent, while others will be proclaimed into force by the government at a future date. The changes in effect since December 2010 include an increase in the unlocking limit for small amounts: previously an annual pension could be unlocked when it was lower than 4% of the Year's Maximum Pensionable Earnings ("YMPE"), but now a pension can be unlocked when its total value is lower than 20% of the YMPE. It is important to note that sponsors must amend their plan provisions if they wish to take advantage of this rule, unless the current plan provisions are general enough to automatically take into account the changes introduced by Bill C-47. ■

Ontario Pension Division on Marriage Breakdown

On March 3, 2011, the Ontario Government released, for comments until April 18, detailed draft regulations relating to pension division on marriage breakdown. The regulations are needed to bring into effect the new legislation for pension division under the *Pension Benefits Act*, as described in *News & Views* (☝), Vol. 6, Issue 1, January 13, 2009. That legislation received Royal Assent in May 2009.

Once the regulations are in place, plan sponsors will be required to provide a prescribed statement to divorcing or separating couples who wish to divide the member's pension and who have an agreement or court order dated on or after the effective date of the regulation, regardless of when the marriage breakdown occurred. The new requirements apply whether the pension to be divided is accruing or in pay.

When the legislation was first introduced, the government highlighted its intent to simplify and reduce the costs of Ontario's current complex pension division scheme by means of two major reforms: (1) valuation of the pension assets will be performed by the plan administrator, rather than an independent actuary, and (2) a former spouse can apply for an immediate lump sum transfer from the plan of his or her pension entitlement, and will no longer be required to wait for pension division until the member retires or terminates employment.

The draft regulations provide the details of the valuation methods the plan sponsor must use, and set out numerous procedural requirements including:

- what needs to be in the valuation statement provided by the plan sponsor;
- the maximum fee the plan sponsor may charge for the statement ($500 if DB plan, $200 if DC plan);
- how to apply for valuation and payout of the former spouse's entitlement;
- the content and form of the required applications and statements; and
- the transfer options available to former spouses of active and deferred members.

Plan sponsors will need to wait for the final version of the regulations in order to know the details of their obligations under the new pension division regime. ■

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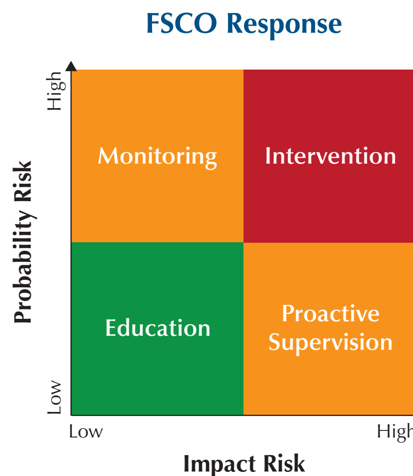
FSCO Consultation on Risk-Based Regulation

On March 8, 2011, the Financial Services Commission of Ontario (FSCO) released a consultation paper on a proposed risk-based regulation framework for pension plans. The stated purpose of the framework is to improve FSCO's overall effectiveness in its monitoring of key pension risks to better protect the interests of pension plan beneficiaries. The risk-based approach would apply to both defined benefit and defined contribution pension plans.

The core of the framework is a Regulatory Response Model (RRM). RRM includes a trigger mechanism based on readily available information and supported by a plan-specific assessment process to identify plans posing the greatest risks. FSCO intends to focus on funding risk, investment risk, administration risk, governance risk and sponsor/industry risk. Under RRM, FSCO would exercise a certain degree of judgment.

RRM categorizes risks by both probability and impact, with a corresponding response from FSCO. Impact refers to both the nature of the risk and size of the plan, while probability refers to the likelihood of the risk materializing. RRM is summarized in the following graph:



The proposed framework would be a significant change to the way FSCO regulates. Instead of the current compliance-based regulatory model, RRM involves a more proactive approach by the regulator. FSCO would consider more risk factors than it currently does, including those related to administration, governance and employer-related risks. Resources may be directed more towards specific plans, industries and employers. The risk-based model could lead to more on-site examinations, information gathering and earlier intervention by FSCO when it judges plans to be high risk. Employers that sponsor larger plans or are operating in economic sectors judged by FSCO to be at risk may face more regulatory oversight. ■

More Electronic Filing Options for Ontario Pension Plans

The Financial Services Commission of Ontario (FSCO) has announced that it is adding three new online forms to its e-filing option, the Pension Services Portal (PSP). The PSP was introduced in March 2010 for Annual Information Returns (AIRs), and an online form for AIRs was launched in September 2010, as reported in *News & Views* (☝) Vol. 7, Issue 8, dated August 9, 2010.

