Knowledge & Insights

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Federal government issues draft tax relief for pension plans

On July 2, 2020, the federal government released new draft regulations aimed at providing relief for registered pension plans, as part of the government of Canada's COVID-19 Economic Response Plan.

The draft regulations would amend the Income Tax Regulations made under the *Income Tax Act* (the Regulations) to provide temporary relief from various rules applicable to registered pension plans.

- The existing restrictions that prohibit pension plans from borrowing money for periods of more than 90 days (with certain exceptions) will be temporarily eased, permitting pension plans to enter into loan agreements after April 2020 and before February 2021, provided the loans are repaid no later than April 30, 2021.
- Where a member's period of reduced services ends in a year, and defined benefit (DB) pension plan past service is credited for that period before April 30 of the following year, restated PAs are reported for the past years rather than PSPAs. Similarly, defined contribution (DC) pension plan contributions made before April 30 of the year following the year of termination of a period of reduced services, to the extent that they relate to a calendar year spanned by the period of reduced services, are included in the PA for the calendar year. These deadlines are extended to June 1, 2020, or a later date acceptable to the Minister, for periods of reduced services that ended in 2019. The extensions will accommodate delays that may have resulted from COVID-19.
- To the extent that required contributions under a DC pension plan had been reduced in 2020, the amended Regulations will allow pension plans to permit catch-up contributions to be made in 2021. Under the amended Regulations, "retroactive contributions" can be made provided:

  If the contribution is made by an individual member,

  - The individual makes the contribution after 2020 and on or before April 30, 2021, or
  - The individual makes a written commitment, on or before April 30, 2021, to the plan administrator or a participating employer, to make the retroactive contribution.

  If the contribution is made by a participating employer,

  - The employer makes the contribution after 2020 and on or before April 30, 2021, or
  - The contribution is conditional on the member making a written commitment, on or before April 30, 2021, to the plan administrator or a participating employer, to make a retroactive contribution as provided above.

Such a retroactive contribution replaces all or part of a contribution that would have been required in 2020 if not for a plan amendment reducing required contributions.

These additional contributions will be deemed to have been made in 2020 for pension adjustment purposes. They will remain deductible in the year in which they are made.

- For the purpose of using prescribed compensation to determine benefit or contribution levels for 2020, the amended Regulations will remove the condition that an employee have been employed for 36-months in the definition of "eligible period of reduced pay."
- The amended Regulations will also allow any periods during which employee wages are reduced in 2020 to qualify as eligible periods of reduced pay for the purposes of prescribed compensation. This would allow a pension plan to provide pension contributions or pension benefits to employees subject to wage reductions based on their wages before the wage reduction.

Comment

While no effective date for the amendments has been announced, longstanding CRA practice permits taxpayers to act on the assumption that proposed tax measures will be enacted. The rules will provide additional flexibility to both employers and employees who are affected by temporary absences of employment or wage reductions, as well as contribution reduction amendments in defined contribution pension plans. The additional borrowing flexibility may also be of assistance during periods of investment volatility.

Quebec publishes draft regulation to provide temporary COVID-19 relief measures for pension plans

The draft regulation titled "Regulation respecting measures related to supplemental pension plans to reduce the consequences of the public health emergency declared on 13 March 2020 due to the COVID-19 pandemic" was published on July 15, 2020 in the Gazette officielle du Québec. The draft regulation provides for temporary measures that are mainly intended to reduce the effects of the economic slowdown and pandemic on pension plans.

The main measures of the draft regulation are described below. Some were previously announced by Retraite Québec and were discussed in the April 2020 *News & Views*.

New measures

1. Active members who are, for a temporary period, no longer accruing benefits in a pension plan may remain as active members of the plan. This measure applies to defined benefit and defined contribution pension plans, including simplified pension plans. However, such temporary cessation of accrued benefits must meet the following conditions:

   - The temporary cessation of benefit accrual only applies to service as of July 15, 2020. Note also that a plan amendment is required to this effect and that the cessation of benefit accrual will only take effect as of the date on which such amendment becomes effective; and

   - The temporary cessation of benefit accrual must begin in 2020 and is limited to a maximum period of one year.

