

Special Communiqué

October 7, 2009

About Us

Morneau Sobeco Income Fund is the largest Canadian-owned firm providing human resource consulting and outsourcing services.

Through Morneau Sobeco and Shepell•fgi, its two operating entities, the firm delivers solutions to assist employers in managing the financial security, health and productivity of their employees.

With over 2,200 employees in offices across North America, Morneau Sobeco Income Fund offers its services to organizations that are situated in Canada, in the United States and around the globe.



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Future employee benefit accounting (municipal sector) — Pension plan relief measure for 2010 and the following years

In the fall of 2008, the Ministère des Affaires municipales, Régions et Occupation du territoire (MAMROT) [department of municipal affairs, regions and territory occupation] issued guidelines allowing use of a specific relief measure for the purposes of 2009 taxation. This measure was needed to limit the accounting impact of the substantial decline in the financial markets that affected pension funds. This measure limits increasing taxation needs for 2009, thus making it easier for municipalities to balance their budgets. It should be noted that this relief measure only applies to funded pension plans.

Since it does not seem likely at the moment that the 2009 returns will be able to fully reverse the losses suffered by pension funds in 2008, MAMROT just issued new guidelines for using the relief measure in the future. The relief approach used in 2009 will be allowed for 2010 and the following years, but subject to a specific guideline.

2009 relief measure approach is maintained ...

The 2008 annual losses that are within a corridor of 10% of the maximum between the plan's assets and liabilities are eligible for the relief. In addition, for municipalities using a smoothing asset valuation approach, any asset losses occurring during the smoothing period will also be eligible and will be added to cumulated losses. No other losses will be eligible. In return, all annual gains after 2008 that are within the corridor will automatically reduce the balance of the cumulated losses affected by the relief measure. By doing this, MAMROT is limiting the relief measures' scope.

MAMROT allows the accounting impact of such cumulative losses (or gains) to be reversed using amount to be funded in the future. Such reversed amount allowed annually applies to the interest component and the amortization of the cumulated amount.

But is subject to guidelines issued for 2010 and the following years

Even with the limited application described above, the MAMROT is still concerned about the extent of the relief that may be used by the municipalities. Therefore, as a precaution, it has issued guidelines for using such relief. The main provisions are:

- > The cumulative amounts thus reversed in the amount to be funded in the future cannot exceed 7% of the maximum assets or liabilities of the plans in question;
- > The cumulative amounts thus reversed in the amount to be funded in the future must have been fully reflected in the taxation over a period that does not exceed the expected average remaining service life of active employees (EARSL). This period is determined (and begins) as at December 31, 2008.

For municipalities with more than one funded pension plan affected, it should be noted that the 7% test applies to all the plans as a whole and not to individual plans. In addition, for these municipalities, the EARSL is determined on a weighted basis. For example, for a municipality with an 11-year weighted EARSL, the amount to be funded in the future must return to 0 by December 31, 2019, while ensuring that it never exceeds the 7% limit during this period.

