

News & Views

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2019 Federal Budget

The federal Budget of March 19, 2019, included a number of measures that will affect pension and benefits plans, as well as executive compensation and healthcare related measures.

Permitting two new types of annuities under registered plans

The Budget proposes to permit two new types of annuities under the tax rules for certain registered plans:

- advanced life deferred annuities (ALDAs) will be permitted under a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) and defined contribution (DC) registered pension plan; and

- variable payment life annuities (VPLAs) will be permitted under a PRPP and DC pension plans.

The measures will apply to the 2020 and subsequent taxation years.

An ALDA will be a life annuity, the commencement of which may be deferred until the end of the year in which the annuitant attains 85 years of age.

An individual will be subject to a lifetime ALDA limit equal to 25 per cent in relation to a particular qualifying plan. An individual will also be subject to a comprehensive lifetime ALDA dollar limit of \$150,000 from all qualifying plans. The lifetime ALDA dollar limit will be indexed to inflation for taxation years after 2020, rounded to the nearest \$10,000.

A VPLA will be payable to members directly from DC pension plans. A VPLA will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants.

DC pension plans and PRPPs will be permitted to establish a separate annuities fund under the pension plan to receive transfers of amounts from members' accounts to provide VPLAs. Only transfers from a member's account will be permitted to be made to the annuities fund. Direct employee and employer contributions to the annuities fund will not be permitted.

A minimum of 10 retired members will be required to participate in a VPLA arrangement in order for a plan to establish such an arrangement and it must be reasonable to expect that at least 10 retired members will participate in the arrangement on an ongoing basis.

VPLAs will be subject to a number of requirements, including that they must be adjusted to reflect the investment performance of the annuities fund and the mortality experience of the pool of VPLA annuitants, if the investment or mortality experience differs materially compared to the investment or mortality assumptions on which the VPLA payments are based.

Although the tax rules will be amended to permit ALDAs and VPLAs to be provided starting in 2020, amendments to pension benefits standards legislation will also be required for ALDAs and VPLAs to be offered from DC pension plans and for ALDAs to be offered from locked-in vehicles such as locked-in retirement accounts.

Permitting purchase of buy-out annuities by federally regulated pension plans

Federal pension legislation will be amended to permit defined benefit plans to fully transfer the responsibility to provide pensions to a regulated life insurance company through the purchase of annuities in order to improve plan sustainability and better protect retirees' pensions from the risk of employer insolvency (i.e., buy-out annuities). Buy-out annuities that provide a full discharge of liability are currently available under pension standards legislation in British Columbia, Ontario and Quebec.

Measures to Enhance Retirement Income Security

The government proposes a number of measures that were discussed in the consultation on Retirement Income Security as discussed in the [December 2018 News & Views](#), specifically:

- new measures that will make insolvency proceedings fairer, more transparent and more accessible for pensioners and workers, in part by requiring everyone involved to act in good faith;
- giving courts greater ability to review payments made to executives in the lead up to insolvency;
- clarify that federally incorporated businesses are able to consider diverse interests, such as those of workers and pensioners, in corporate-decision making;
- require publicly traded, federally incorporated firms to disclose their policies pertaining to workers and pensioners and executive compensation, or explain why such policies are not in place; and
- require publicly traded, federally incorporated firms to hold and disclose the results of non-binding shareholder votes on executive compensation.

Changes relating to bankruptcies and insolvencies would apply to all pension plans in Canada, while the other changes would only affect federally incorporated businesses.

Unclaimed assets from terminated federally regulated pension plans

The government proposes to introduce legislative amendments to expand the scope of the unclaimed asset framework to include foreign denominated bank accounts and unclaimed pension balances from terminated federally regulated pension plans. Ongoing federally regulated pension plans and provincially regulated pension plans are not within the scope of this proposal.

Restrictions on pensionable service under individual pension plans

An individual pension plan (IPP) is a defined benefit registered pension plan that has fewer than four members, at least one of whom (e.g., a controlling shareholder) is related to an employer that participates in the plan.

