Knowledge & Insights

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Ontario government to end OHIP+ drug coverage for young people with private drug plans

On January 2, 2019, the Ontario government released a regulatory notice and a draft regulation that will make OHIP+ drug coverage only available to Ontarians under the age of 25 who do not have drug coverage through a private drug benefit plan. The changes will take effect in March 2019. Young people without private drug benefit coverage will continue to have OHIP+ coverage, which grants access to the approximately 4,400 drugs included in the Ontario Drug Benefit Formulary. The OHIP+ youth pharmacare initiative was introduced by the previous Ontario government effective January 1, 2018. The new Ontario government had previously announced its intention to amend the program in June 2018. The announcement was summarized in the August 2018 *News & Views*.

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Definition of private drug plan

The draft regulation defines a private drug plan broadly as "an employer, group or individual plan, program or account, however described, that could provide coverage for, including the provision of funding that could be used to pay for, any drug product," regardless of whether:

- the private insurance plan covers the particular drug for which coverage is sought;
- the child or youth or another person captured under the private insurance plan is required to pay a co-payment, deductible, or premium; or
- the child or youth has reached their annual maximum under the private insurance plan and no further coverage is available.

Individuals or families with private insurance that encounter significant out-of-pocket costs will once again be able to apply for additional financial support through the Trillium Drug Program. This was the case prior to the implementation of OHIP+ on January 1, 2018.

Comment

The impact of the change will vary from plan to plan, but employers and other drug plan sponsors should know that any cost savings they may have realized under the original OHIP+ youth pharmacare program will likely be negated.

The proposed regulations raise a number of questions. It is not clear how pharmacists and the government are to confirm whether young people have private insurance and how the transition will occur in March 2019. Some forms of indirect private drug coverage, such as a health care savings account, may raise interpretation questions. Finally, it is also open to question whether plan sponsors will be allowed to purposely exclude drug coverage for Ontario-resident youth under age 25 so that they can rely on the public OHIP+ program instead.

Ontario eliminates "personal emergency leave"

Effective January 1, 2019, the Ontario government has repealed provisions introduced by the previous Ontario government in 2017 that provided for up to 10 days, including two paid days, of personal emergency leave, replacing it with separate entitlements to sick leave, family responsibility leave and bereavement leave. These new forms of leave are all unpaid.

New forms of unpaid leave

As of January 1, 2019, Ontario employees who have been employed for at least two consecutive weeks are annually entitled to:

- three days of sick leave due to personal illness, injury or medical emergency;
- three days of family responsibility leave due to a family member's illness, injury or medical emergency or due to an urgent matter concerning a family member; and
- two days of bereavement leave due to the death of a family member.

Personal emergency leave has been abolished, and the two paid days of personal emergency leave have not been replaced by new paid leave days.

Other changes to employment standards legisaltion

The Ontario government has also repealed a provision that had prohibited employers from requiring an employee to provide a doctor's note as evidence of entitlement to leave.

Finally, the Ontario government has also repealed a provision that had prohibited compensating part-time, casual or temporary workers differently than their full-time counterparts, except where based on a seniority, merit or production-based system, or on another factor apart from employment status. The provision did not affect pension or benefit plans.

Comment

The changes adopted by the Ontario government repeal some of the changes to employment standards leave that were adopted by the previous Ontario government. However, a number of other new and extended leave provisions introduced by the previous provincial government remain unaffected. The details of these provisions were summarized in the January 2018 edition of *News & Views*.

While a number of jurisdictions have moved towards requiring employers to provide paid leave to employees or to treat part-time and temporary employees the same as full-time employees, the new Ontario government has reversed this trend.

We will continue to monitor developments in this area.

CRA draft newsletter on annuity purchases from pension plans

The Registered Plans Directorate of the Canada Revenue Agency (CRA) has released a draft newsletter for public consultation (the Draft Newsletter). The Draft Newsletter provides guidance on the tax effects of the purchase of annuities by both plan administrators and individuals from registered pension plans, with a focus on purchases of annuities from defined benefit (DB) pension plans.

CRA's interpretation of "materially different"

Section 147.4 of the *Income Tax Act* provides safe harbour for the purchase of an annuity from a pension plan, provided that the annuity terms are not "materially different" from the pension plan terms. If the annuity terms are materially different, then section 147.4 does not apply and the individual is deemed to have received the full purchase price as a taxable payment from the pension plan.