   Note that it is already possible to amend a pension plan in order to suspend benefit accrual. However, without the proposed measure, plan members whose benefits cease to accrue would stop being active members of the plan and would have to be issued termination or retirement statements.

2. An actuarial valuation as at December 31, 2020 will not be required for a defined benefit pension plan in the private sector whose funding level, determined by an actuarial valuation as at December 31, 2019, is less than 90%. The notice on the financial position of the plan as at December 31, 2020 must be sent to Retraite Québec no later than nine months after that date. In addition, the next actuarial valuation will be required no later than on December 31, 2021.

Previously announced measures

1. With regard to the payment of benefits to members and beneficiaries of a defined benefit plan in the period from April 17, 2020 to December 31, 2020, the proposal is to use a degree of solvency established monthly based on the plan's estimated financial position. It is also proposed to use the last estimated degree of solvency of 2020 for payments made in 2021, until a more recent degree of solvency, established by an actuarial valuation or a notice on the financial position of the plan, has been sent to Retraite Québec.

2. A number of the deadlines in the *Supplemental Pension Plans Act* for sending certain documents to Retraite Québec or plan members have been extended by three months. The extension applies for all deadlines that had not expired as at March 12, 2020 and which otherwise would have expired in 2020. For example, for a pension plan with a financial year ending on December 31, 2019, the September 30, 2020 deadline for sending annual statements to plan members has been extended to December 31, 2020. The same holds for actuarial valuations.

Updates to Retraite Québec's Frequency Asked Questions

In addition, the Frequently Asked Questions page on the Retraite Québec website has been updated with new information.

Retraite Québec advises that the 2020 annual meeting must still be held and pension committee members whose term of office expires must still be elected, although the annual meeting may be held by videoconference or other electronic means. An annual meeting can cover both 2019 and 2020, provided it is held at the beginning of 2021. For pension plans with a financial year ending on December 31, 2019, the pension committee has until December 31, 2020 (instead of September 30, 2020) to call the annual meeting for 2019. The annual meeting is intended to provide members and beneficiaries with information about the pension plan's financial situation and about all amendments made to the plan in 2019; it must therefore be held within a reasonable time following the call to meeting.

Retraite Québec has also provided guidance with respect to the new measure regarding active participation during a temporary suspension of benefit accrual, the degree of solvency for defined benefit pension plans on member annual and termination statements and the impact of the 2020 Agreement Respecting Multi-Jurisdictional Pension Plans on certain measures. For example, the temporary measure regarding payments based on the estimated degree of solvency applies to non-Quebec members and beneficiaries of a pension plan registered in Québec, provided the Agreement has been signed by the legislative jurisdiction applicable to the members and beneficiaries.

Effective dates

Any interested person may submit comments on the draft Regulation until August 29, 2020. The draft Regulation takes effect as of July 15, 2020, except that the measures regarding the degree of solvency for the purpose of paying benefits applies as of April 17, 2020, and the deadline extensions apply as of March 13, 2020.

Ontario COVID-19 deemed leave of absence raises pension issues

On May 29, 2020, the Government of Ontario enacted O. Reg 228/20: Infectious Disease Emergency Leave (the Regulation) which expanded the scope of the Infectious Disease Emergency Leave under the *Employment Standards Act, 2000* (the ESA). This introduces a new form of deemed leave for temporarily laid-off non-unionized employees. Although primarily aimed at ensuring that temporary lay-offs due to COVID-19 do not result in mandatory terminations under the ESA, the new deemed leave can also have an impact on pension and benefit plan coverage. This development provides an update to the COVID-19 related leaves, discussed in the May 2020 *News & Views*.