The Budget proposes to prohibit IPPs from providing retirement benefits in respect of past years of employment that were pensionable service under a defined benefit plan of an employer other than the IPP's participating employer (or its predecessor employer). Any assets transferred from a former employer's defined benefit plan to an IPP that relate to benefits provided in respect of prohibited service will be considered to be a non-qualifying transfer that is required to be included in the income of the member for income tax purposes.

This measure applies to pensionable service credited under an IPP on or after March 19, 2019.

Restrictions on contributions to a Specified Multi-Employer Plan (SMEP) for older members

Under the tax rules, pension benefits may not be accrued by a member after the end of the year in which the member attains 71 years of age. In addition, no benefit may be accrued under a

defined benefit (DB) provision a plan by a member who returns to work for the same or a related employer and is receiving a DB pension from the plan (except under a qualifying phased retirement program). However, in contrast to other defined benefit RPPs, employers are not prevented by the pension tax rules from making contributions to a SMEP in respect of workers over age 71 or those receiving a pension from the plan, if such contributions are required by the plan. Such contributions do not benefit the member because they can no longer accrue any corresponding pension benefits under the plan.

The Budget proposes to amend the tax rules to prohibit contributions to a SMEP in respect of a member after the end of the year the member attains 71 years of age and to a defined benefit provision of a SMEP if the member is receiving a pension from the plan (except under a qualifying phased retirement program). The proposed changes will ensure that employers do not make pension contributions on behalf of older SMEP members in these situations from which they cannot benefit.

Restrictions on employee stock options

The government has announced its intention to limit the use of the current employee stock option tax regime for employees of large, established companies.

Currently, the tax rules provide a stock option deduction for employee stock options, which effectively results in the benefit being taxed at a rate equal to one half of the normal rate of personal taxation, the same rate as capital gains. The government proposes to apply a \$200,000 annual cap on employee stock option grants (based on the fair market value of the underlying shares) that can receive tax-preferred treatment for employees of large, established companies. For start-ups and rapidly growing employers, employee stock option benefits would remain uncapped. Further details of this measure are expected by the summer of 2019. Any changes would apply on a go-forward basis only.

Increasing Home Buyers' Plan withdrawal limit

The Home Buyers' Plan (HBP) allows first-time home buyers to withdraw up to \$25,000 from their Registered Retirement Savings Plan (RRSP) to purchase or build a home, without having to pay tax on the withdrawal. Unlike regular RRSP withdrawals, HBP withdrawals are not added to a person's income when withdrawn. Instead, the HBP withdrawals must be repaid over a 15-year period or included in the individual's income if not repaid.

To provide first-time home buyers with greater access to their RRSP savings to purchase or build a home, the Budget proposes to increase the HBP withdrawal limit to \$35,000. This would be available for withdrawals made after March 19, 2019. Furthermore, individuals affected by a breakdown of marriage or common-law spousal relationship will be able to take advantage of the HBP, provided that certain conditions are met.

Increased Guaranteed Income Supplement (GIS) exemption

To allow low-income older Canadians to effectively take home more money while they work, the Budget proposes to introduce legislation that would enhance the GIS earnings exemption beginning with the July 2020 to July 2021 benefit year. The enhancement would:

- Extend eligibility for the earnings exemption to self-employment income.
- Provide a full or partial exemption on up to \$15,000 of annual employment and self-employment income for each GIS or Allowance recipient as well as their spouse, specifically by:
 - Increasing the amount of the full exemption from \$3,500 to \$5,000 per year for each GIS or Allowance recipient as well as their spouse; and
 - Introducing a partial exemption of 50 per cent, to apply to up to \$10,000 of annual employment and self-employment income beyond the initial \$5,000 for each GIS or Allowance recipient as well as their spouse.

Proactively enroll Canada Pension Plan (CPP) contributors age 70 or older

To ensure that all Canadian workers receive the full value of the benefits to which they contributed, the government proposes to introduce legislative amendments to pro-actively enroll CPP contributors who are age 70 or older in 2020 but have not yet applied to receive their retirement benefit.