Until the release of the Draft Newsletter, the CRA's practice has been to take a conservative view of the term "materially different", effectively requiring annuity terms to be substantively identical to the pension plan terms. This has proven problematic where the pension plan provides for adjustment based on the Consumer Price Index (CPI), as it can be difficult to find insurers willing to issue annuities to replicate that feature.

The Draft Newsletter states that the CRA will now accept fixed-rate indexation in lieu of CPI indexation. The fixed rate can either be the mid-range of the Bank of Canada's inflation control range at the date of purchase (currently, 2%) or the spread between Canada long bond and real return bonds in the month of purchase or the month preceding (currently, 1.57%). Where the pension plan provides a lesser rate of indexing based on CPI (such as CPI minus 1% or 40% of CPI), that rate must be adjusted accordingly.

This revised position applies to both buy-out annuities purchased by the pension plan administrators and annuities purchased by individuals using their commuted value upon termination of employment.

The Draft Newsletter states that, if a different method is elected, it is recommended that a written request be made to the Registered Plans Directorate with the rationale outlined. Such requests will reviewed on a case by case basis.

Annuity purchases by individuals using the commuted value

Where the commuted value of pension plan benefits is not enough to purchase an annuity to provide the promised benefits, the purchase of the annuity with the commuted value is acceptable, provided that the purchase price is the only payment from the pension plan. The annuity can provide lesser benefits than the pension plan in such a situation.

Where the commuted value of pension plan benefits is more than enough to provide the promised benefits under an annuity, the CRA has always maintained that the excess must be paid in cash to the member. This position is maintained in the Draft Newsletter.

Comment

The main change in the Draft Newsletter is the new guidance respecting the forms of inflation indexing that will not be considered materially different by the CRA from CPI-based indexing. These will be welcome to plan administrators of pension plans who wish to purchase annuities with respect to benefits with CPI-based indexing.

Written comments on the Draft Newsletter can be made on or before March 1, 2019.

Inclusion of Provision for Adverse Deviation in financial reporting for DB pension plan sponsors reporting under CPA Canada Handbook Sections 3462 and 3463

The Accounting Standards Board (AcSB) has issued a Decision Summary which affects defined benefit pension plan sponsors that report under Sections 3462 (Private Enterprise) and 3463 (Not-for-Profit Organizations) of the Chartered Professional Accountants of Canada (CPA Canada) Handbook and elected to use funding valuation assumptions for financial reporting. The Decision Summary provides long-awaited guidance on the inclusion or exclusion of the explicit Provision for Adverse Deviations (PfAD) in the financial reporting of these entities.

The AcSB's standard for funding valuation requires valuations to be prepared in accordance with legislative, regulatory and contractual requirements. In its Decision Summary, the AcSB has indicated that, where legislative, regulatory and contractual requirements stipulate separate calculations for various components of the funding requirement, the funding valuation reflected in financial statements will be comprised of the aggregate of those various components. This will include the PfAD.

It is expected that audit firms will follow the AcSB's Decision Summary. For entities that have elected to use results from their funding valuations rather than conducting separate accounting valuations in their financial statements, this would mean including the explicit PfAD in the going concern liability and normal cost when reporting in their financial statements.

Comment

This change will affect the financial reporting of defined benefit pension plan sponsors who report under CPA Canada Handbook Sections 3462 and 3463 and elected to use funding valuation assumptions for financial reporting, are registered in provinces that require a PfAD be included as a component of funding valuations, and have not been including the PfAD in their financial reporting. It remains unclear whether auditors will require revisions of 2018 financial statements, or will wait until the coming year before implementing. Companies that are still in the process of preparing their 2018 financial reporting may wish to consult with their auditors to confirm what they would deem reasonable in the financial reporting for the 2018 year.

The AcSB has directed its staff to consider further public communications in regards to the Decision Summary. Additional details and direction clarifying the Decision Summary may therefore be released in the coming months.

