Knowledge & Insights

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In this issue

Additional Canada Pension Plan enhancements adopted

On June 21, 2018, Bill C-74 received royal assent. Among other things, this bill provides for the enhancements to the Canada Pension Plan (CPP) agreed upon by the Finance Ministers in December 2017. These enhancements are in addition to the agreement made in 2016 to expand the CPP by increasing the contribution and income replacement rates. Effective January 1, 2019, these additional features will provide enhanced death and disability benefits in specific cases, as well as further protection of the value of benefits for caregivers of young children.

Improved death benefits

Under the current CPP provisions, there is a 10% reduction for each year a survivor is under the age of 45 unless disabled or raising dependent children at the time of the contributor's death. Effective January 1, 2019, reductions applied to a survivor's pension for survivors under the age of 45 will be removed.

Under the current provisions, the death benefit payable to a deceased CPP contributor's estate is equal to six months of their CPP benefit payable at age 65, to a maximum of $2,500. Effective January 1, 2019, the CPP will provide a flat guaranteed payment of $2,500 to the contributor's estate regardless of the contributor's monthly CPP amount.

Expanded disability provisions

Under the current provisions, if a CPP recipient is deemed disabled after commencing their pension prior to age 65, the CPP recipient is not eligible for a CPP disability pension. As part of the adopted changes, a CPP recipient who meets the requirements for a CPP disability will receive an additional payment while continuing to receive their regular CPP benefit, adjusted for early commencement.

Earnings drop-in for parents of young children and for disabled CPP contributors

The additional CPP benefits to take effect in 2019 will be improved with the introduction of "drop-in" income during periods of low or no earnings for parents of children under the age of seven. For the purpose of calculating the additional CPP benefits, an amount equal to the average earnings during the five years prior to the birth or adoption of the child will be "dropped-in" if they are higher than the parent's actual earnings for the years until the child turns seven. The traditional "drop-out" model will continue to apply to base CPP benefits.

A similar mechanism will be applied to CPP contributors who have low or no earnings during periods of disability. A "drop-in" amount equal to 70% of the average earnings in the six years prior to the onset of the disability will be used to calculate the additional CPP benefits during disability periods.

Impact of the additional CPP enhancements

A supplemental actuarial report for the CPP has been released in light of these additional enhancements. The purpose is to show the effect that these changes will have on the CPP's long-term financial state.

The additional contributions required as a result of the new CPP tiers, effective January 1, 2019, will be held and valued in a separate account called the Additional Canada Pension Plan Account. Accordingly, the report values the impact on the base, or traditional, CPP and the enhanced, or additional, CPP separately.

The report estimates that these additional enhancements will increase total base CPP expenditures by $230 million and total additional CPP expenditures by $679 million by 2050. For perspective, these amounts represent only 0.1% and 2.4% of total base and additional CPP expenditures, respectively. The report also confirms that the contribution levels legislated in 2016 (including increases phased in from 2019-2024) are sufficient to cover these improvements in the long term.

Comment

Although these new amendments can have a sizeable impact on the ultimate CPP benefit of many contributors, it is the first phase of CPP expansion amendments that will have the biggest impact on all employees and employers. To recap, from 2019 to 2023, an increase of 1% (from 4.95% to 5.95%) in employer and employee contributions on earnings up to the YMPE will be phased in, while new contributions of 4% on earnings above the YMPE up to the Year's Additional Maximum Pensionable Earnings (YAMPE) are to commence in 2024. Refer to our June 2016 *Special Communiqué* and our November 2016 *News & Views* for more details.

An increase from 25% to 33.33% in the replacement rate for pensionable earnings will be phased in from 2019 to 2024. This enhancement will only apply to years after the implementation of the increased contributions; it is not retroactive. Specifically, starting January 1, 2019, the basic monthly pension will increase incrementally, according to a pre-determined schedule, from 25% to 33.3% of the contributor's average monthly pensionable earnings.

As the 2019 implementation date for the CPP expansion approaches, plan sponsors should review their plan designs to ensure that retirement programs still meet their organization's objectives. For example, the sponsor of an integrated plan intended to provide a specific replacement ratio may want to adjust the contribution formula to reflect the improved CPP retirement benefit. Another important consideration is whether the plan sponsor is willing to absorb the increased cost of CPP contributions or would rather remain cost neutral by reducing the retirement program to offset the additional expense.