Update on national pharmacare

In March 2019, the Advisory Council on the Implementation of National Pharmacare delivered an interim report with several recommendations that could be implemented immediately. The Budget proposes to implement several recommendations from the interim report, namely:

- Creating the Canadian Drug Agency to provide a coordinated approach to reviewing drug effectiveness and negotiating drug prices (with projected long-term savings of up to \$3 billion per year); and
- Through the Canadian Drug Agency, developing a national drug formulary in partnership with provinces, territories and other stakeholders to provide a consistent approach to patient access to drugs across Canada.

Furthermore, in response to a need identified in the interim report, the government will develop a national strategy for high-cost drugs for rare diseases to provide consistent coverage for treatments for all Canadians. The Budget also proposes new funding of up to \$1 billion over two years starting in 2022 and ongoing funding of up to \$500 million to make drugs for rare diseases more accessible to Canadians.

The final report from the Advisory Council on the Implementation of National Pharmacare is expected in spring 2019.

Training credits and benefits

The Budget proposes to implement a new non-taxable Canada Training Credit accumulating at \$250 per year for employees who meet certain criteria, to a lifetime limit of \$5,000, to pay for up to half of the cost of tuition and training fees.

The funds could be used towards training fees at colleges, universities, and eligible institutions providing occupational skills training, starting in 2020.

The Budget also proposes an Employment Insurance Training Support Benefit to provide partial income replacement during job training for up to four weeks every four years. The government also intends to consult on changes to labour legislation in various jurisdictions to ensure that workers can take time away from work to pursue training without risk to their job security.

Sales tax exemption for health related expenses

The Budget proposes to eliminate Goods and Services Tax/Harmonized Sales Tax (GST/HST) effective March 20, 2019 from several health related expenses including:

- Human ova and in vitro embryos for Canadians experiencing infertility;
- Multidisciplinary health care service, such as when several professionals work together to coordinate their service to a patient; and
- Certain foot care devices, if prescribed by a licensed podiatrist or chiropractist.

The Medical Expense Tax Credit will also be reviewed in relation to the income tax treatment of fertility related medical expenses.

Opioids

Additional funding of \$30.5 million over 5 years is proposed to support measures to reduce gaps in harm reduction and treatment such as expanding access to prescription opioids, reduce the risk of overdose and death, and improve access to opioid overdose response training and to naloxone (a drug used in response to overdoses).

National suicide prevention service

\$25 million in funding over five years, and \$5 million per year ongoing, is proposed to work with partners to support a national suicide prevention service. This would provide access to bilingual, 24/7 qualified crisis support accessible by voice, text or chat.

Comment

The Budget includes a variety of announcements and developments that will affect a broad range of individuals and businesses. With many of these proposed changes, there remains a number of details that have yet to be released by the government. We will keep you informed of future developments in these areas.

CAPSA publishes final version of DC pension plans guideline

On February 7, 2019, the Canadian Association of Pension Supervisory Authorities (CAPSA) published the final version of Guideline No. 8 – Defined Contribution Pension Plans Guideline (the DC Guideline).

Defined Contribution Pension Plans

The draft form of the DC Guideline was published on July 26, 2018, and discussed in the [September 2018 News & Views](#). Morneau Shepell made a submission to CAPSA in respect of the draft DC Guideline.

The DC Guideline, originally published in 2014, sets out regulators' expectations with respect to the administration of defined contribution (DC) pension plans, and provides administrators with guidance regarding the tools and information to be provided to plan members. Compared to the 2014 version, the new DC Guideline has a greater focus on fee disclosure, providing estimates of final account balances and retirement incomes, options for unlocking as well as the payout phase, and variable benefit accounts.

The final version of the DC Guideline has several changes compared to the draft DC Guideline. In several places, it advises members consider obtaining not only investment advice, but retirement planning advice and financial advice from qualified advisors. While it continues

to indicate that administrators should consider the nature, risks and historical performance of investments when selecting investment options, the final version also points out that historical performance will not necessarily be predictive of future performance.