Alberta adopts joint governance structure for large public sector pension plans

On December 11, 2018, Alberta adopted Bill 27, which will transition the Local Authorities Pension Plan, the Public Service Pension Plan, and the Special Forces Pension Plan to a joint governance structure. Once the plans have transitioned to the new governance structure, newly created sponsor boards and corporations will be responsible for the plan design and administration, respectively, and the Alberta government will no longer act as the plan sponsor and administrator.

The three affected pension plans are large public sector pension plans, with a combined 450 employers, 350,000 members, and $59.3 billion of managed assets. The plans will continue to be under the jurisdiction of the *Employment Pension Plan Act* and the Alberta Superintendent of Pensions.

Role of the sponsor board

The legislation will transition the sponsor role for each plan from the Alberta government to a newly created sponsor board for each plan.

The three newly created sponsor boards will be made up of equal numbers of employee and employer representatives, providing the two sides with an equal say in managing and designing their plans to suit their needs.

The sponsor board will manage contribution and benefit levels, and will also establish the funding policy for the plan. The sponsor board will have the power to amend the pension plan and to change plan design.

The sponsor board will also establish rules respecting expenses that may be charged to the plan by the administrative corporation.

The sponsor board will not include retiree representatives, but is required to consider the needs of all members, including retirees.

Role of the administrative corporation

The plan trustee administrative roles will now be performed by the corporation of each plan. Directors of the corporation are also appointed equally by the employees and employers, but a person may not sit on both the sponsor board and corporation board. Appointment to either board is not subject to approval from the Alberta government.

Service agreements in place with the Alberta Investment Management Company and Alberta Pension Services will remain in place for next five years, and, after this period, any decisions to renew the contracts will be made by the corporations.

Timing

The affected plans will transition to the new structure on March 1, 2019, and regulations will be adopted in early 2019 to accommodate the new governance structure.

After March 1, 2019, the sponsor boards and administrative corporations will begin to manage their respective pension plans, and the government of Alberta will no longer act as sponsor and administrator for the plans.

Correction: federal pay equity compliance deadline

The article titled "New pay equity obligations for federally regulated employers" in the January 2019 *News & Views* erroneously stated that federally regulated employers of ten or more employees are required to establish a pay equity plan and make the required pay increases, if any, by December 13, 2021.

In fact, the deadline will be three years after the new *Pay Equity Act* comes into force. The date the new *Pay Equity Act* comes into force is unknown, and therefore the deadline is also unknown.

The article has been corrected on the Morneau Shepell website. We apologize for the error.

Comment

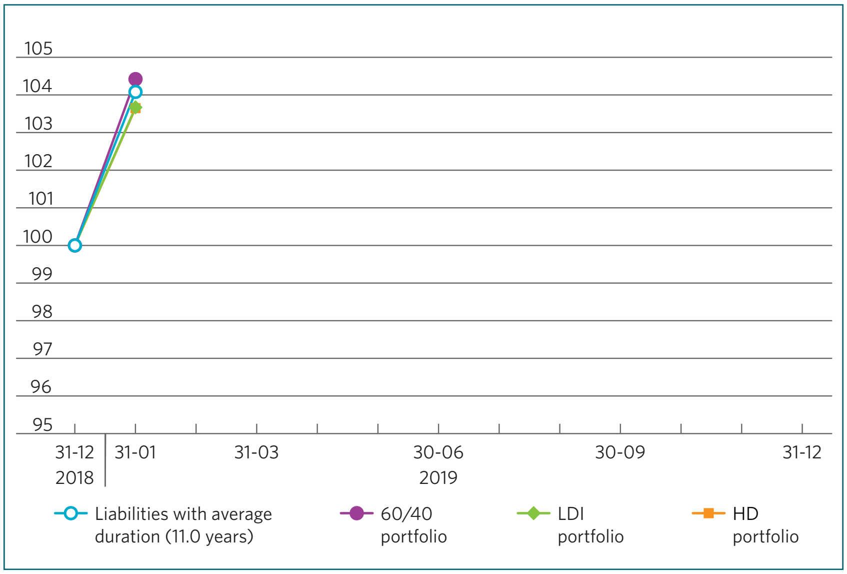
Members will see little change over the short term, as the new legislation only affects the governance structure and does not impact plan benefits or how they are funded. The sponsor boards will be responsible for any future contribution and benefit changes, and the government will be removed from the decision making process.

