Knowledge & Insights

MORNEAU SHEPELL

News & Views

Volume 15 | Issue 7
July 2018

In this issue

1 Ontario Human Rights Tribunal finds employer's failure to provide post-65 employee benefits discriminatory

3 B.C. proposes all long term disability plans be insured

4 Update: Quebec adopts prohibition on orphan clauses and expands leaves of absence

5 Recent cases demonstrate how family and estate law can affect pension plan administration

7 Tracking the funded status of pension plans as at June 30, 2018

8 Impact on pension expense under international accounting as at June 30, 2018

Ontario Human Rights Tribunal finds employer's failure to provide post-65 employee benefits discriminatory

In a ruling that sets up further legal battles, the Ontario Human Rights Tribunal recently decided that exemptions in the Ontario *Human Rights Code* (the Code) permitting employers to exclude post-65 employees from employment benefits violate the *Canadian Charter of Rights and Freedoms* (the Charter). If upheld by the courts, the ruling could require employers to either add employees to their benefit plans or demonstrate why it would not be practical to do so.

Improving business. Improving lives.

Background

Ontario abolished mandatory retirement in 2006. Ontario employers are allowed to decide whether they wish to provide employee benefits after age 65, because the Code permits employers to exclude or make distinctions in employee benefits for employees older than age 65 and younger than 18.

In the case *Talos v. Grand Erie District School Board* (Talos), the complainant was a high school teacher who challenged the termination of his group health, dental and life insurance benefits when he reached age 65. The termination of his participation in the employee-paid and union-managed long term disability program was not challenged, in part because this particular program was not funded by the employer.

The decision

The Tribunal overturned an earlier decision by an arbitrator who had upheld the constitutionality of the exclusion of employees from age discrimination protections with respect to post-65 benefits. It rejected the argument that the complainant had suffered no disadvantage because he had a generous pension and his benefits had been negotiated by a union.

The Tribunal decision found that the Code was discriminatory because it did not require employers to prove that it is impossible to provide benefits to older employees:

> "the financial viability of workplace benefits plans can be achieved without making the age 65 and older group vulnerable to the loss of employment benefits … [T]he impugned provisions do not minimally impair the rights of these older workers, as an employer is not required to demonstrate that their exclusion from employment benefits is reasonable or *bona fide*, or justified on an actuarial basis, or because their inclusion would cause undue hardship."

Accordingly, the Tribunal found the exclusion of post-65 employees from the Code was contrary to the Charter and the usual prohibitions on age discrimination in the Code should be applied to this situation.

Cost of post-65 benefits

The Tribunal found that the Ontario government's decision to enact a "carve-out" in the Code was not supported by empirical evidence. The Tribunal relied in large part on the evidence provided by the actuarial expert for the complainant. That expert made the following assertions:

1. Dental costs peak at age 40 to 49 and 60 to 64, and steadily decrease thereafter.
2. Extended health care plan costs are highest for employees in the 50 to 64 bracket and decrease after age 65 so that costs in the age 65 to 79 bracket are similar to costs in the 40 to 49 bracket.
3. Life insurance costs increase steadily with age, but age 65 is not significant in terms of mortality. Extending life insurance benefits for employees over age 65 would increase average plan costs, but benefit reductions could be made to keep the average cost of coverage unchanged.

The Tribunal did not accept claims that post-65 employees could potentially remain at work in order to take advantage of coverage for high-cost drugs, thereby creating a risk of "anti-selection" for the benefit plan.

The Tribunal invited the parties to decide whether they wished to engage in mediation, failing which the matter would be decided on its merits and the appropriate remedial order would be made, if required.

Comment

This particular decision applies to a particular circumstance and has been made by a Tribunal rather than a court, so it does not yet have general application. However, if the principle that the general exclusion of post-65 employee benefits from human rights legislation contravenes the Charter is upheld by the courts, employers who continue to exclude post-65 employees from all benefits could be subject to human rights complaints. In order to successfully defend against such complaints, employers would be required to demonstrate that the termination of benefits for those over age 65 is reasonable and *bona fide*. If employers decide that it is impossible or cost-prohibitive to defend such complaints, employers could potentially be required to provide health, dental and life insurance coverage to employees over age 65.

