Knowledge & Insights

MORNEAU SHEPELL

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In this issue

New pay equity obligations for federally regulated employers

On December 13, 2018, the federal government's Bill C-86, which among other things establishes a new *Pay Equity Act* (the Act), received royal assent. The Act, which comes into force on a date to be proclaimed by the federal government, will create new requirements for federally regulated employers with the aim of providing that women receive equal pay for work of equal value.

The Act requires federally regulated employers of ten or more employees to establish a pay equity plan within three years of the Act being proclaimed into force. Different deadlines apply to provincially regulated employers that become subject to the Act as a result of becoming federally regulated after the Act comes into force.

The pay equity plan must:

- Indicate the number of employees;
- Identify job classes within the workplace;
- Indicate what gender is predominant in each class;
- Evaluate the value of work performed by each job class;
- Identify the compensation associated with each job class;
- Compare the compensation associated with female- and male-predominant job classes of similar value;
- Set out the results of the comparison, identifying which female-predominant job classes require an increase in compensation and when increases in compensation are due; and
- Provide information on the dispute resolution procedure available to employees.

Employers will also be required to post notices setting out their obligations and reporting on their progress in fulfilling them. The pay equity plans must be reviewed and updated at least once every five years.

If a pay equity plan discloses differences in compensation between predominantly female and predominantly male job classes, the employer must increase compensation to employees in the underpaid predominantly female job classes as required by the pay equity plan. These pay increases must begin within three years of the Act being proclaimed into force, although phased-in increases are permitted in some circumstances. Different deadlines apply to provincially regulated employers that become subject to the Act as a result of becoming federally regulated after the Act comes into force.

In addition, employers of 100 or more employees, as well as unionized employers, are required to establish a pay equity committee to develop and update the pay equity plan. The committee must comprise a minimum of three members, at least two thirds of whom must represent employees covered under the pay equity plan and at least half of whom must be women. The committees must include representatives of the employer, non-unionized employees and, in the case of unionized workplaces, the union. Non-unionized employees must have one or more representatives, chosen by a majority vote. In the case of unionized employees, there must be at least the same number of representatives as there are bargaining agents.

Finally, a Pay Equity Commissioner and Pay Equity Unit will be appointed within the Canadian Human Rights Commission to administer and enforce the Act. The Pay Equity Commissioner will facilitate dispute resolution and issue binding orders where necessary, promote compliance through a system of administrative monetary penalties, and conduct compliance audits and investigations.

Comment

Since 1977, the *Canadian Human Rights Act* has prohibited discrimination in wages between federally regulated male and female employees performing work of equal value. The new *Pay Equity Act* imposes additional requirements on federally regulated employers that will require them not only to refrain from discrimination contrary to the *Canadian Human Rights Act*, but also to take proactive steps to ensure men and women receive equal pay for work of equal value. Federally regulated employers of ten or more employees should prepare to take steps to create a pay equity plan or, in the case of employers of 100 or more employees, to establish a pay equity committee. Employers that anticipate having to report significant discrepancies between male- and female-predominant job classes may also wish to being contemplating the costs involved with remedying those imbalances.

Paid and unpaid leaves to be expanded for federally regulated employees

On December 13, 2018, the federal government passed Bill C-86 which, among other things, will expand certain paid and unpaid leaves for federally regulated employers and employees under the *Canada Labour Code* (the Code).

In order to facilitate the new Employment Insurance parental sharing benefit, which becomes effective in March 2019, the Code is amended to increase the aggregate amount of parental leave that may be taken by two parents from 63 weeks to 71 weeks. However, as before, no one employee may take more than 63 weeks of leave with respect to the same birth or adoption. Similarly, the aggregate amount of combined maternity and parental leave that may be taken by two parents is increased from 78 weeks to 86 weeks, with no one employee taking more than 78 weeks of leave with respect to the same birth or adoption.

Bill C-86 also makes available several new types of leave. Specifically, it now provides five days of personal leave for all employees. Three of those days will be paid if the employee has completed at least 3 months of employment. Grounds for granting personal leave will include leave for:

- treating an employee's illness or injury;
- carrying out responsibilities related to the health or care of any of the employee's family members;
- carrying out responsibilities related to the education of any of their family members who are under 18 years of age;
- addressing any urgent matter concerning themselves or their family members;
- attending the employee's citizenship ceremony; and
- any other reason prescribed by regulation.