While the DC Guideline continues to state that plan administrator should provide estimates of account balances, it now states that plan administrators should consider providing, at least annually, estimates of the benefit that may result from that value. The draft DC Guideline had stated that administrators should provide estimates of retirement benefits based on future account balances.

The DC Guideline continues to require significant fee disclosure, including with respect to asset-based fees. However, the final version does not include the statement that fee increases could constitute an adverse amendment to the pension plan.

Comment

While the DC Guideline does not have the force of law, it sets out regulators' expectations for the administration of DC pension plans. This version of the DC Guideline indicates a greater focus by regulators on fee disclosure, estimates of future pension benefits, and providing information on the payout phase. Sponsors and administrators of DC pension plans should consider the DC Guidelines, along with other guidelines published by CAPSA, in the design and administration of their pension plans.

CAPSA publishes final version of guideline on searching for un-locatable members

On February 7, 2019, the Canadian Association of Pension Supervisory Authorities (CAPSA) published the final version of Guideline No. 9 – Searching for Un-locatable Members of a Pension Plan (Guideline No. 9).

CAPSA's Guideline No. 9 was released in response to numerous inquiries from pension plan members and administrators regarding un-locatable members. Guideline No. 9 was published in draft form on June 21, 2018 and was summarized in the [August 2018 News & Views](#).

The final version of Guideline No. 9 emphasizes that retaining and maintaining plan records is ultimately the administrator's responsibility, although it states that pension plan beneficiaries have a role to play in keeping administrators informed of changes to their contact information.

CAPSA has included a new suggestion in the final version of Guideline No. 9 that information could be shared and co-ordinated among various entities, such as custodians, service providers, bargaining agents and plan sponsors, as a way of ensuring member and beneficiary information remains current.

If a member cannot be located, Guideline No. 9 recommends using all "reasonable" methods to locate plan members, a departure from the draft guideline, which suggested using all "possible" methods. The guideline recommends a variety of possible search tools, ranging from inexpensive to relatively costly options. CAPSA has added the use of last known e-mail addresses, newspaper advertisements and the custodian/fund holder associated with the plan as possible search tools in its final version of Guideline No. 9. CAPSA states that administrators should consider privacy concerns when conducting searches.

Consistent with the draft version of Guideline No. 9, CAPSA discusses the Canada Revenue Agency letter forwarding service, unclaimed property legislation, and suggests a searchable database or registry of missing members on the employer's website.

Comment

Guideline No. 9 includes helpful information for plan administrators to consider when searching for un-locatable members and beneficiaries. It states that it is the responsibility of plan administrators to conduct periodic searches and to maintain current contact information for members and responsibilities, although members and beneficiaries have a role to play.

Guideline No. 9 recommends administrators develop a fulsome policy for dealing with all components of a search process, including how frequently to conduct a search. It also emphasizes the need to develop and implement a comprehensive records management and retention policy.

As noted by Guideline No. 9, plan administrators must consider privacy concerns when sharing or publicizing member information, even when they are acting with the intention of finding missing members.

British Columbia announces extension of solvency funding relief measures

The government of British Columbia has amended the *Pension Benefits Standards Regulation* to extend temporary solvency funding relief measures for defined benefit (DB) pension plans to valuations with review dates on and after December 31, 2018 and prior to January 1, 2021. The measures will affect DB pension plans registered in British Columbia.

Past funding relief measures

In October 2016, British Columbia enacted solvency funding relief measures for valuations with review dates between December 31, 2015 and December 31, 2017 inclusive.

The previously announced solvency relief permitted DB pension plans to reduce their solvency funding requirements by:

- extending the regular solvency amortization period from 5 to 10 years, and
- consolidating all prior solvency deficiencies into a single new solvency deficiency.

New funding relief measures

Employers who took advantage of solvency funding relief during the original 2015 to 2017 period will be eligible to fund new solvency deficiency payments over an amortization period of 10 years. They will not be able to consolidate previously established solvency deficiencies.