B.C. proposes all long term disability plans be insured

The British Columbia Ministry of Finance has undertaken a review of the province's *Financial Institutions Act* and *Credit Union Incorporation Act* to consider the regulatory framework governing the financial sector. A "Preliminary Recommendations" document posted by the Ministry in March 2018 includes a recommendation to "require employee long-term disability (LTD) plans to be insured, with exemptions for certain employers with low risk of insolvency," subject to further consultation.

The Preliminary Recommendations document does not include detailed proposals for the funding requirements or exemptions. The proposals would potentially affect all employers with provincially regulated employees in British Columbia who currently offer self-funded LTD arrangements. Any changes with regard to this issue are likely some time away.

Similar legislation has been introduced in the past few years by the Ontario and federal governments, and other jurisdictions and provinces may be contemplating similar legislation. These developments were triggered by Nortel and other insolvency cases that resulted in losses for employees in unfunded LTD plans.

Comment

Morneau Shepell has made a submission to the B.C. Ministry of Finance regarding these proposals. Morneau Shepell's submission encourages the Ministry of Finance to consider introducing additional requirements for plan sponsors who choose to self-insure LTD plans, rather than requiring all LTD plans be insured with a third-party carrier.

Plan sponsors may self-insure LTD for a variety of reasons including cost, an inability to obtain insurance due to undesirable risk, and/or for greater control over plan design and claims management. If a requirement for LTD plans to be insured were to be introduced, some plan sponsors might withdraw coverage or terminate the LTD benefit altogether.

Given the importance of this benefit to disabled individuals, a key concern is the ability of self-insured LTD plans to pay financial obligations relating to LTD claims. Morneau Shepell's submission suggests that self-insured plan sponsors be required or incentivized to pre-fund LTD liabilities rather than being forced to insure LTD liabilities in all cases.

The Morneau Shepell submission also includes recommendations regarding ways to address LTD affordability, benefit-plan design, communication and transition issues. We note that the Canadian Institute of Actuaries has issued a public position statement regarding self-insured LTD plans.

(continued on next page)

While this is a very complex issue, our view is that the best way to satisfy the needs of various stakeholders and preserve LTD plans as a viable option for a wide range of employers is to give plan sponsors options to ensure the proper funding of LTD benefits. Morneau Shepell's submission underlines the importance of properly managed LTD plans for both plan sponsors and employers. As well, since other jurisdictions may be contemplating similar legislation regarding self-insured LTD benefits, British Columbia may be in a position to coordinate the application of new requirements with other jurisdictions to ensure a consistent approach. This will be particularly relevant for plan sponsors offering LTD plans to employees in more than one province.

We will continue to monitor these proposals. Even though changes are not imminent, plan sponsors should continue to monitor and review their LTD arrangements, particularly if they are self-insured.

Update: Quebec adopts prohibition on orphan clauses and expands leaves of absence

Bill 176, "An Act to amend the Act respecting labour standards and other legislative provisions mainly to facilitate family-work balance," (the Act) was adopted on June 12, 2018 by the Quebec National Assembly. The Act mostly comes into force on June 12, 2018, but some changes will take effect on January 1, 2019 (or on the coming into force of upcoming regulations). Bill 176 was summarized in the April 2018 edition of *News & Views*.

Prohibition on orphan clauses

The Act now prohibits "orphan" clauses, i.e., differences in treatment with respect to pension plans or other employee benefits based solely on the hiring date of employees who perform the same tasks in the same establishment. Existing clauses that provide for differences in treatment may continue to apply. Employers must comply with the Act with respect to their provincially regulated employees in Quebec regardless of where a pension plan is registered.

Recourse is provided for employees who believe they have been the victim of a prohibited distinction with respect to pension plans or other benefits. The employee may file a complaint with the *Commission des normes, de l'équité, de la santé et de la sécurité du travail* (CNESST) within 12 months (and not 90 days as initially provided in the initial version of Bill 176) of the distinction becoming known to the employee. The complaint may be referred to the Administrative Labour Tribunal (ALT) by the CNESST. The ALT may render any decision it believes fair and reasonable, including:

- order that the distinction no longer be made;
- order that an employee be made a member of a pension plan, or make other employee benefits applicable to the employee;
- order that the employer pay the employee an indemnity for the loss resulting from the distinction.