The Form 8 Investment Information Summary (IIS) will be added to the PSP in May 2011. Electronic information packages regarding the new e-filing options will be sent over 2011 to plan administrators and delegated agents who have provided FSCO with their e-mail addresses.

The Pension Benefits Guarantee Fund (PBGF) Assessment Certificate will be added to the PSP in August 2011. Invoice statements for the PBGF will be generated by the PSP and available to the plan administrators and delegated agents for printout and payment.

The Actuarial Information Summary (AIS) will be added to the PSP in November 2011. Actuarial Valuation Funding Reports will be allowed to be filed via the PSP as an attachment to the AIS form.

Plan administrators would have provided their e-mail addresses to FSCO when registering for the PSP. They should make sure that FSCO has a current email address on file, including that of any delegated agent who uses the PSP. ■

Pension Plan Financial Statements (Quebec)

The Régie des rentes du Québec (Régie) recently announced that it would apply more stringent requirements with regards to audited pension plan financial statements. These financial statements must be prepared on an annual basis and sent to the Régie along with the annual information return. Requirements for financial statements are covered by Section 161 of the *Supplemental Pension Plans Act*.

In recent years, the Régie has noted many anomalies in the Generally Accepted Accounting Principles (GAAP) application. The Régie has specifically noted these with respect to the additional disclosures required by Section 3862 of the CICA Handbook. That section requires disclosure on financial instruments with regards to risks and also level of plan assets (level 1 to level 3) that depends on the valuation basis used. These disclosures are in addition to those required by Section 4100 (a section that applies specifically to pension plans).

The Régie affirmed that it requires general purposes statements and, as such, is looking for full GAAP compliance. It indicated that the only departure from GAAP application allowable is the exclusion of the pension obligation amount and related disclosures. However, it has indicated that such departure will require an adverse opinion from the auditor, which is not necessarily the current practice for pension plan financial statements. This departure has been in place for many years and has been used widely. It is likely though that the Régie might end this departure next year and, therefore, may force inclusion of plan obligations for 2011 financial statements. A joint communication with the Ordre des comptables agréés du Québec [Quebec order or chartered accountants] indicates that this departure applies "exceptionally for the fiscal year ended December 31, 2010", which may indicate that the Régie will revise its position next year.

The Régie has provided an example of an adverse opinion that would be presented by the auditor. In such opinion, the auditor determines that the effect of the misstatement on plan obligation is pervasive because it is fundamental to users' understanding of the pension plan's financial statements. The suggested wording is strong, and includes, for example: "the financial statements **do not present fairly** the financial position of ABC Pension Plan … and the changes in its net assets available for benefits for the year then ended in accordance with Canadian generally accepted accounting principles." (sentence abridged and emphasis added).

Note that, starting in 2011, pension plan financial statements will be covered by Section 4600 of the CICA Handbook instead of Section 4100. The main differences include the following:

> Possibility to present plan obligations on the employer accounting basis; that is, the basis used for the company's own financial statements, which is currently not a possibility under Section 4100.

> Requirement to present a statement of net financial situation of the pension plan (excess/deficit) whereas currently it is a statement of net assets with disclosure of plan obligations shown distinctly.

What to expect:

> Since many pension plan financial statements are prepared without including pension obligation, we may expect that many will be simply adjusted to include the adverse opinion illustrated by the Régie.

> In most cases, having an adverse opinion should not cause a problem, although some may feel uncomfortable about the strong wording.

> Some may decide to start including plan obligation, especially if it is expected that requirement for it will follow in a year.

