Quebec: Adoption of the 
Act to enhance the Quebec Pension Plan and to amend various retirement-related provisions

Bill 149, an Act to enhance the Quebec Pension Plan and amend various retirement-related provisions (the “Act”), received assent by the Quebec National Assembly on February 22, 2018. For details about the bill, see our News & Views of November 2017. The Act came into force on February 22, 2018, but some provisions have been in effect since January 1, 2018.
This Act amends the Act respecting the Quebec Pension Plan mainly to enhance the Quebec Pension Plan by creating an additional component.

The Act also amends the Supplemental Pension Plans Act (SPP Act) as follows:

• To ease certain administrative rules, namely:
  - plans that pay transfer values in proportion to the plan’s solvency ratio should use the solvency ratio on the date on which the value of the member’s benefit is established instead of the settlement date;
  - the timeline for submitting the notice regarding the financial position of the plan to Retraite Québec has been changed from 4 months to 9 months after the end of the fiscal year. This notice is no longer required when an actuarial valuation is filed with Retraite Québec that establishes the solvency ratio of the plan at a date that falls between the end of the plan’s fiscal year (e.g.: December 31) and the notice filing deadline (September 30);
  - the timeline for providing notice of the annual meeting has been changed from 6 months to 9 months after the end of the fiscal year.

• To include, in the banker’s clause, amounts paid by the employer:
  - to reduce a letter of credit;
  - as a special annuity purchasing payment, if the annuity purchasing policy so provides.

• To clarify the rules regarding the surplus assets of defined benefit plans in the private sector, primarily with respect to the utilization of surplus assets while the plan is ongoing.

Federal Budget 2018: Announcements relating to pensions, Employment Insurance, health and welfare trusts, national pharmacare and pay equity

The 2018 Federal Budget was released on February 27, 2018. It included several announcements relating to pension plans and Employment Insurance, but no notable announcements relating to employee benefits.

Consultation on retirement security

In recent years, a number of companies have entered insolvency proceedings with substantial unfunded pension liabilities. This can result in unexpected financial losses for former employees and retirees that can affect retirement security. The government plans to hold a consultation in the coming months to find a balanced way forward.

Consultation on unclaimed pension balances

The government intends to shortly announce public consultations on a regime to address unclaimed pension balances. Following the consultation, the government may introduce legislative and regulatory amendments.

Employment Insurance Parental Sharing Benefit

The government is introducing an additional five weeks of Employment Insurance (EI) Parental Sharing Benefit. In addition to 15 weeks of maternity leave, 35 weeks of parental benefits can currently be shared between two parents. The change would allow for up to 40 weeks of parental benefits among two parents, provided that each parent takes at least 5 weeks of parental benefits. If one parent takes all of the parental benefits, the current 35 week limit remains unchanged.
If extended parental benefits are taken for a period of up to 61 weeks, at a benefit rate of 33% instead of 55%, then the second parent can take an additional 8 weeks of parental benefits.

**Health and Welfare Trusts to be converted to Employee Life and Health Trusts**

A Health and Welfare Trust (HWT) is a trust established by an employer to provide health and welfare benefits to employees. HWTs are not regulated by the *Income Tax Act*, but are subject to administrative positions published by the Canada Revenue Agency.

Since 2010, the *Income Tax Act* has included rules relating to Employee Life and Health Trusts (ELHTs). The rules for ELHTs are similar to those for HWTs but deal explicitly with more issues, such as surpluses and pre-funding of benefits.

As of February 28, 2018, no new HWTs can be created. Furthermore, the existing rules relating to HWTs will cease to apply after December 31, 2020. Existing HWTs will have the option to convert to ELHTs or be subject to the usual taxation rules relating to trusts.

Legislative amendments are expected to address the transition from HWTs to ELHTs. The government is holding a consultation on the transitional rules. Public comments are invited by June 29, 2018.

**Advisory Council on National Pharmacare**

The government is establishing an Advisory Council on the Implementation of National Pharmacare, to be chaired by Dr. Eric Hoskins, former Ontario Minister of Health. The Advisory Council will hold a national dialogue with experts from all relevant fields as well as national, provincial, territorial and aboriginal leaders.

The Advisory Council will report to the Minister of Health and the Minister of Finance, and will conduct an economic and social assessment of domestic and international models, and recommend options on how to move forward.

**Pay equity**

The Canadian government will introduce proactive pay equity legislation for federally regulated sectors. This legislation will draw on legislative models in Ontario and Quebec, which seek to offer total compensation for women’s job classes that is equal to that of men’s job classes of equivalent value. Under this legislation, the intrinsic values of jobs performed by women and men will be measured using a method that is free of gender bias. Such methods must take into account factors with respect to qualifications, duties, effort and other working conditions for the jobs in question.

The new pay equity regime will apply to employers in federally regulated sectors with 10 or more employees, but a streamlined process will apply to employers with less than 100 employees. The rules will also apply to the Federal Contractors program on contracts equal to or greater than $1 million.