Bill C-86 also provides that the first five days of leave for victims of family violence shall be paid for employees who have completed 3 months of employment.

Effective September 1, 2019, employees will no longer be required to complete 6 months of employment before being entitled to maternity leave or parental leave, leave to care for a child or adult with a critical illness, or a leave related to death or disappearance of a child. Also effective September 1, 2019, employees will be entitled to unlimited unpaid leave to be a witness in court or for jury duty.

Comment

The changes to the Code resulting from Bill C-86 continue the trend of expanding employee leaves, providing for employer-paid leaves in some circumstances. These changes will be of interest to federally regulated employers and employees. Other than the changes that come into force on September 1, 2019, the changes will come into force upon proclamation by the federal government.

Update: second Exposure Draft of new rules for pension commuted value calculations

On November 23, 2018, the Actuarial Standards Board (ASB) of the Canadian Institute of Actuaries released the second Exposure Draft of proposed changes to the actuarial standards applicable for the calculation of pension commuted values (CVs). The second Exposure Draft includes some noteworthy updates that will affect both defined benefit (DB) and target pension arrangements (TPAs) across Canada. The previous Exposure Draft was released in July 2017 and summarized in the July 2017 edition of *News & Views*.

Updates affecting DB pension plans

Consistent with the July 2017 Exposure Draft, the interest rate spread over the Government of Canada bonds will be a market-linked spread rather than a fixed 90 basis points (bps) spread. The first Exposure Draft's proposed approach of adding a spread to Government of Canada bonds of 67% provincial bonds and 33% investment-grade corporate bonds is retained.

The second Exposure Draft proposes that a floor of 0 bps and cap of 150 bps be applied to the spread added to the Government of Canada bond yields used for determining commuted values (CVs). The purpose is to mitigate large interest rate spreads during unusual financial market conditions.

Depending on market conditions, the proposed approach could lead to a reduction (or increase) in CV amounts compared to the current standard. However, current market spreads indicate a much smaller impact on CVs than would have been seen 10 years ago during the financial crisis of 2008 and the years after. The introduction of the minimum and maximum spread will serve to mitigate impacts to CVs during times of extreme market fluctuations and instability.

In addition to the changes respecting interest rate spreads, the second Exposure Draft would permit, but not require, the use of an alternate approach for the assumed age of pension commencement used in determining the commuted value. Historically, the assumed member retirement age to calculate CVs has been equal to the age that maximizes the CV.

The second Exposure Draft proposes this assumption be changed to a blend of 50% of the age that maximizes the CV, and 50% of the member's earliest unreduced retirement age. A pension plan could continue to use the current approach, as long as it produces a higher CV amount than the new approach.

Updates affecting TPAs

The definition of a TPA remains unchanged compared to the July 2017 Exposure Draft. A TPA is defined as "a pension plan for which applicable legislation contemplates the reduction to the accrued pensions of plan members while the pension plan is ongoing as one of the available options for maintaining the funded status of the pension plan, and where the reduction in accrued pensions is not necessarily caused by the financial distress of the plan sponsor or sponsors."

However, the second Exposure Draft notes that policy makers should consider whether pension legislation in their jurisdiction should permit the use of this section by other plans, such as jointly sponsored pension plans.

The proposed methodology for calculating CVs for TPAs has been updated in the second Exposure Draft from a proportionate share of plan assets to the going-concern liability. The assumptions for the most recently filed going-concern valuation must be used, including margins for adverse deviations. However, in the case of determining the CVs of deferred members, some of these assumptions could be modified if deemed unreasonable for the purpose of calculating CVs.

It will be possible, if permitted by plan terms or legislation, to adjust a member's CV up or down to reflect the plan's funded status. If the going-concern funded ratio is used for this purpose, the calculation date of this ratio should be no earlier than the valuation date of the most recently filed actuarial funding valuation report or cost certificate.