> Finally, some may decide to adopt Section 4600 of the CICA Handbook early and start presenting plan obligation on the basis used by the employer for its own financial statement

Similar requirements for annual information returns and financial statements also apply to other legislations. Specifically, Ontario and federal practices are not changed and financial statements that do not include disclosure of the plan obligations would still meet their requirements. Contrary to the Régie, legislation in these jurisdictions refers to statements for pension **funds** (rather than pension **plans**) and are identified as "not for general purposes". They would therefore not draw a similar adverse opinion. We will continue to follow this issue and advise you of any change in the position of these authorities. ■

CAPSA Releases New Guidelines

On March 1, 2011, the Canadian Association of Pension Supervisory Authorities ("CAPSA") released the final version of CAPSA *Guideline No. 5: Guideline on Fund Holder Agreements* ("Guideline No. 5"). On the same day, CAPSA released drafts of the *Pension Plan Prudent Investment Practices Guideline* (the "Draft Prudent Investment Practices Guideline") and the *Self-Assessment Questionnaire on Prudent Investment Practices* (the "Self-Assessment Questionnaire") as well as the *Pension Plan Funding Policy Guideline* (the "Draft Funding Policy Guideline").

CAPSA Guideline No. 5

CAPSA Guideline No. 5 identifies good governance practices relating to the trustees and insurance companies that hold pension fund assets, as well as to pension plan administrators. Guideline No. 5 focuses on fund holder arrangements in a number of ways. First, it expands on the relevant principles contained in CAPSA Guideline No. 4: Pension Plan Governance Guidelines and Self-Assessment Questionnaire (CAPSA Guideline No. 4), released in 2004. Second, Guideline No. 5 acknowledges that in addition to being held by a trust or an insurance company, fund holder arrangements may, in accordance with applicable pension legislation, be held by pension fund societies and individual trustees. Third, Guideline No. 5 identifies and discusses the roles and responsibilities of key players in fund holder arrangements such as the administrator, fund holder, custodian, employer, plan sponsor, third-party service provider, regulator and the Canada Revenue Agency. Lastly, and for the benefit of many of these key players, Guideline No. 5 describes what specific criteria and issues a regulator considers when examining a pension plan's fund holder arrangements and makes it clear that the overriding focus is on compliance with relevant legislation and sound governance processes.

Guideline No. 5 had been released in draft form on May 4, 2010, for stakeholder review and comments (please see *News & Views* (☞), Volume 7, Issue 6, dated June 10, 2010). Following the consultation period, which ended on September 15, 2010, CAPSA made a number of revisions to the draft before releasing it in its final form.

Draft Prudent Investment Practices Guideline

Pension legislation in all Canadian jurisdictions contains general and specific requirements for investing a pension plan's assets prudently, and in accordance with specific limits and restrictions. The Draft Prudent Investment Practices Guideline is intended to guide plan administrators on how to demonstrate the application of prudence in the investment of pension plan assets. To advance this objective, the draft document addresses what are considered prudent investment practices, the roles of the plan administrator and plan sponsor and communication between plan administrator and plan sponsor, as well as communication with plan beneficiaries. In addition, it describes the various principles that should guide the prudent investment of plan assets including the concept of the prudent person rule, prudent delegation, risk tolerances, asset allocation, investment selection and due diligence, monitoring, and the use of both an investment policy and statement of investment policies and procedures (SIP&P). The draft explains that the investment policy, which may include the SIP&P, guides decision making and sets out how the plan administrator is to comply with investment principles that, amongst other things, identifies the kinds of investments that should be held and the expected return on investment.

The Self-Assessment Questionnaire, which is a compliment to the Draft Prudent Investment Practices Guideline, is designed to help plan administrators review the investment practices of the pension funds they have responsibility over. The questionnaire allows a plan administrator to examine and assess the elements of its current pension fund investment practices in relation to good governance practices that are likely to satisfy a plan administrator's fiduciary responsibility to invest pension fund assets in accordance with legislative requirements that reflect the prudent person rule. The Self-Assessment Questionnaire has broad application, and is intended to address all sizes and types of pension plans.