Employers who did not take advantage of solvency funding relief during the original 2015 to 2017 period will also be eligible to consolidate their prior solvency deficiencies up to the date of the review.

These relief measures may only be applied once in the December 31, 2018 to December 31, 2020 period.

To elect solvency relief, plan administrators must include an amortization schedule in their actuarial valuation that reflects the election to amortize the plan's solvency deficiencies in accordance with the solvency funding relief measures. In addition, plan administrators are required to disclose on member statements that the plan has elected to amortize solvency deficiency payments over the 10-year period.

The Financial Institutions Commission of British Columbia has released bulletin PENS 19-001, titled "Updated Extension of Solvency Deficiency Payment Period," which summarizes the regulation.

Comment

The extension of solvency funding relief measures will be welcome to British Columbia sponsors of DB pension plans.

The deadline for public submissions in respect of British Columbia's consultation on solvency funding reform measures was January 31, 2019. Morneau Shepell made a submission to the government. After review of the public submissions, it is expected that British Columbia will consider permanent solvency funding reform measures.

FSCO restricts use of excess contributions

On February 4, 2019, the Financial Services Commission of Ontario (FSCO) published three guidelines to assist in interpreting the new defined benefit (DB) funding rules that came into force on May 1, 2018. FSCO's guideline on the permitted use of excess contributions that have been previously made is more restrictive than prior interpretations and will be of concern to DB plan sponsors. FSCO has also issued guidance on the funding of benefit improvements as well as the definition of a closed plan for the purposes of calculating the provision for adverse deviation (PfAD).

Treatment of excess contributions

FSCO's guidance restricts the ways in which a DB plan sponsor can use excess contributions. In the FSCO guideline, "excess contributions" refers to contributions that have been made by the employer in excess of minimum contribution requirements set out in the last valuation report, including those that were made in accordance with the requirements of an expired valuation report while a new valuation report with lower funding requirements was being prepared. Because of the introduction of the new DB funding rules, many DB plan sponsors may have accumulated significant excess contributions over

the period from December 31, 2017, until a valuation report could be filed under the new DB funding rules.

There are two major changes from past practice. First, FSCO has made clear its interpretation that excess contributions are not an overpayment to a plan and so, cannot be refunded under the *Pension Benefits Act* (the Act). Refunds will only be permitted for mistaken payments that were not required under the Act.

Secondly, FSCO states that the new contribution holiday restrictions in the Act significantly limit the flexibility to use a prior year credit balance (PYCB). Excess contributions may still be used to establish a PYCB or increase the PYCB in a valuation report. However, FSCO interprets the new provisions as only permitting the PYCB to be used to offset special payments in respect of a funding deficit. A PYCB can no longer be applied against the normal cost of benefits or the PfAD on normal cost contributions, unless there is an available actuarial surplus. We note that the plan would be allowed to use the available actuarial surplus for a contribution holiday even without a PYCB, so effectively a PYCB can only be used for special payments.

FSCO will still allow excess contributions to be used to reduce any contributions otherwise required during the remaining months of the fiscal year, but excess contributions cannot be applied in respect of contributions beyond the fiscal year.

The new interpretations will be applied on a go-forward basis.

Funding benefit improvements

The new DB funding rules do not affect the requirement to file a valuation report or cost certificate if a plan amendment affects employer contributions, or creates or changes a going concern unfunded liability or solvency deficiency. A valuation report or cost certificate with a valuation date on or after December 31, 2017 must apply the new funding rules.

FSCO states that, if the last full valuation was filed under the old funding regime, it is not possible to file a cost certificate in respect of a benefit improvement. In that case, a full valuation report is required.

Under section 14.0.1 of the Act, a plan amendment will be void if the solvency ratio or the going concern funded ratio of the pension plan, determined in accordance with the Regulation, would fall below 0.80 after the amendment, unless a top-up contribution is made. FSCO advises that the test for determining whether a benefit improvement is void is measured under the later of the effective date of the benefit improvement and the date on which the amendment is adopted. Any top-up contribution must be made before the cost certificate or valuation report supporting the amendment is filed.