Regardless of whether or not plan sponsors decide to alter retirement programs in light of the CPP expansion, consideration should be given to communicating the CPP changes to employees, especially as these changes will reduce take-home pay. Providing employees with advance notice could be better than fielding questions in January 2019, when the increased CPP contributions are reflected in take-home pay reductions.

OHIP+ changes announced by new Ontario government

On June 30, 2018, the new Ontario government announced their intention to amend the OHIP+ youth pharmacare initiative which was introduced earlier this year by the previous Liberal government. The goal is to make OHIP+ the second payer for Ontarians under age 25 who have drug coverage through private drug benefit plans. Ontarians under age 25 who are not covered by a private drug benefit plan will continue to have access to the approximately 4,400 drugs included in the Ontario Drug Benefit Formulary.

The announcement did not provide details on how the government will implement this change. Following the introduction of OHIP+ earlier this year, the OHIP+ program became the first payer for all Ontarians under age 25, although private insurers had given the government a grace period in which they continued primary coverage for some medications until July 1, 2018. The government has asked for an extension of this grace period in order to implement the recently announced changes.

The Ministry of Health and Long-Term Care has subsequently advised that OHIP+ will continue in its current form while they work with private insurers and other stakeholders to effect the proposed changes.

Comment

The impact of the change will vary from plan to plan but employers and plan sponsors should anticipate that any cost savings they may have realized or expected to realize under the original OHIP+ program will likely be negated. The timeframe for the announced changes is not yet known.

Funding policy implementation for defined benefit pension plans registered in Quebec

Defined benefit (DB) pension plans registered in Quebec are required to adopt a funding policy by January 4, 2019. This requirement is imposed pursuant to the *Regulation to amend the Regulation respecting supplemental pension plans* (the "Regulation"), which came into force on January 4, 2018. The Regulation was adopted in relation to Bill 29, which passed in 2015, and sets out, among other things, the content required for a DB funding policy.

Plan sponsor to adopt funding policy

The requirement for a funding policy applies to DB plans in both the private and public sectors. The funding policy must be established by the person or body who may amend the plan; for most DB plans in Quebec, this means the plan sponsor (i.e., the employer). For some plans, an agreement between the sponsor and one or more unions is needed in order to amend the plan. In such circumstances, union cooperation is necessary to implement this new policy.

It should be noted that the plan administrator, which is in most cases the pension committee, is **not** responsible for adopting the funding policy. The funding policy must be promptly forwarded to the pension committee.

For private sector plans, since the coming into force of Bill 29 on January 1, 2016, pension committee bylaws must now cover the measures to be used for quantifying risk. If addressed in the funding policy, the information in the two documents should be consistent.

Those who participate in the implementation of a funding policy should ensure that the policy is consistent with other policies and documents already in place, such as the statement of investment policies and procedures, annuity purchase policy, plan text, internal by-laws of the pension committee and any other plan documents.

With respect to municipal, para-municipal and university plans, given that there are two separate components and each one has different characteristics, the objectives and risks should also be identified separately for each component.

Items the funding policy must contain

The funding policy must:

1. Indicate that its purpose is to establish the principles related to plan funding that must guide the pension committee in the performance of its duties;
2. Describe the main characteristics of the employer and the industry sector in which the employer operates, as well as the plan type, the main provisions and the demographic characteristics that could influence plan funding;
3. Describe the funding objectives of the pension plan with regard to variations in and the level of contribution and benefits;
4. Identify the main risks related to funding of the pension plan and the employer's and active members' level of tolerance for such risks.

The description of objectives and identification of risks may be qualitative or quantitative (using deterministic and/or stochastic analyses).

Optional items in the funding policy

The funding policy may be made more complete by incorporating other items related to funding objectives and the management of funding-related risks. Under the Regulation, these include asset and liability smoothing methods, use of implicit margins for adverse deviation, frequency of actuarial valuations, and measures that may be used to quantify funding risks.