Draft Funding Policy Guideline

The Draft Funding Policy Guideline is intended to provide guidance on the development and adoption of funding policies. Funding policies are recommended as an integral part of a plan administrator's internal control framework for a plan under Principle 7—Risk Management of CAPSA Guideline No. 4. The purpose of a funding policy is to establish a framework for funding a defined benefit pension plan taking into account factors that are relevant to the plan and the sponsor, such as benefit security, the duration of the pension promises, the plan's investment policy, the minimum funding requirements under applicable pension legislation and

the terms of the plan documents and any related agreement between the plan sponsor and plan beneficiaries. The draft describes the roles of the plan sponsor and plan administrator as well as the advantages of a funding policy. Without duplicating what may already be in an investment policy, a funding policy should contain a number of elements, including plan overview, funding objectives, key risks faced by the plan, funding volatility factors and management of risk, funding target ranges, cost sharing mechanisms, utilization of funding excess, actuarial methods, assumptions and reporting, frequency of valuations, monitoring, communication policy and special considerations for multi-employer pension plans.

Comments on Drafts

These Draft Prudent Investment Practices Guideline, Self-Assessment Questionnaire and Draft Funding Policy Guideline are all follow-ups to the CAPSA consultation paper titled *Prudence Standard and the Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment*, which was released on November 20, 2009 (please see Volume 6, Issue 11 *News & Views* (☝) issued on December 11, 2009).

CAPSA is accepting comments on these documents until June 1, 2011.

Importance of CAPSA Guidelines

CAPSA guidelines do not have the force of law. However, through these guidelines, CAPSA has been instrumental in shedding light on what pension regulators in Canada consider to be "best practices". Furthermore, as more and more companies adopt the principles enunciated in these guidelines, they will inevitably become minimum standards.

Consequently, plan administrators should not only give serious consideration to complying with the requirements under Guideline No. 5, but, when finalized, the requirements under the Draft Prudent Investment Practices Guideline, Self-Assessment Questionnaire and Draft Funding Policy Guideline as well. ■

Investment Corner

Strategies to Reduce Market Risk

Retirement plan administrators are constantly looking for strategies for achieving attractive returns while controlling portfolio volatility. Adding alternative investments such as private real estate, investments in infrastructure or hedge funds has been shown to improve portfolio diversification and thereby reduce volatility. These alternative strategies typically have low correlations with equity markets, which reduce losses during market downturns.

Investors lacking the skill or resources to participate in alternatives may wish to consider new products being offered by fund mangers. New equity funds with lower volatility than equity indices are now offered to investors who want more control over their exposure to market risks. The managers of these funds say they can obtain long-term returns similar to equity indices, but with much lower volatility or risk.

The underlying hypothesis behind these low volatility equity funds is that high volatility does not necessarily translate into higher returns. In fact, some studies show that it is the securities with low volatility that obtain the best long-term performance. Of course, some periods are more conducive to risky or speculative securities. During these periods, equity funds with low volatility should be expected to offer lower returns than the benchmark indices.

In constructing the low volatility portfolio the manager will underweight securities or sectors that are more volatile to substantially reduce return instability. These funds will therefore have weightings by security and sector that differ greatly from those of the benchmark index. A quantitative approach is generally used to create and maintain these funds. A number of security and portfolio factors are examined to identify the combination of securities that will produce the desired level of volatility and to signal when rebalancing is necessary to maintain the desired level of volatility. ■

Draft Stress Testing Guideline

The federal Office of the Superintendent of Financial Institutions (OSFI) has just issued a guideline on pension plan stress testing. The document is called *Draft Stress Testing Guideline for Plans with Defined Benefit Provisions*.

The guideline is for plan administrators and addresses the use of stress testing as a way to identify and manage pension plan risk. Stress testing is not, however, required by the *Pension Benefits Standards Act, 1985* and the administrator is not required to inform the OSFI of stress test results.

Stress testing makes the administrator aware of possible adverse events that could have a negative impact on the plan, and can lead to decisions to minimize or avoid unfavourable outcomes.

The guideline identifies methods and techniques that can be used, namely sensitivity testing, scenario testing and reverse stress testing. The OSFI document also describes the risks to which pension plans are exposed, the benefits of stress testing and the risk factors that stress testing can identify.