Amendments to leaves of absence

Amended and new leave periods correspond to the versions set out in the initial version of Bill 176. In addition, the current unpaid leave of absence of not more than 26 weeks over a period of 12 months due to sickness, organ or tissue donation for transplant, or accident has been extended to employees who are victims of domestic violence or sexual violence.

Effective January 1, 2019, an employee who has three months of uninterrupted service will now be entitled to remuneration for the first two days of absence per year taken to deal with family obligations (10 days a year are provided) and for an absence due to sickness, organ or tissue donation for transplant, accident, or domestic violence or sexual violence. However, the employer is not required to pay employees for more than two days of absence even if more than one such leave is taken.

Comment

Employers should check the wording in pension and benefit plans to ensure that all leaves of absence for which benefit accrual is required in Quebec are adequately covered. Employers should also ensure they comply with all new requirements relating to leave provisions.

Several issues relating to orphan clauses are not clearly addressed in the Act. It is not clear whether a future amendment to an existing clause that establishes a distinction based on the date of hiring will be permitted. Furthermore, the exact meaning of the terms "pension plans" and "other employee benefits" is not defined in the Act. These provisions will require further clarification.

Recent cases demonstrate how family and estate law can affect pension plan administration

Two recent pension administration cases demonstrate that unique family and estate situations can at times take precedence over the usual rules of plan administration. These court rulings provided additional protections to a dependent child and a vulnerable former spouse who made claims to pension benefits in unusual circumstances.

Dependent child's right to pension death benefit defeats spousal rights

In *Cotnam v. Rousseau* (Cotnam), the applicant, a dependent child of the deceased who suffers from developmental delay, made a claim against the pension death benefit under the *Ontario Succession Law Reform Act* (SLRA). The SLRA provides that, where a deceased has not made adequate provision for the proper support of his dependants, the court may order that "assets of the deceased's estate" be paid to those dependants. For this purpose, the assets of the estate include assets payable to beneficiaries of the estate.

Among the assets that can be used for the support of a dependant are amounts paid to a designated beneficiary. In Cotnam, the deceased was a pension plan member and his pre-retirement death benefit was paid to his spouse. The dependent child argued that the pre-retirement death benefit forms part of the estate for the purposes of the SLRA. The spouse disagreed, arguing that the death benefit had been paid by operation of subsection 48(6) of the *Pension Benefits Act* (PBA), which creates an automatic right to a pre-retirement death benefit for a spouse who exists at the time of death. This automatic appointment is not a "beneficiary designation," since it is a right that does not require any action by the member or the spouse.

The court awarded the dependent child one-half of the pre-retirement death benefit paid to the spouse. The court found that excluding this benefit from the calculation would frustrate the purpose of the SLRA and the legislature's intention to protect dependants.

BC Court provides 50% share of entire pension benefit to former spouse

In *Kraft v. Kraft* (Kraft), the pension plan member and his former spouse were married in 1970 and had two children. In 1997, the member went to play hockey and never returned, instead moving in with another woman. The former spouse commenced proceedings in 2014, seeking retroactive and ongoing spousal support and a division of the family assets. There had never been an order dividing the family assets and the former spouse had lived a life of hardship since the separation. The member earned a comfortable salary and participated in a defined benefit pension plan. He began receiving his pension in January 2015, with his common-law spouse as his survivor under the pension plan.

The former spouse commenced proceedings approximately 17 years after the parties separated. When justifying the claimant's delay, the court relied on medical evidence confirming a "prolonged

psychological illness" which rendered the former spouse incapable of resolving the divorce matters sooner. The court awarded the former spouse retroactive spousal support from the date that the parties separated, and determined that the respondent owed the claimant $563,376.