Comparison with other provinces

By imposing the requirement to establish funding policies, Quebec joins Alberta and British Columbia, which require funding policies under their new pension legislation, which came into force in 2014 and 2015, respectively. The requirements in those provinces are similar to Quebec, but with some additional required items that are similar to the optional items in Quebec.

Ontario's previous government included the requirement for funding policies in 2017 amendments to the *Pension Benefits Act* (Ontario), but those provisions have not been proclaimed into force and regulations specifying the details of Ontario funding policies have not been released. The intentions of the new Ontario government in relation to funding policies are not clear.

Comment

Drafting and developing a funding policy is a process that takes time and careful consideration. It can also require consultation with a number of stakeholders, depending on the circumstances.

Given the January 4, 2019, deadline, it is important for all Quebec DB pension plan sponsors to commence work on the plan's funding policy, if they have not already done so. A Morneau Shepell consultant will be pleased to assist you in setting up the funding policy for your Quebec DB pension plan by January 4, 2019, to make sure it meets both your objectives and legislative requirements.

Consultations respecting un-locatable members and unclaimed balances in federal plans

Plan administrators across Canada have had problems dealing with un-locatable or missing pension plan members, and dealing with unclaimed pension amounts. Canadian pension regulators have released a draft guideline on searching for missing pension plan members and beneficiaries. At the same time, the federal Department of Finance has released a proposal for dealing with unclaimed pension balances in federally regulated pension plans that are being terminated.

Draft CAPSA guideline on missing pension plan members

On June 21, 2018, the Canadian Association of Pension Supervisory Authorities (CAPSA) released draft Guideline No. 9 – Searching for Un-locatable Members of a Pension Plan (the Draft Guideline) for public comment. According to CAPSA, the Draft Guideline was created as a result of regulators receiving large numbers of inquiries from pension plan members looking for their pensions, as well as, pension plan administrators and third party consultants who could not locate members entitled to pension benefits.

The Draft Guideline provides CAPSA's recommended best practices and options for plan administrators searching for un-locatable pension plan members. The recommended options include tools that are free and tools that involve costs. The Draft Guideline suggests that administrators should periodically review and modify their search process as new approaches become available, and suggests a fulsome policy that deals with all components of a search process, including frequency.

The Draft Guideline also includes options after an unsuccessful search. It notes that the Canada Revenue Agency (CRA) provides a letter forwarding service at a cost to locate individuals, but only when all other efforts to locate an individual have been

exhausted, including those through the private sector. The CRA must review and approve any letter forwarded to an individual.

The Draft Guideline also suggest that, where feasible, pension plan administrators could develop a database or registry of missing members on the sponsoring employers or administrator's website. It is noted that privacy and security issues would have to be considered.

CAPSA is seeking written comments and feedback on the Draft Guideline by August 2, 2018.

Federal proposals on unclaimed pension balances

On June 22, 2018, the Department of Finance launched consultations on a regime that would address unclaimed balances from federal pension plans.

Bank of Canada to hold unclaimed pension assets

The federal *Pension Benefits Standards Act*, 1985 (PBSA) already permits the Minister of Finance to designate an entity to hold unclaimed pension balances. It is proposed that the designated entity would be the Bank of Canada, and that the Bank would act as the custodian and administrator of unclaimed pension balances. This would capitalize on the Bank's existing infrastructure and experience, by listing unclaimed balances in the Bank's public online registry of unclaimed balances.

Application to terminate pension plans only

It is proposed that the *Pension Benefits Standards Regulations* (PBSR) be amended to make the federal unclaimed pension balances framework available to terminated federally regulated pension plans only. Future consideration could be given to expanding the program to ongoing federally regulated pension plans.

Method of applying for a transfer to the Bank of Canada

It is proposed that the PBSA be amended to provide that, after a pension plan administrator has undertaken what it considers to be sufficient time and effort searching for un-locatable beneficiaries, it would apply to the Superintendent of Financial Institutions for permission to transfer the assets related to the pension benefit credits of un-locatable beneficiaries to the designated entity. The Office of the Superintendent of Financial Institutions (OSFI) would review the application and either ask the plan administrator for further efforts and/or information, or would agree to the transfer.