Note that under new actuarial standards, actuarial valuations must now also include sensitivity testing; however, plans that wish to comply fully with the guideline may be required to perform other tests or scenarios as well. Ordinarily, the stochastic projections of assets and liabilities conducted periodically by some pension plans should meet the guidelines, especially if they include a few specific stress scenarios.

Lastly, the OSFI notes that "external market conditions, the economy, resources available to the plan and the risks faced by each pension plan will assist in determining the scope and frequency of stress testing conducted for a plan."

This guideline is aligned with the risk-based monitoring process that OSFI has put in place in the recent years. ■

As at March 31, 2011

Market Indices

The following table shows the Morneau Shepell monthly summary of returns from various market indices. It also includes returns from benchmark portfolios used by pension funds. ■

	Returns			
	Monthly	Quarter to date	Year to date	1 Year
TSX Group/PC-Bond				
DEX Universe Bond Index	-0.1%	-0.3%	-0.3%	5.1%
DEX 91 Day Treasury Bill Index	0.1%	0.3%	0.3%	0.8%
DEX Short Term Bond Index	0.2%	0.3%	0.3%	3.4%
DEX Mid Term Bond Index	-0.2%	-0.2%	-0.2%	5.8%
DEX Long Term Bond Index	-0.4%	-1.4%	-1.4%	8.2%
DEX High Yield Bond Index	0.6%	3.0%	3.0%	13.2%
DEX Real Return Bond Index	1.7%	0.5%	0.5%	10.6%
Canadian Equity Indices				
S&P/TSX Composite Index (total return)	0.1%	5.6%	5.6%	20.4%
S&P/TSX Composite Index Capped	0.1%	5.6%	5.6%	20.4%
S&P/TSX 60 (total return)	-0.3%	5.8%	5.8%	17.5%
S&P/TSX Completion	1.2%	4.9%	4.9%	29.9%
S&P/TSX Small Cap	1.2%	4.2%	4.2%	34.3%
BMO Small Cap Unweighted	-0.3%	3.7%	3.7%	33.6%
BMO Small Cap Weighted	-0.2%	3.7%	3.7%	33.7%
U.S. Equity Indices				
S&P 500 (US$)	0.0%	5.9%	5.9%	15.6%
S&P 500 (C$)	-0.1%	3.3%	3.3%	10.4%
Foreign Equity Indices[1]				
MSCI EAFE (C$)	-2.4%	1.2%	1.2%	5.9%
MSCI World (C$)	-1.2%	2.6%	2.6%	8.8%
MSCI Europe (C$)	-1.0%	4.2%	4.2%	8.0%
MSCI Pacific (C$)	-5.1%	-4.1%	-4.1%	2.5%
MSCI Emerging (C$)	5.7%	-0.1%	-0.1%	13.8%
Other				
Consumer Price Index (Canada, February 2011)	0.3%	0.5%	0.5%	2.2%
Exchange Rate US$/C$	-0.2%	-2.5%	-2.5%	-4.5%
Morneau Shepell Benchmark Portfolios[2]				
60% Equity/40% Bonds	-0.3%	2.4%	2.4%	10.7%
55% Equity/45% Bonds	-0.3%	2.2%	2.2%	10.6%
50% Equity/50% Bonds	-0.2%	2.1%	2.1%	10.4%
45% Equity/55% Bonds	-0.2%	1.9%	1.9%	10.2%

1. Returns net of taxes on dividends, except for MSCI Emerging.
2. The returns are compounded monthly.

About Morneau Shepell Asset Management Consulting Practice

This practice provides objective advice on all aspects of asset management for pension funds, including investment policy statements, portfolio manager searches, investment performance measurement and investment strategy. If you have any questions, please contact your Morneau Shepell consultant, or e-mail us at info@morneausobeco.com.