It was apparent that the member could not financially meet this obligation. As such, the court ordered a reapportionment of the entire pension, including pension earned after the separation, to ensure that the claimant received compensation for the spousal support payments owed by the respondent, as well as an independent source of income. This is a power that a court has pursuant to Section 129 of the British Columbia *Family Law Act*. The Court ordered that the former spouse receive 50% of the member's entire pension, payable from the first day of trial.

There were also orders made in respect of the family home and farm properties. Together, they cancelled out the unpaid spousal support arrears owing to the claimant.

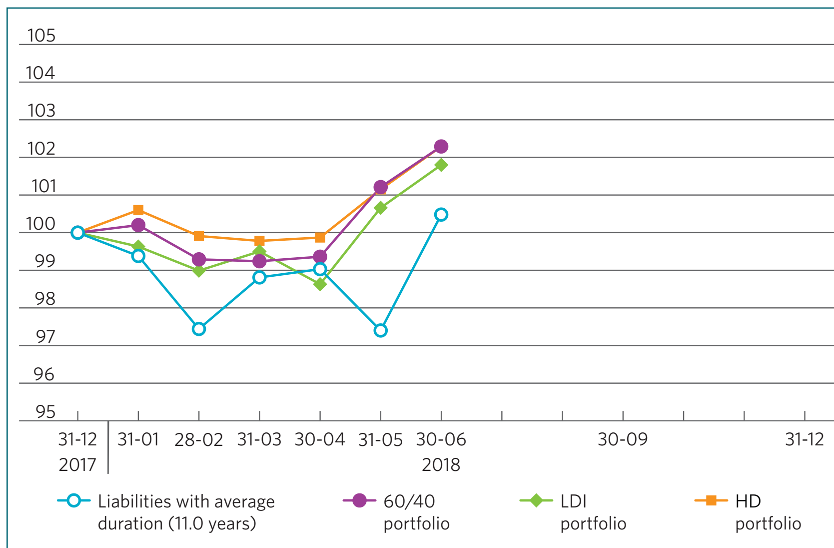
Comment

In most cases, the rules of pension administration are applied by the pension plan administrator based on pension plan documentation, pension legislation and the facts. However, the two cases discussed above demonstrate the possibility of unique claims to pension plan benefits by dependants and former spouses, and the court system has broad rights to deal with these claims. Pension plan administrators who become aware of such claims or potential claims must tread carefully to balance the rights of competing parties, to ensure legal compliance, and to manage risks to both the administrator and the pension plan.

Tracking the funded status of pension plans as at June 30, 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 March 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, 2017



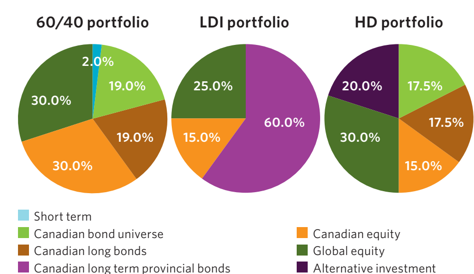
During the month of June, Canadian equity markets, Canadian universe and long-term bonds, Canadian long-term provincial bonds, global equity markets (CAD) and alternative investments all showed positive returns. The 60/40 portfolio, the low volatility portfolio (LDI[1]) as well as the highly diversified portfolio (HD) obtained a return of 1.1%. The prescribed CIA Annuity purchase rates and the commuted value rates used in the calculation of solvency liabilities decreased during the month. As a result, the solvency liabilities increased by 3.2% for a medium duration plan. For this type of plan, an investment in the 60/40, LDI portfolio or the HD portfolio resulted in a decrease 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.

Initial solvency ratio as at December 31, 2017	Evolution of the solvency ratio as at June 30, 2018 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	101.8%	101.3%	101.8%
90%	91.6%	91.2%	91.6%
80%	81.4%	81.1%	81.4%
70%	71.3%	70.9%	71.3%
60%	61.1%	60.8%	61.1%

[1] Liability driven investment

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.