The government will also take measures to more quickly close the gap between women’s and men’s pay in the Canadian job market. The most significant of these measures is the funding of training for women who want to work in traditionally male-dominated skilled trades, as well as pay transparency. With respect to the latter, the pay information filed by federally regulated employers must be communicated via user-friendly online content, with specific attention to making wage gaps more evident. The government has announced that it will spend $3 million over five years to promote the implementation of pay transparency in Canada.

The new process will involve specific timelines for implementation and compulsory maintenance reviews. The government estimates the measures could reduce the gender pay gap by 2.6 cents in the federal private sector (to 90.7 cents on the dollar).
British Columbia: Changes in health care funding

The British Columbia provincial government is continuing to make changes to its healthcare programs, most recently by announcing the elimination of Medical Services Plan (MSP) premiums, the implementation of a new employer health payroll tax and a reduction to the deductible for prescription drug coverage for lower income earners.

MSP premiums and payroll tax

The provincial budget released on February 20, 2018 included the elimination of MSP premiums by January 1, 2020. In 2017, the premiums were $900 per year for single people and $1,800 per year for families, and since January 1, 2018, the premiums are $450 per year for single people and $900 per year for families, and will likely remain at their current levels until they are phased out. Employers commonly pay part or all of the premiums on behalf of their employees and sometimes also for retirees.

It was also announced in the provincial budget that a new employer health tax will replace MSP premiums. The government intends to introduce legislation in 2018 to implement an employer health tax effective January 1, 2019, with the following rate structure:

- Businesses with a payroll of more than $1.5 million will pay a rate of 1.95% on their total payroll.
- Businesses with a payroll between $500,000 and $1.5 million will pay a reduced tax rate.
- Businesses with a payroll under $500,000 will not pay the tax.

The government noted it would provide further details about the employer health tax before it takes effect in 2019. The announced changes would go into effect provided the current provincial government remains in power—in the most recent election, the NDP government won a minority of seats and is being supported by the Green Party to form government.

The government established a task force in Fall 2017 to recommend a new approach to fund provincial health care. It is worth noting that the budget announcement goes against the interim advice from the task force. A preliminary report was filed February 1, 2018, and recommended MSP revenue be replaced with a combination of measures and alluded to a combination of personal and payroll tax. The interim report also suggested there be no phase-in or phase-out of revenue measures and to provide a reasonable notice period for when

Comment

A number of the items in the Budget are potentially significant, but require further consultation until definite action can be taken. The consultation on retirement security could lead to enhanced protection for members and former members with entitlements in defined benefit pension plans, but it remains to be seen what the government’s balanced approach actually means. The possibility of legislative amendments on unclaimed pension benefits is welcome news. The Advisory Council on the Implementation of National Pharmacare could have far-reaching consequences, if it develops recommendations translating to government policy.

As for the concrete measures, enhanced EI benefits may result in somewhat greater usage of parental leave by fathers and second parents. The new pay equity regime will be important to federally regulated employers and federal contractors. Finally, trustees and contributing employers of an HWT will have to take measures to convert HWTs to ELHTs before 2021. As part of the conversion process, the HWT documentation and plan design will need to be reviewed to ensure compliance with the ELHT rules. A broader plan design review could also be useful to consider the implications of the ELHT model.
the changes will take effect. The task force is still expected to submit a final report by March 31, 2018.

MSP has been a contentious issue in the province in recent years. Premiums have risen steadily over the last decade and the system has been criticized for being regressive and unfair since all households with annual net income of $42,000 or more pay the same amount. As previously mentioned in our News & Views of March 2017 and October 2017, MSP premiums had already been revised to no longer consider children in a household and were reduced by 50% effective January 1, 2018.

This proposed change in health care revenue sources aligns BC more closely with other provinces. BC is currently one of only three provinces that require health care premium payments from individuals (the others being Ontario and Quebec) and the only one of those three not collecting premiums through income tax. Four other provinces (Manitoba, Ontario, Quebec, and Newfoundland & Labrador) require employer health care premiums through payroll taxes similar to the measure proposed in BC. The remaining provinces and territories fund health care from general revenue instead of specific premiums.

While some employers may welcome the elimination of the MSP monthly premiums and the associated administration they require, the new employer health tax likely represents an increased cost for many employers. The ultimate change in cost to employers will depend on whether the employer currently pays some or all MSP premiums and the earnings of employees. As well, since the employer health tax is scheduled to begin in 2019, some employers may pay both the payroll tax and MSP premiums in that year.

Employers should review employment contracts and collective agreements to determine the specific impact of these changes and how their total compensation strategy may change as a result. Plan sponsors who pay some or all of the MSP premiums for retirees or disabled employees are likely to benefit from a significant impact to the obligation for MSP premiums included in their financial statements. Affected plan sponsors are encouraged to discuss the accounting treatment with their auditors to determine whether to reflect this change in financial statements prior to the budget measures being enacted.

**Prescription drug deductible**

In most cases, the BC Pharmacare program currently pays 70% of eligible prescription drug expenses once an annual deductible has been met. Once a subsequent threshold of expenses has been met, 100% of further eligible prescription drug expenses are covered for the rest of the calendar year. Both the deductible and subsequent expense threshold are based on family income.