Deemed infection disease emergency leave

The temporary provisions of the Regulation are retroactive to March 1, 2020, and continue until six weeks after the provincial declared emergency is terminated (COVID-19 Period). The Ontario Government enacted the Regulation to automatically place non-unionized employees on a deemed Infectious Disease Emergency Leave during the COVID-19 Period at any point in which their hours of work are temporarily reduced or eliminated by their employer due to COVID-19.

The Regulation applies to all non-unionized employees. Notably, the Regulation does not apply to employees who were terminated prior to May 29, 2020, and to employees who were terminated during the COVID-19 Period due to permanent discontinuance of the employer's business.

Ordinarily, an employer is only permitted under the ESA to place an employee on temporary lay-off for up to 13 weeks in a 20 week period, at which point the employee is automatically considered terminated. This period is extended in some cases, for example, if the employee is provided with pension benefits

during the leave or if the employee agrees to a longer temporary lay-off period. The Regulation now permits employers to provide for longer temporary absences without having to provide for automatic terminations.

Impact on benefit plans during the COVID-19 Period

Unless an employee has stopped participating in a pension or benefit plan prior to May 29, 2020, the employee continues to participate in the pension plan during the Infectious Disease Emergency Leave unless the employee elects in writing not to continue. This is consistent with the treatment of other leaves provided for under the ESA, such as pregnancy and parental leave.

However, if the employee had already stopped participating in the pension plan as of May 29, 2020, they do not have the right to continue to participate in the plan during the COVID-19 Period. Under such circumstances, this would mean that employers would not be required to provide pension coverage in respect of most temporary layoffs resulting from COVID-19, assuming that they began prior to May 29, 2020.

ACPM submission

A submission was made by the Association of Canadian Pension Management (ACPM) dated June 29, 2020, to the Minister of Labour in respect of the deemed Infectious Disease Emergency Leave. The ACPM raised concerns that there may be unintended consequences as a result of the deemed leave. For example, pension plan terms may give members a right to continued pension accrual during employment leaves that go above and beyond minimum statutory requirements. In addition, pension plan members may gain additional pension buy-back rights as a result of the deemed leave, or may be subject to different pricing rules under a leave as opposed to lay-offs.

The ACPM also highlights the disparity in treatment between employers who ceased providing pension accrual prior to May 29, 2020, and those that did not. Lastly, the ACPM noted that the new provisions do not apply to unionized employees and may raise perceptions of unfairness between unionized and non-unionized employees.

Termination of the deemed leave period

On July 24, 2020, Ontario's provincial declaration of emergency in response to the COVID-19 pandemic terminated. Therefore, the termination of the provincial declaration of emergency on July 24, 2020, means that the temporary changes to the ESA under the Regulation will end on September 4, 2020. After September 4, 2020, any deemed Infectious Disease Emergency Leave will end and the usual rules respecting lay-offs under the ESA will once again apply.

Comment

Employers who implemented temporary lay-offs of Ontario non-unionized employees due to the COVID-19 pandemic should be aware of the potential impact of the deemed Infectious Disease Emergency Leave. Depending on the pension plan terms and whether the employees continued or ceased contributing to a pension plan as of May 29, 2020, there may be an impact on pension plan administration and the employer may be obligated to provide for pension accrual in certain cases.

Ontario introduces forms for DC plans offering variable benefits

The Financial Services Regulatory Authority of Ontario (FSRA) has introduced various variable benefit forms, which will enable Ontario members of defined contribution (DC) plans and their spouses to access variable benefits and access various options with respect to variable benefit accounts. Variable benefits became permitted in Ontario effective January 1, 2020, as discussed in the January 2020 *News & Views*. A DC pension plan is not required to offer variable benefit accounts.