Only the assets related to a pension benefit credit, not the credit itself, would be transferred to the Bank of Canada, who would then be responsible for disbursing those assets in a lump sum. In a defined benefit pension plan, this would be the commuted value at the wind up date plus interest. The amount would also include any portion of surplus for which the un-locatable beneficiaries are eligible, and that the entity would be responsible for disbursing that surplus.

Claiming funds from the Bank of Canada

It is proposed that the PBSA be amended to allow the pension plan member, or the spouse, the beneficiary or the estate in the case of a deceased member, to be eligible to claim the balance until the expiry of the prescription period. Funds would be disbursed as an unlocked lump sum to the claimant. The prescription period would be 100 years for pension balances (including surplus) of $1000 or more, and 30 years for balances less than $1000. Consideration is also being given for a third "small balances" threshold with a shorter prescription period.

Interests and fees

It is proposed that no interest would be credited on unclaimed pension balances, nor would any administration fees be charged when individuals submit a claim or receive a verified claim.

Taxation issues

It is proposed that payments of unclaimed pension balances to a designated entity be made on a pre-paid tax basis. Tax would be withheld and remitted to the CRA by the administrator of the registered pension plan at the time the administrator transfers an unclaimed pension balance to the designated entity.

The Bank of Canada would not report a lump sum payment to the CRA and the amount would not be included in the claimant's taxable income. The unclaimed pension balance would no longer be "registered" tax-deferred funds after being paid to the designated entity and could not be transferred to a tax-deferred account such as a registered retirement savings plan.

Consultation period

Written comments respecting the consultation paper may be submitted by August 21, 2018. Following the consultation, the government may introduce legislative and regulatory amendments to implement the proposal.

Comment

The Draft Guideline includes helpful information for plan administrators in search for un-locatable members and beneficiaries, although it does not create any new options. The CRA letter forwarding service is a little known service that is worth considering when all other approaches have failed.

The federal proposal providing for transfers to the Bank of Canada is of limited scope in itself, being applicable to federally regulated pension plans that are being terminated. However, it may be extended to ongoing federally regulated pension plans in the future. Furthermore, the potential changes to income tax legislation could be of assistance in administering provincially administered funds for unclaimed pension balances.

Currently, Alberta, British Columbia and Quebec have provincially administered funds for unclaimed pension balances. The Alberta and Quebec frameworks apply to ongoing and terminated pension plans, while British Columbia's framework only applies to terminated pension plans.

BC court finds that multi-employer pension plan entitled to keep information confidential

A British Columbia court has overturned the decision of a provincial privacy commissioner that the Superintendent of Pensions is required to turn over information related to union-sponsored multi-employer pension plans to a business association. The case gives some comfort to pension plan sponsors that it is less likely that the information filed with pension regulators can be turned over to third parties.

Background

Pension plan administrators are required to provide a great deal of information to regulators as part of the administration of a pension plan. Although plan members and others with a direct interest in a pension plan have a right to view most of these documents, third parties sometimes attempt to use access to information legislation to obtain information filed with regulators. One of the reasons for such requests is to gain a competitive advantage over the party who must disclose the information.

In *United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry of the US and Canada, Local 170 v. British Columbia*, the dispute centred around a request made by the Independent Contractors and Business Association (ICBA) for information about 16 union-sponsored pension plans. The ICBA and the unions were said to be in an "adversarial" relationship.

The ICBA requested information from the British Columbia Superintendent of Pensions (the Superintendent) related to the plans, including average pension, average accrued monthly pension and the amount of surplus or deficit.

The initial decision

In 2017, the Office of the Information and Privacy Commissioner (OIPC) ordered that all the information requested by ICBA be released by the Superintendent.

The OIPC accepted that the release of the information would provide the ICBA with ammunition to criticize the union pension plans and could influence workers to leave the pension plans. If workers left the plans, the OIPC acknowledged that the unions would face financial harm. Despite those findings, however, the OIPC held that the probability was very low that the "average rational worker" would be swayed by the criticism levelled by the ICBA. The OIPC indicated that it should have been provided with evidence of workers leaving unions as a result of such criticism.

The court ruling

The Supreme Court of British Columbia has now reversed the OIPC's decision on the basis that OPIC had adopted a "balance of probability" standard, requiring the unions to prove, on a balance of probabilities, that harm was likely to occur. Instead, based on previous precedents the Court held that the unions were simply required to show that the risk of harm is "considerably above a mere possibility". It did not matter that the objecting party could not show that the potential harm had happened before.