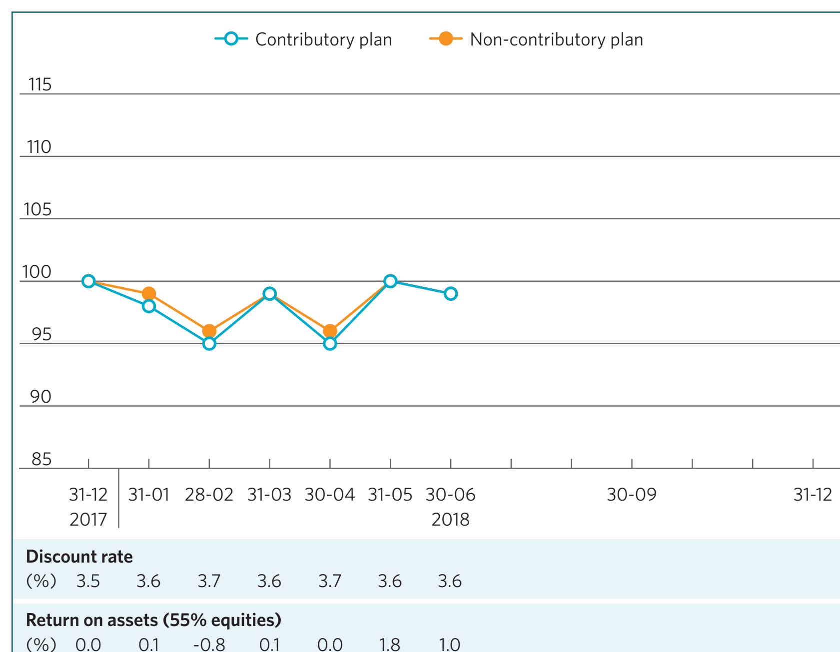
Since the beginning of the year, driven by positives returns in Canadian equity markets, Canadian universe and long-term bonds, Canadian long-term provincial bonds, global equity markets (CAD) as well as the alternative investments, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned 2.3%, 1.8% and 2.3% respectively. The solvency liabilities fluctuated over that same period from 0.4% to 0.5% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at June 30, 2018 stands between 0.8% and 1.8%.

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

Impact on pension expense under international accounting as at June 30, 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	June 2018	Change in 2018
11	3.39%	3.49%	+10 bps
14	3.48%	3.56%	+8 bps
17	3.53%	3.60%	+7 bps
20	3.57%	3.63%	+6 bps

Since the beginning of the year, the pension expense has decreased by 1% (for a contributory plan) due to an increase in discount rates.

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).

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

MORNEAU SHEPELL

Editorial Team

LEAD EDITOR:
Andrew Zur, LL.B.
Pension Consulting

ACTUARIAL EDITORS:
Sonia Trudeau, FCIA, FSA
Pension Consulting

Emily J. Tryssenaar, FCIA, FSA
Pension Consulting

BENEFITS EDITOR:
David White, CEBS
Benefits Consulting

TRANSLATION:
Paule Mercier, C. Tr.
Senior Manager, Translation Department

Authors

Luca Centomo
Asset and Risk Management

Sébastien Éthier, FCIA, FSA
Pension Consulting

Omid Afshari Niko, CFA, ASA
Asset and Risk Management

Tracy Solhi, J.D.
Pension Consulting

Alexandra Sonnenwirth
Pension Consulting

Marcel Theroux, LL.B.
Pension Consulting

Julie Vandal-Lemoyne, LL.B.
Pension Consulting

David White, CEBS
Benefits Consulting

Morneau Shepell is the only human resources consulting and technology company that takes an integrated approach to employee assistance, health, benefits and retirement needs. The Company is the leading provider of employee and family assistance programs, the largest administrator of retirement and benefits plans and the largest provider of integrated absence management solutions in Canada. As a leader in strategic HR consulting and innovative pension design, the Company helps clients solve complex workforce problems and provides integrated productivity, health and retirement solutions. Established in 1966, Morneau Shepell serves approximately 20,000 clients, ranging from small businesses to some of the largest corporations and associations. With more than 4,000 employees in offices across North America, Morneau Shepell provides services to organizations across Canada, in the United States and around the globe. Morneau Shepell is a publicly-traded company on the Toronto Stock Exchange (TSX: MSI). For more information, visit morneaushepell.com.

@Morneau_Shepell

Morneau Shepell

© 2018 Morneau Shepell Ltd.