The new variable benefit forms are as follows:

Form VB 1 - Waiver of Joint and Survivor Pension – Variable Benefit Account provides for spousal consent to the establishment of a variable benefit account for a plan member. This form is required because Ontario members who have spouses from whom they are not living "separate and apart" must obtain the spouse's consent in order to establish a variable benefit account.

Form VB 2 - Application to Withdraw or Transfer up to 50% of Amount Transferred to a Variable Benefit Account enables a member to withdraw as cash or transfer to an unlocked RRSP or RRIF up to 50% of the amount transferred to a variable benefit account within 60 days of its establishment.

Form VB 3 - Direction of Retired Member to Transfer an Amount out of a Variable Benefit Account permits a retired member to transfer part or all of a variable benefit account to a locked-in retirement account (LIRA), a life income fund (LIF), another DC pension plan or a life insurance company for the purchase of a life annuity.

Form VB 4 - Spousal Waiver of Death Benefit from a Variable Benefit Account enables a spouse to waive his or her right to a death benefit under a variable benefit account.

Form VB 5 - Direction of Spouse as Specified Beneficiary to Continue Receiving Variable Benefit Payments enables a spouse who was designated a "specified beneficiary" by a member to elect to continue to receive variable benefit payments. The election must be made within 90 days after the death of the retired member.

Form VB 6 - Direction of Spouse as Specified Beneficiary to Transfer an Amount out of a Variable Benefit Account permits a spouse who is receiving variable benefit payments as a "specified beneficiary" to transfer part or all of the variable benefit account to a LIRA, a LIF, another DC pension plan or a life insurance company for the purchase of a life annuity.

FSRA is also developing family law forms for use in the event of a marriage breakdown where there is family property to be divided in the form of a variable benefit account.

Comment

The adoption of the new variable benefit forms for Ontario members and their spouses will assist in the administration of variable benefit accounts. Variable benefit accounts can be an attractive feature for DC pension plan members and their spouses as they face the need to convert accumulated retirement assets into retirement income.

Supreme Court of Canada orders repayment of pension benefits made in error

The Supreme Court of Canada has ruled in *Threlfall v. Carleton University* that a Quebec woman must repay nearly half a million dollars she had collected on behalf of a missing member of the Carleton University pension plan while the member was missing for a period of nearly six years.[1] The plan administrator was able to recover payments it had made after it was discovered that the member had in fact died shortly after his disappearance.

The facts

On September 10, 2007, a retired former professor suffering from Alzheimer's disease disappeared while on a walk near his home. As a member of the university's pension plan, he had been in receipt of a pension benefit which, under the terms of the plan and the option he selected, was payable for the rest of his life, with no survivor benefits.

Upon his disappearance, the retiree became an "absentee" within the meaning of articles 84 and 85 of the *Civil Code of Québec* (CCQ), and was therefore presumed to be alive for seven years following his disappearance, unless proof of his death was made before then. As required under the CCQ's absentee regime, the plan administrator continued to pay

1 2019 SCC 50.

the pension to the member's "tutor"—the person appointed by a court to administer the absentee's property—who was also his former spouse and his sole heir.

The member's remains were discovered almost six years following his initial disappearance. A coroner concluded he had died sometime in 2007 and the province's Registrar of Civil Status recorded his death as having occurred on September 11, 2007, one day after he had gone missing. The administrator of the Carleton University pension plan then sought to recover the payments it had made during the period between the member's disappearance and the discovery of his remains.

Court decision

On October 31, 2019, the Supreme Court of Canada ruled in favour of the administrator, upholding the decisions of the Quebec Court of Appeal and the trial judge, who had ordered the deceased member's spouse to repay approximately $500,000 in pension benefits that had been paid while the member was missing.

The court ruled that the presumption that the absentee is alive is extinguished retroactively to the time he actually died, rather than prospectively from when his death was discovered. In the court's view, the presumption of life created under the CCQ did not create any permanent substantive rights, and could be rebutted by new facts. Since the member was in fact dead during the period in which he had been presumed to be alive, and since the plan's obligation to pay his pension ended on upon his death, the continued pension payments the administrator had made were not required in order to satisfy a genuine debt and therefore represented a "payment not due" under the CCQ.