Comment

The British Columbia court's decision provides pension plan sponsors with good support to resist requests for information from pension regulators by rivals and competitors. As long as there is more than a fanciful possibility of harm, it appears that disclosure may successfully be resisted so that the information is not released to third parties.

2018 survey – economic assumptions for accounting

Recently, Morneau Shepell issued its 18th 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, 2017.

Here are a few highlights of the survey:

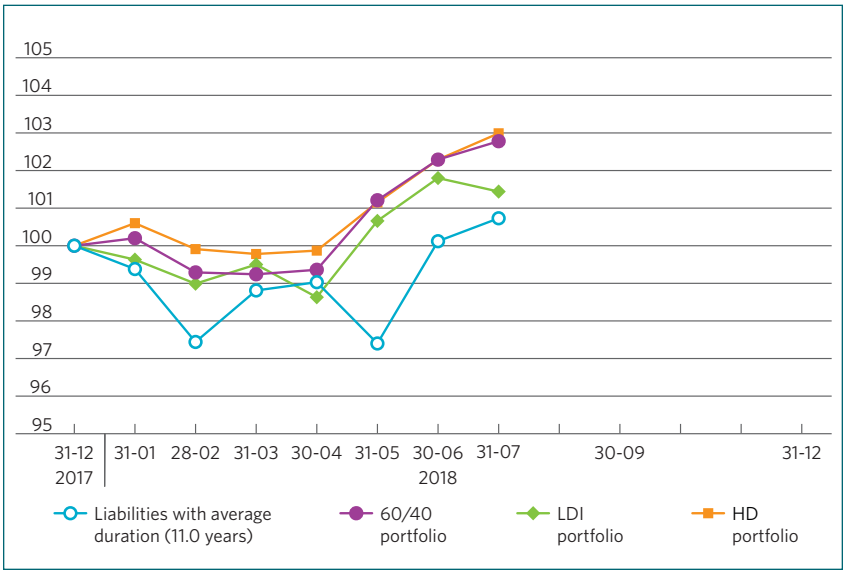
- Discount rates at December 31, 2017 have decreased when compared to the prior year. The median discount rate was 3.50% as at December 31, 2017 compared to 3.80% a year earlier. The discount rates used for non-pension benefits are similar to those used for pension benefits.
- More than three quarters 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 95% overall ratio of pension assets to defined benefit obligation for accounting purposes.
- The median assumption for the short-term medical cost trend rate was 5.90% (a 0.30 % decrease over the previous year's median), while the median ultimate trend rate was 4.50% (identical to last year).

For complete details of the survey, please refer to the document available on the Morneau Shepell website.

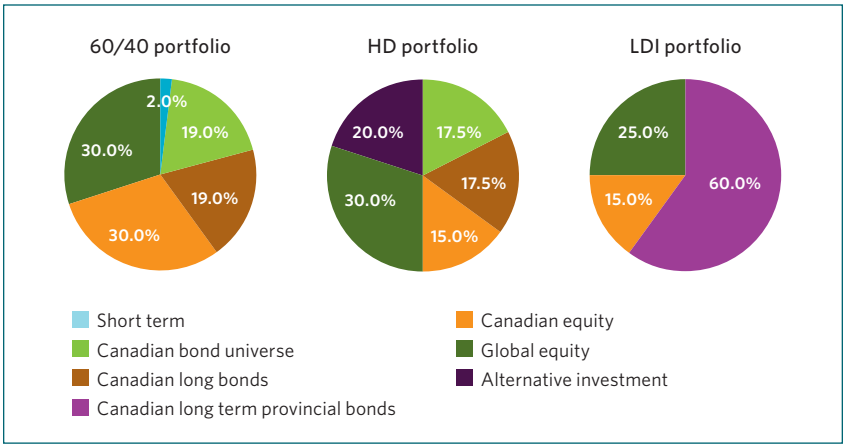
Tracking the funded status of pension plans as at July 31, 2018

This graph shows the changes in the financial position of a typical defined benefit plan with an average duration since December 31, 2017. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2017. The estimate of the solvency liabilities reflects the new CIA guidance for valuations effective June 30, 2018 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, 2017



During the month of July, Canadian equity markets, global equity markets (CAD) as well as alternative investments showed positives returns while Canadian universe bonds, Canadian long-term bonds as well as Canadian long-term provincial bonds showed negatives returns. With a return of 0.7%, the highly diversified portfolio (HD) outperformed the 60/40 portfolio (0.5%) and the low volatility portfolio (LDI[1]) (-0.4%).