Finally, the increase in going concern liability of any benefit improvement must be funded over 8 years if it causes the going concern funded status (including PfAD) to drop below 100%.

Determining whether a plan is closed

Under the new DB funding regime, whether a plan is closed impacts the PfAD calculation and therefore the level of funding required.

The regulation provides that a plan is closed if at least one portion of it does not permit new members to join and accrue defined benefits. However, whether a plan is closed depends on the particular facts.

While the ultimate determination as to whether a plan is closed rests with the plan administrator, FSCO has provided some general guidance as to how to determine whether a plan is closed.

- A plan amendment providing that a class of members who participate in a plan will no longer accrue benefits and/or that no new members of the class will be allowed to join and accrue benefits suggests the plan is closed.
- An amendment to a benefit formula for a class of members does not, in and of itself, cause the closing a portion of the plan.
- If external factors (not caused by a plan amendment) result in members not joining the plan, this does not, on its own, mean that a plan is closed.

FSCO expects plan administrators to make their own determination as to whether a particular plan is closed or open. It retains the right to ask the signing actuary to provide facts and analysis to support the administrator's determination of a plan being open if it believes the facts in a valuation report indicate otherwise.

Comment

FSCO's new interpretations relating to the use of excess contributions will be of concern to DB plan sponsors in Ontario who had been counting on the use of excess contributions to cover the normal funding cost on a prospective basis. The restrictions on applying a PYCB against the normal cost appears to be an inadvertent result of amendments to the Act and it may be hoped that the government amends this language in the future.

Ontario DB sponsors who are contemplating benefit improvements should be aware of the revised funding requirements for benefit improvements and should consider the implications prior to making such improvements.

Proposed amendment to the Quebec Pay Equity Act introduced in February 2019

Bill 10, *An Act to amend the Pay Equity Act mainly to improve the pay equity audit process*, was introduced in the Quebec National Assembly on February 12, 2019 (the Bill). The Bill will come into force on the date it receives assent and also contains transitional provisions. The amendments stem from a Supreme Court of Canada¹ decision dated May 10, 2018, which concluded that certain provisions of the *Pay Equity Act* (the Act) contravened the *Canadian Charter of Rights and Freedoms*.

¹ *Quebec (Attorney General) v. Alliance du personnel professionnel et technique de la santé et des services sociaux*, 2018 SCC 17

Under the Act, employers must conduct a pay equity audit every five years. If there are unjustified differences in compensation between male and female job classes of equal intrinsic value on the prescribed audit date, the employer must pay an adjustment as of that date. However, under the Bill, the pay equity audit must identify any events that have led to differences in compensation since the previous audit and, if applicable, determine the adjustments required as of the date of such events. The pay equity adjustments are thus payable as of the date of the events. This is to ensure that adjustments identified in the pay equity audit are retroactive to the date of the event in question (e.g., change in organizational structure), which is not currently the case. The Bill also sets the terms and conditions of payment of the adjustments with respect to the predominantly female job classes concerned.

The Bill creates new obligations for certain employers with respect to the internal postings about the pay equity audit. An employer who has set up a pay equity committee to establish a pay equity plan or whose business has at least one certified association representing the employees covered by the pay equity audit must, if the employer conducts the audit

alone, set up a process that allows for participation from employees. During this process, the employer must send information on the pay equity audit in progress to the certified associations and to the unrepresented employees, and establish consultation measures to enable those associations and employees to ask questions or make observations to express their concerns, expectations, opinions or suggestions.

Under the Bill, pay equity audit postings will now include a summary of the questions asked and observations made during the participation process, the manner in which such questions and observations were taken into account by the employer, a list of the events leading to adjustments and, for each of those events, the start date and, where applicable, end date, or, where no adjustments are required, a notice to that effect.