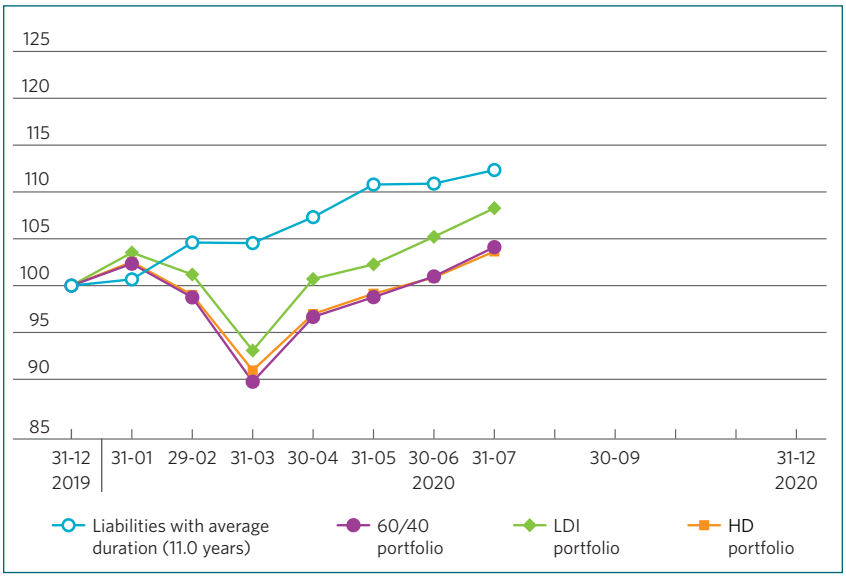
Comment

While the facts of this case are unusual, the court's ruling highlights that, in general, pension payments made in error or to those without genuine entitlements will be recoverable by pension plan administrators when the true facts are discovered. It also highlights that family members are responsible for notifying the pension plan administrator of the death of a pension plan member and that payments mistakenly continued after the death of a member will generally be required to be returned to the pension plan.

Tracking the funded status of pension plans as at July 31, 2020

This graph shows the changes in the financial position of a typical defined benefit plan with an average duration since December 31, 2019. For this illustration, assets and liabilities of the plan were each arbitrarily set at $100 million as at December 31, 2019. The estimate of the solvency liabilities reflects the CIA guidance for valuations effective June 30, 2020 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, 2019



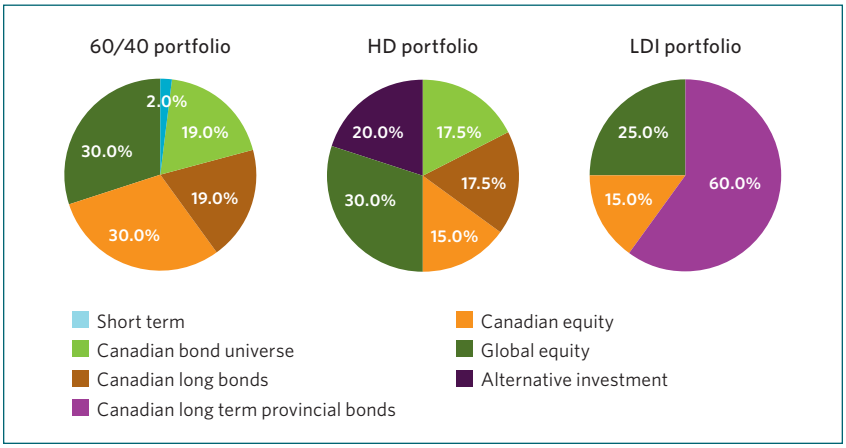
During the month of July, Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian equity markets, global equity markets (CAD) as well as alternative investments showed positive returns. With a return of 3.1%, the 60/40 portfolio outperformed the low volatility portfolio (LDI[1]) (2.9%) and the highly diversified portfolio (HD) (2.8%).