The joint governance structure of public section pension plans has already been adopted by British Columbia and Ontario for large public sector pension plans. With Alberta also adopting this structure, other Canadian provinces may also consider establishing joint governance of their own public sector pension plans.

Tracking the funded status of pension plans as at January 31, 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



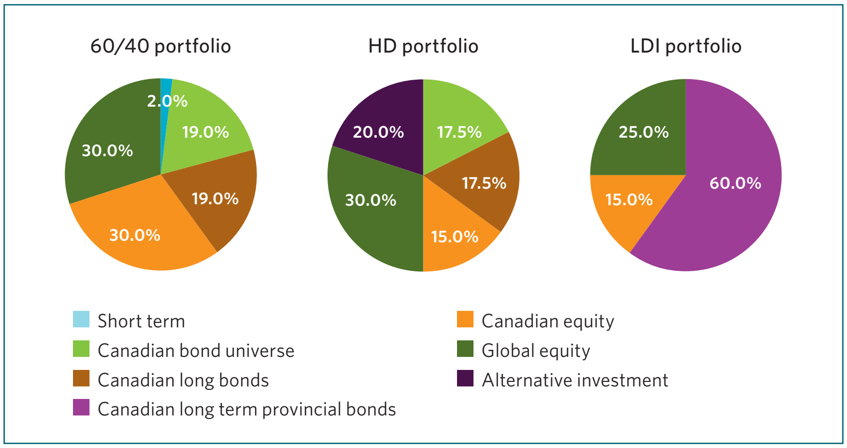
During the month of January, Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian equity markets, the global equity markets (CAD) as well as alternative investments showed positive returns. With a return of 4.4%, the 60/40 portfolio outperformed the low volatility portfolio (LDI[1]) (3.7%) and the highly diversified portfolio (HD) (3.6%).

The prescribed CIA annuity purchase rates as well as the commuted value rates used in the calculation of solvency liabilities decreased. As a result, the solvency liabilities increased by 4.1% for a medium duration plan. For this type of plan, an investment in the LDI or the HD portfolio resulted in a decrease of the solvency ratio while an investment in the 60/40 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 January 31, 2019 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	100.3%	99.6%	99.6%
90%	90.3%	89.6%	89.6%
80%	80.3%	79.7%	79.7%
70%	70.2%	69.7%	69.7%
60%	60.2%	59.8%	59.7%



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

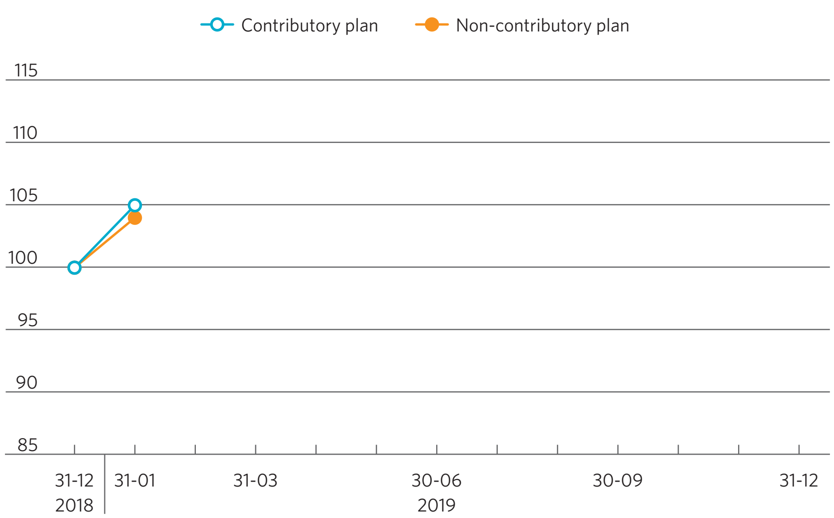
Comments

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 January 31, 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



Discount rate
(%) 3.8% 3.6%

Return on assets (55% equities)
(%) 0.0% 4.2%

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	January 2019	Change in 2019
11	3.72%	3.52%	-20 bps
14	3.81%	3.62%	-19 bps
17	3.87%	3.68%	-19 bps
20	3.90%	3.72%	-18 bps

Since the beginning of the year, the pension expense has increased by 5% (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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