[1] Liability driven investment

The relative outperformance of the HD portfolio is mainly due to excellent returns in alternative investments. The prescribed CIA Annuity purchase rates increased while the commuted value rates used in the calculation of solvency liabilities decreased during the month. As a result, the solvency liabilities increased by 0.6% for a medium duration plan. For this type of plan, an investment in the 60/40 portfolio or the LDI portfolio resulted in a decrease of the solvency ratio while an investment in the HD portfolio resulted in a slight increase in solvency ratio.

The tables 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, 2017 as well as the asset allocation of the three typical portfolios.

Initial solvency ratio as at December 31, 2017	Evolution of the solvency ratio as at July 31, 2018 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	102.0%	100.7%	102.2%
90%	91.8%	90.6%	92.0%
80%	81.6%	80.6%	81.8%
70%	71.4%	70.5%	71.6%
60%	61.2%	60.4%	61.3%

Since the beginning of the year, driven by positives returns in Canadian equity markets, global equity markets (CAD) as well as alternative investments, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 2.8%, 1.4% and 3.0% respectively. The solvency liabilities fluctuated over that same period from 0.7% to 1.0% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at July 31, 2018 stands between 0.4% and 2.2%.

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

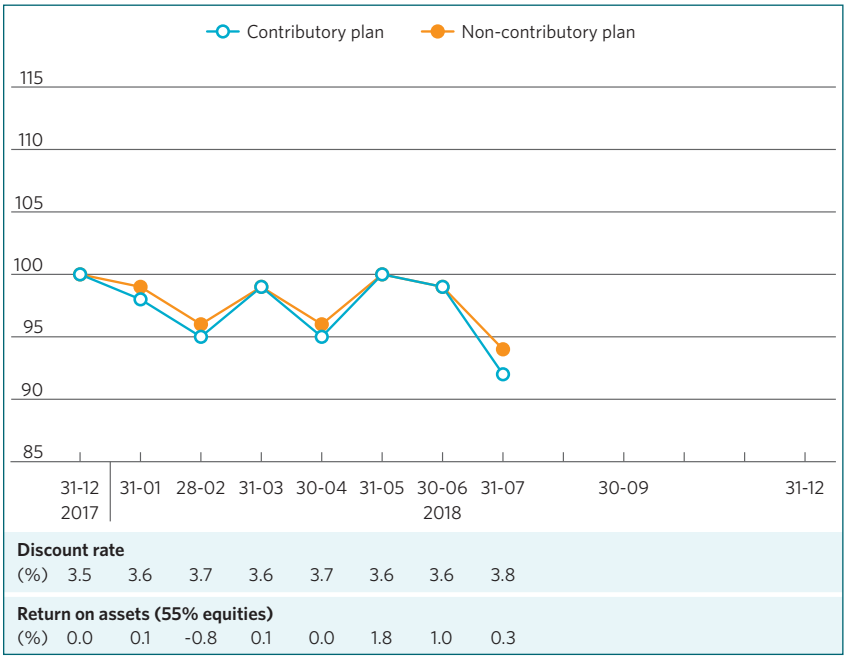
Comments

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 Canadian Institute of Actuaries (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 July 31, 2018

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, 2017



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 2017	July 2018	Change in 2018
11	3.39%	3.68%	+29 bps
14	3.48%	3.75%	+27 bps
17	3.53%	3.79%	+26 bps
20	3.57%	3.82%	+25 bps

Since the beginning of the year, the pension expense has decreased by 8% (for a contributory plan) due to an increase in 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, 2017, based on the average financial position of the pension plans used in our *2017 Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits report* (i.e. a ratio of assets to obligation value of 93% as at December 31, 2016).
2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (55% equities and 45% fixed income), which reflects the average asset mix in our 2017 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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