Beginning January 1, 2019, the provincial government has announced that deductibles will be reduced for families with net household income of less than $45,000 and eliminated for those families with net household income of less than $30,000 or those with a member aged 79 and older with net income of less than $13,750. The government projects these changes will impact 240,000 families in BC.

While this news may be favourable for many families in the province, there is likely a limited impact for private plan sponsors. Plans with a significant number of lower income plan members or retiree plans may see cost reductions. Regardless, plan sponsors should encourage all plan members to register with the provincial Fair Pharmacare program. Many insurers require proof of such registration for reimbursement of prescription drug expenses under private plans once a certain threshold has been reached to prevent payment of expenses that can be covered by the government plan.

**Saskatchewan eliminates provincial sales tax on insurance premiums**

The province of Saskatchewan announced that provincial sales tax (PST) no longer applies to insurance premiums. The change is effective February 26, 2018, but also extends retroactively
to August 1, 2017, the date the change previously came into effect. This change affects employers with employees in Saskatchewan, even if the organization is headquartered in another province.

The government has stated that information regarding refunds of PST paid on insurance premiums will be provided in April 2018 following consultation with the insurance industry.

As reported in our News & Views bulletin in April and June 2017, the 2017 provincial budget included a change to apply the PST to all insurance premiums as defined in the Saskatchewan Insurance Act as well as an increase in the PST from 5% to 6%. Following consultations with the insurance industry, the effective date for PST being applied to insurance premiums was delayed from July 1, 2017 to August 1, 2017.

This change will create unexpected savings for plan sponsors, especially with the change being retroactive. This may create some additional administrative complexity for an interim period, as systems will need to be updated.
Tracking the funded status of pension plans as at February 28, 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 December 31, 2017, 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 February, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian equity markets as well as alternative investments showed negative returns, while global equity markets (CAD) showed slightly positive returns. With a return of -0.6%, the low volatility portfolio (LDI1) outperformed the highly diversified portfolio (HD) (-0.7%) and the 60/40 portfolio (-0.9%). The relative outperformance of the LDI portfolio is mainly due to a smaller allocation in the Canadian equity markets and no exposure to alternative investments. The prescribed CIA Annuity purchase rates remain unchanged, while the commuted value rates used in the calculation of solvency liabilities increased during the month. As a result, the solvency liabilities decreased by 2.0% for a medium duration plan. For this type of plan, an investment in the 60/40, LDI portfolio or the HD portfolio resulted in an increase of the solvency ratio.

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, 2017, as well as the asset allocation of the three typical portfolios. Since the beginning of the year, driven by negative returns in Canadian equity markets, Canadian long-term bonds, Canadian long-term provincial bonds as well as the alternative investments, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned -0.7%, -1.0% and -0.1% respectively. The solvency liabilities fluctuated over that same period between 2.5% and 2.7% for all types of duration regarding the group of retirees. The variation in the plan’s solvency ratio as at February 28, 2018, stands between 1.0% and 2.5%.

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.

<table>
<thead>
<tr>
<th>Initial solvency ratio as at December 31, 2017</th>
<th>Evolution of the solvency ratio as at February 28, 2018 for three different portfolios</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>101.9% 101.9% 102.5%</td>
</tr>
<tr>
<td>90%</td>
<td>91.7% 91.4% 92.3%</td>
</tr>
<tr>
<td>80%</td>
<td>81.5% 81.3% 82.0%</td>
</tr>
<tr>
<td>70%</td>
<td>71.3% 71.1% 71.8%</td>
</tr>
<tr>
<td>60%</td>
<td>61.1% 61.0% 61.5%</td>
</tr>
</tbody>
</table>

1 Liability driven investment
Impact on pension expense under international accounting as at February 28, 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

<table>
<thead>
<tr>
<th>Date</th>
<th>Non-contributory plan</th>
<th>Contributory plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-12-17</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>31-01-18</td>
<td>95</td>
<td>100</td>
</tr>
<tr>
<td>31-02-18</td>
<td>90</td>
<td>100</td>
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<td>31-03-18</td>
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<tr>
<td>30-06-18</td>
<td>80</td>
<td>100</td>
</tr>
<tr>
<td>30-09-18</td>
<td>75</td>
<td>100</td>
</tr>
</tbody>
</table>

Discount rate (%) 3.5 3.6 3.7
Return on assets (55% equities) (%) 0.0 0.1 -0.8

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

<table>
<thead>
<tr>
<th>Duration</th>
<th>December 2017</th>
<th>February 2018</th>
<th>Change in 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>3.39%</td>
<td>3.55%</td>
<td>+16 bps</td>
</tr>
<tr>
<td>14</td>
<td>3.48%</td>
<td>3.64%</td>
<td>+16 bps</td>
</tr>
<tr>
<td>17</td>
<td>3.53%</td>
<td>3.69%</td>
<td>+16 bps</td>
</tr>
<tr>
<td>20</td>
<td>3.57%</td>
<td>3.72%</td>
<td>+15 bps</td>
</tr>
</tbody>
</table>

Since the beginning of the year, the pension expense has decreased by 5% (for a contributory plan) due to the increase in the discount rates, despite the poor returns on assets (relative to the discount rate).
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