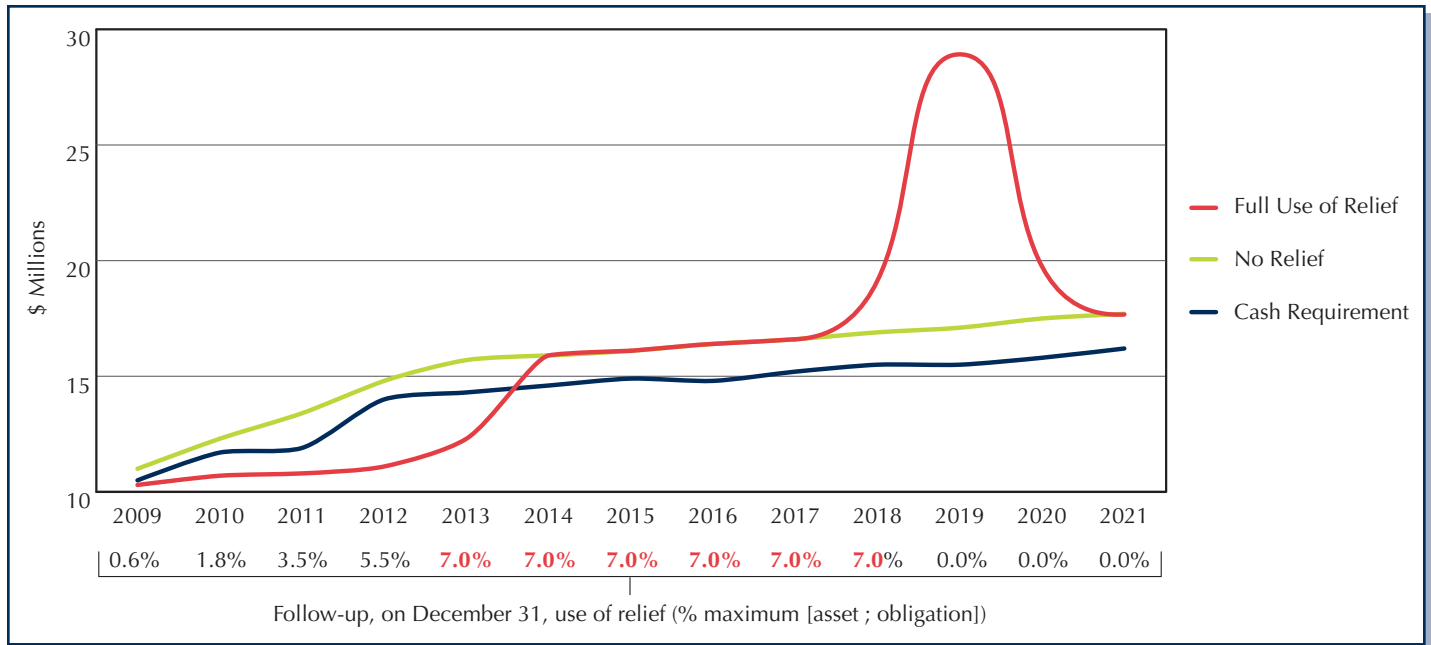
MAMROT believes that this measure will enable municipalities to manage the short-term effect on taxation. It also insists on the fact that municipalities, as prudent managers, must make good use of this relief; not necessarily using it fully and not deferring taxation increases until the last year.

What does this change mean for municipalities that have funded defined benefit plans?

- > In the short term, this should allow them to minimize the impact on their taxation needs;
- > It should also allow them, as prudent managers, to plan a structured taxation increase;
- > MAMROT's taxation relief measure could be used as a tool that allows municipalities to manage the differences between their taxation requirements and cash needs based on the funding relief measures that should apply to the municipal sector.

Illustration of full use of the relief measure

We analyzed a sample case that assumes full use of the relief measure. It is based on a smoothed value of the assets and a return scenario over the next few years that does not generate the gains needed to reverse the losses of 2008. The following chart illustrates the accounting expense without relief with the required taxation for full use of the relief. It also shows the cash needs based on the latest information available on funding relief measures. This information remains to be confirmed and is only presented for illustrative purposes to show the cash shortages or surpluses that could occur.



We can see that if a municipality were to fully use the relief measure during the first years, it may face a significant taxation increase at the end of the EARSL

period (72% increase between 2018 and 2019 in our example).

Action Plan

Before long, a municipality could find itself in a difficult situation that would then require a significant increase in taxation needs, especially if it uses the relief fully. It would then be advisable for municipalities to:

- 1 determine the change in the pension plan expense and the allowed relief measure over several years;
- 2 validate the sensitivity of the results based on various return scenarios (e.g. significant recovery of the financial markets, a mild recovery, no recovery, additional decline);
- 3 compare a) the disbursement that will result from the funding relief measures provided by the Régie des rentes du Québec, and b) the pension plans' accounting expense and taxation relief in order to determine the expected cash shortages or surpluses;
- 4 establish a structured taxation increase for the following few years in order to a) return to the new accounting expense amount, and b) reverse all the amounts transferred to the amount to be funded in the future over the eligible period;
- 5 inform the municipality's various stakeholders about the MAMROT guidelines and communicate the planned approach;
- 6 review the municipality's budgets to reflect this new data.

For additional information and to set up your action plan, please contact your Morneau Sobeco consultant.