Jean Bergeron, Partner
Tel.: 514.392.7852
Fax: 514.875.2673
E-mail: jbergeron@morneausobeco.com

Robert F. Boston, Partner
Tel.: 416.380.2765
Fax: 416.445.1858
E-mail: rboston@morneausobeco.com

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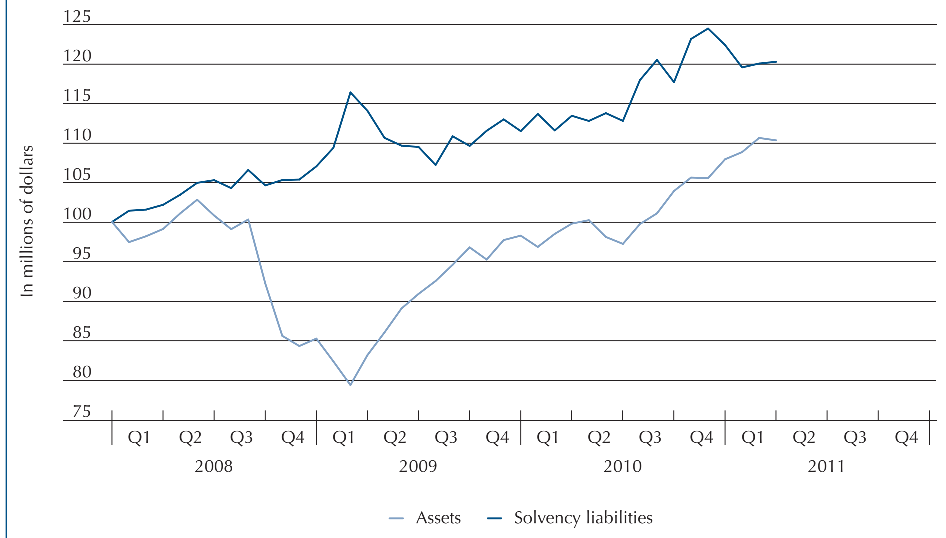
As at March 31, 2011

Tracking the Funded Status of Pension Plans

This graph shows the changes in the financial position of a typical defined benefit plan since December 31, 2007. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2007. The graph shows the impact of past returns on plan assets and the effect of interest rate changes on solvency liabilities.

Pension plans have experienced significant swings in their financial position since December 31, 2007. At its lowest point, in February 2009, this typical pension plan showed a deficit on a solvency basis of $37 million. The situation has since significantly improved. This improvement is mainly due to equity markets rallying since the beginning of 2009. Assets went from a trough of about $80 million up to about $110 million at the end of March 2011. Liabilities have also climbed over this period, but at a much slower rate, rising from $116 million to $120 million.



There was very little movement on either the asset or liability side of the surplus equation in March. Unfortunately, the movement was all in the wrong direction. For the first time in four months, the deficit of this plan has increased. Despite this small setback, the deficit still remains below $10 million.

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

Canada Bond Yields

	Yields (at closing)		Change in 2011
	Dec. 2010	March 2011	
Overnight rate target	1.00%	1.00%	0 bps
3 months	0.97%	0.93%	-4 bps
2 years	1.67%	1.82%	15 bps
5 years	2.41%	2.77%	36 bps
7 years	2.70%	2.94%	24 bps
10 years	3.11%	3.35%	24 bps
30 years	3.52%	3.75%	23 bps

Source: Bank of Canada

Comments:

1. No consideration has been made for contributions paid into the plan or for benefits paid out of the plan.
2. Solvency liabilities are projected using the rates prescribed by the Canadian Institute of Actuaries for the purpose of determining pension commuted values. Early application of the 2009 standards is not reflected.
3. The underlying typical defined benefit plan is a final average plan with no pension indexing.
4. Solvency liability calculations take into account revised CIA guidance on the solvency valuation assumptions (annuity proxy) announced on February 16, 2011.
5. Assets are shown at full market value. Returns on assets are based on those of the Morneau Shepell benchmark portfolio (55% equities and 45% fixed income).