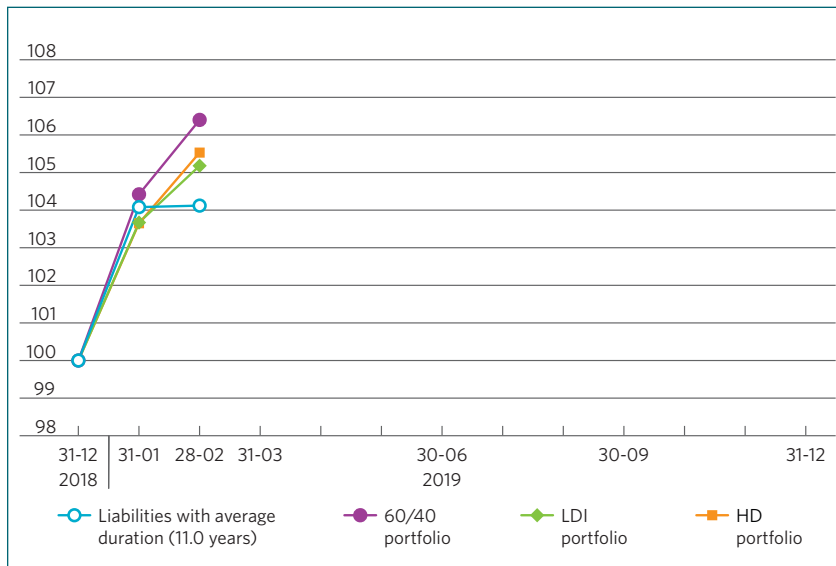
Among other proposed changes, the Bill requires the use of a prescribed form to file a complaint with the *Commission des normes, de l'équité, de la santé et sécurité du travail*. This commission assists employees seeking help in drafting a complaint.

We will keep you updated on developments in this matter.

Tracking the funded status of pension plans as at February 28, 2019

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



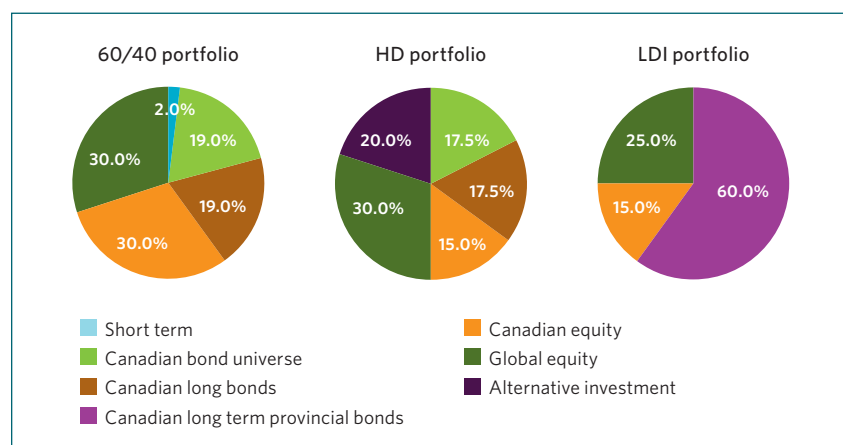
During the month of February, Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian equity markets, the global equity markets (CAD) as well as alternative investments showed positive returns. With a return of 1.9%, the 60/40 portfolio outperformed the highly diversified portfolio (HD) (1.8%) and the low volatility portfolio (LDI¹) (1.5%).

The prescribed CIA annuity purchase rates increased while the commuted value rates used in the calculation of solvency liabilities remained stable. As a result, the solvency liabilities remained stable for a medium duration plan. For this type of plan, an investment in the 60/40, in the HD or in the LDI 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, 2018. The graph shows the asset allocation of the three typical portfolios.