The prescribed CIA annuity purchase rates as well as the commuted value rates used in the calculation of solvency liabilities decreased during the month. As a result, the solvency liabilities increased for a medium duration plan. For this type of plan, an investment in the 60/40, in the LDI and in the HD 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, 2019.
The graph shows the asset allocation of the three typical portfolios.

Initial solvency ratio as at December 31, 2019	Evolution of the solvency ratio as at July 31, 2020 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	92.7%	96.4%	92.3%
90%	83.4%	86.7%	83.0%
80%	74.1%	77.1%	73.8%
70%	64.9%	67.5%	64.6%
60%	55.6%	57.8%	55.4%



Since the beginning of the year, driven by positive returns in the Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds and global equities, the LDI portfolio, the 60/40 portfolio and the HD portfolio returned 8.3%, 4.1% and 3.6% respectively. The solvency liabilities fluctuated over that same period from 12.1% to 12.4% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at July 31, 2020 stands between -7.7% and -2.2%.

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

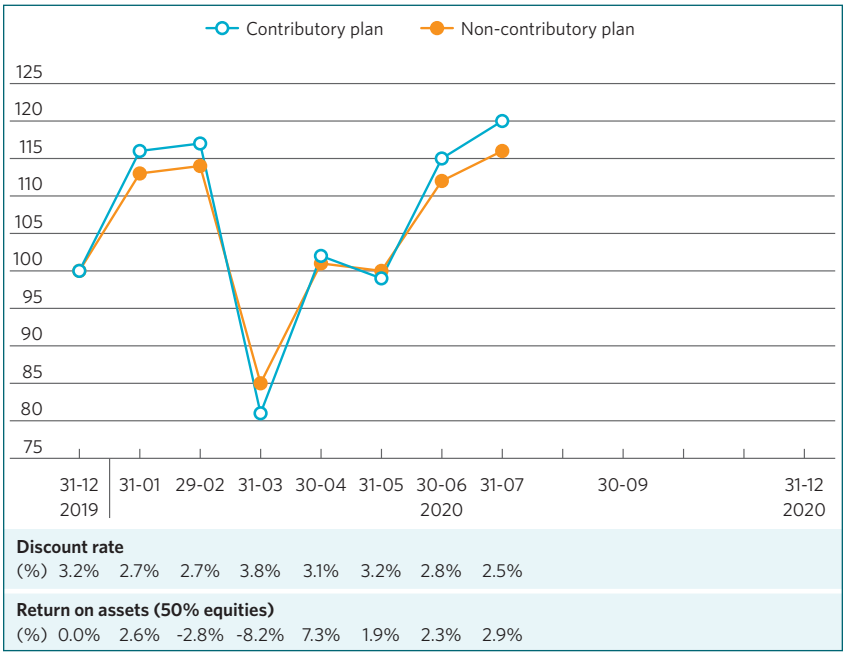
Comments

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 July 31, 2020

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, 2019



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 2019	July 2020	Change in 2020
11	3.06%	2.36%	-70 bps
14	3.13%	2.51%	-62 bps
17	3.17%	2.59%	-58 bps
20	3.20%	2.65%	-55 bps

Since the beginning of the year, the pension expense has increased by 20% (for a contributory plan) mainly due to the decrease in the discount rates, despite the good returns on assets (relative to the discount rate).

Note that the calculation of the expense for June 2020 has been adjusted following certain corrections.

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

Comments

1. The expense is established as at December 31, 2019, based on the average financial position of the pension plans used in our 2019 *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, 2018).
2. The return on assets corresponds to the return on the Morneau Shepell benchmark portfolio (50% equities and 50% fixed income), which reflects the average asset mix in our 2019 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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