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Impact on Pension Expense Under International Accounting

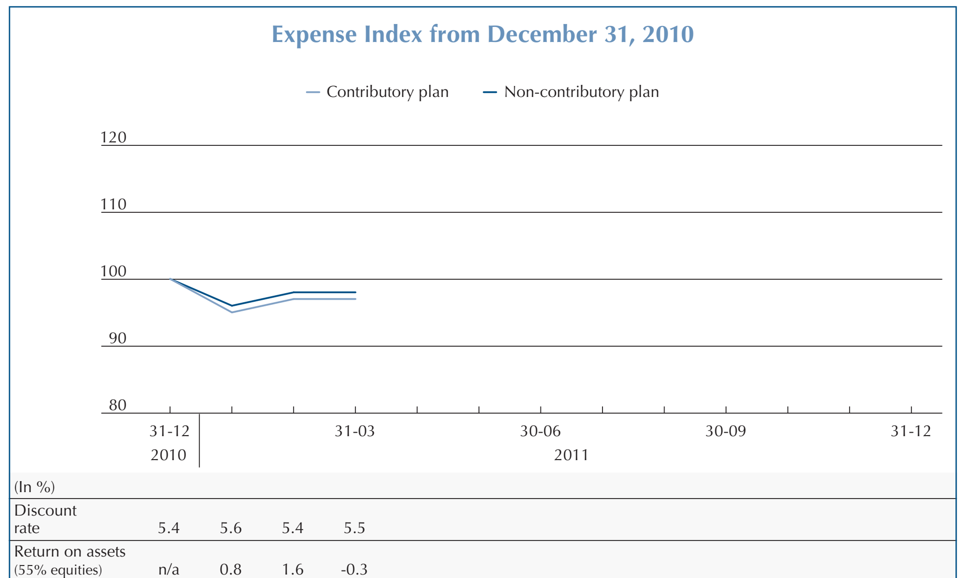
Every year, companies must establish an expense for their defined benefit pension plans.

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 bonds and the median return of pension fund assets.

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 2010	March 2011	Change in 2011
11	5.13%	5.23%	10 bps
14	5.49%	5.60%	11 bps
17	5.70%	5.84%	14 bps
20	5.84%	5.99%	15 bps



(In %)				
Discount rate	5.4	5.6	5.4	5.5
Return on assets (55% equities)	n/a	0.8	1.6	-0.3

The pension expense has slightly decreased since the beginning of the year largely due to an increase in the discount rate.

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

Comments:

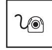
1. The expense is established as at December 31, 2010, based on the average financial position of the pension plans used in our *2009 Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits* report (i.e. a ratio of assets to obligation value of 91% as at December 31, 2008).

   Also, we are assuming that, under the international accounting, the employer elected the exemption at transition with regards to past gains and losses, and that future gains and losses are recognized in other comprehensive income (excluded from expenses shown).

2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (55% equities and 45% fixed income).
3. The actuarial obligation is that of a final average earnings plan, without indexing (two scenarios: with and without employee contributions).

About Us

Morneau Shepell Inc. is Canada's largest human resource consulting and outsourcing firm focused on pensions, benefits, employee assistance program (EAP) and workplace health management and productivity solutions. We offer business solutions that help our clients reduce costs, increase employee productivity and improve their competitive positions by supporting their employees' financial security, health and well-being.



CALGARY	FREDERICTON	HALIFAX	KITCHENER
403.246.5228	506.458.9081	902.429.8013	519.568.6935
LONDON	**MONTRÉAL**	**OTTAWA**	**PITTSBURGH**
519.438.0193	514.878.9090	613.238.4272	412.919.4800
QUÉBEC	**ST. JOHN'S**	**TORONTO**	**VANCOUVER**
418.529.4536	709.753.4500	416.445.2700	604.642.5200

INFO@MORNEAUSOBECO.COM

WWW.MORNEAUSHEPELL.COM

More Information

Please contact your Morneau Shepell consultant for additional information about this newsletter.

Contributing Editors

Jean Bergeron, FCIA, FSA, CFA
  Asset Management Consulting
Robert F. Boston
  Asset Management Consulting
Lois Gottlieb, J.D., Ph.D.
  Pension Legislation
Greg Heise, FCIA, FSA, FCA
  Retirement Consulting
Tejash Modi, LL.B.
  Pension Legislation
Martin Raymond, FCIA, FSA, MBA
  Retirement Consulting
Larry Swartz, LL.B., CFA
  Pension Legislation
Julie Vandal-Lemoyne, LL.B.
  Pension Legislation
Andrew Zur, LL.B.
  Pension Legislation