Initial solvency ratio as at December 31, 2018	Evolution of the solvency ratio as at February 28, 2019 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	102.2 %	101.0 %	101.4 %
90%	92.0 %	90.9 %	91.2 %
80%	81.8 %	80.8 %	81.1 %
70%	71.5 %	70.7 %	71.0 %
60%	61.3 %	60.6 %	60.8 %



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

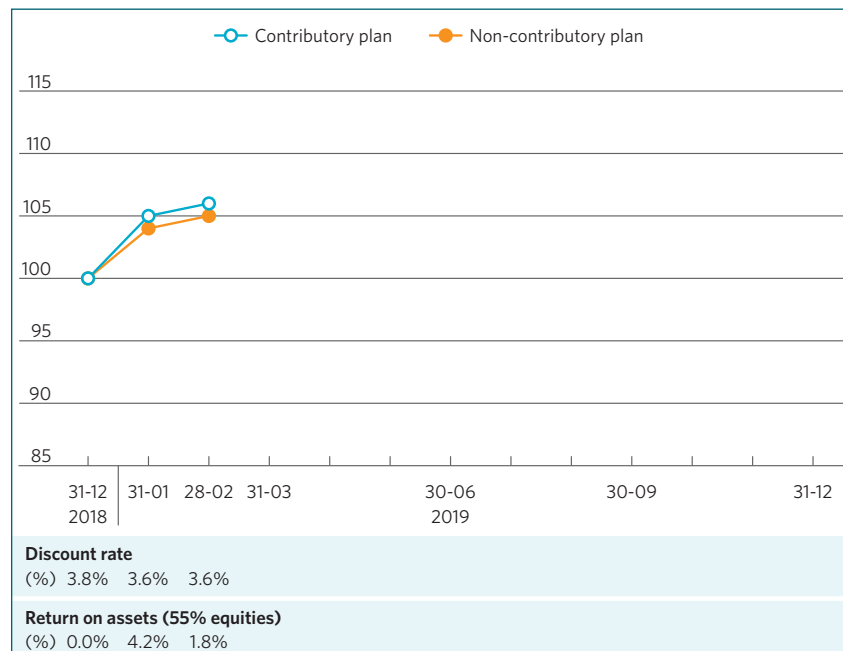
Comments

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 February 28, 2019

Every year, companies must establish an expense for their defined benefit pension plans. The graph shows the expense impact for a typical pension plan that starts the year at an arbitrary value of 100 (expense index). The expense is influenced by changes in the discount rate based on high-quality corporate and provincial (adjusted) bonds and the median return of pension fund assets.

Expense Index from December 31, 2018



The table below shows the discount rates for varying durations and the change since the beginning of the year. A plan's duration generally varies between 10 (mature plan) and 20 (young plan).

Discount rate

Duration	December 2018	February 2018	Change in 2019
11	3.72%	3.48%	-24 bps
14	3.81%	3.58%	-23 bps
17	3.87%	3.64%	-23 bps
20	3.90%	3.68%	-22 bps

Since the beginning of the year, the pension expense has increased by 6% (for a contributory plan) due to the decrease in the discount rates, despite the good returns on assets (relative to 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, 2018, based on the average financial position of the pension plans used in our 2018 *Survey of Economic Assumptions in Accounting for Pensions and Other Post-Retirement Benefits report* (i.e. a ratio of assets to obligation value of 95% as at December 31, 2017).
2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (55% equities and 45% fixed income), which reflects the average asset mix in our 2018 Survey.
3. The actuarial obligation is that of a final average earnings plan, without indexing (two scenarios: with and without employee contributions).

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About Morneau Shepell

Morneau Shepell is the only human resources consulting and technology company that takes an integrated approach to employee well-being to meet health, benefits and retirement needs. The Company is the largest administrator of retirement and benefits plans and the largest provider of integrated absence management solutions in Canada. LifeWorks by Morneau Shepell is the leading total well-being solution that combines employee assistance, wellness, recognition and incentive programs. As a leader in strategic HR consulting and innovative pension design, the Company also helps clients solve complex workforce problems and provides integrated productivity, health and retirement solutions.

Established in 1966, Morneau Shepell serves approximately 24,000 clients, ranging from small businesses to some of the largest corporations and associations. With more than 4,500 employees in offices worldwide, Morneau Shepell provides services to organizations around the globe. Morneau Shepell is a publicly-traded company on the Toronto Stock Exchange (TSX:MSI). For more information, visit morneaushepell.com.



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