Comment

Feedback on the second Exposure Draft must be submitted by January 31, 2019. Unless the feedback submitted results in significant revisions to the second Exposure Draft, it is expected that the changes to the standard will be finalized in early 2019, with an effective date no earlier than mid-2019. Changes to the standard are automatically adopted in most jurisdictions in Canada, but would require regulatory changes in Ontario. The ASB is considering allowing TPA plan administrators to implement the final version of the standard prior to the effective date.

For both TPAs and traditional DB plans, the updates included in the second Exposure Draft do not change the fact that these proposed changes will impact CV amounts, solvency liabilities and potentially required contributions, and will require plan sponsors to review and potentially make changes to existing pension asset immunization strategies.

For TPAs, the change in proposed CV calculation methodology will likely be less administratively onerous than the changes proposed in the July 2017 Exposure Draft; however the current proposed changes could result in comparatively higher CV amounts. For traditional DB plans, the optional update to the retirement age assumption could result in lower CV amounts, and could therefore be viewed as an advantageous change by some plan sponsors.

Quebec to modify funding rules for multi-jurisdictional defined benefit pension plans

A draft regulation titled "Regulation respecting the funding of multi-jurisdictional defined benefit pension plans" (the Draft Regulation) was published in the *Gazette officielle du Québec* on December 5, 2018.

This Draft Regulation applies to pension plans registered in Quebec that have members in other provinces. Under the 2016 multi-jurisdictional pension plans agreement between a number of Canadian provinces (the 2016 Agreement), Quebec members' benefits were not well protected in the event of a defined benefit plan split or wind-up, in that their accumulated benefits for service since 2016 would be given the lowest priority in the allocation of plan assets by province. This stems from the fact that, since January 1, 2016, Quebec no longer requires solvency funding.

The most recent discussions among the provinces that signed the 2016 Agreement did not produce a new agreement fully protecting the benefits of Quebec members. The aim of the Draft Regulation is thus to protect Quebec members' benefits accumulated since 2016 and to ensure that plan assets are allocated more fairly between members in different provinces in the event of a defined benefit plan split or wind-up. While the Draft Regulation only applies to plans registered in Quebec, it will also protect the benefits of Quebec members of plans registered in other provinces based on the terms of the 2016 Agreement.

For all actuarial valuations effective beginning December 31, 2018, plans with members in more than one province will be required to make solvency amortization payments if the solvency ratio is under 75%. A 5-year amortization period will apply to the solvency deficit, which equals the asset shortfall below 75% of the solvency liability. However, an amortization period of 10 years will apply to the solvency deficit of multi-employer plans and target benefit plans.

A full actuarial valuation as at December 31, 2018, will be required for these plans unless an actuarial certificate at that date establishes the solvency ratio at 75% or higher.

Interested parties have a period of 45 days to submit comments on the Draft Regulation.

Comment

According to an analysis by Retraite Québec, as of December 31, 2018, there are only two major corporate pension plans registered in Quebec that would be affected by these regulations. Thus, the funding impact of the proposed changes should be minimal, at least in the short term, while the impact on protecting the benefits of all Quebec members, whether the plan is registered in Quebec or in another province, is much greater.

OSFI releases statistics on pension and savings plan coverage in Canada

The Office of the Superintendent of Financial Institutions (OSFI) recently released a fact sheet titled *Registered Pension Plans (RPPs) and Other Types of Savings Plans – Coverage in Canada*. The fact sheet was issued by the Office of the Chief Actuary of OSFI, and was assembled using information available from Statistics Canada and the Canada Revenue Agency.

The fact sheet summarizes the following key trends on pension and savings coverage in Canada:

- The total number of active RPP members increased from 5.8 million to 6.3 million from 2006 to 2016; however, the proportion of employees covered by a RPP in Canada remained at 38% over the 10-year period (dropping by approximately 1% on an unrounded basis).
- Women represent just over 50% of active RPP members in 2016. This proportion has risen steadily over the past thirty years – women represented 35% of active RPP membership in 1986, 44% in 1996, and 48% in 2006.
- The proportion of active RPP members participating in a contributory vs. non-contributory plan increased from 81% to 88% from 2006 to 2016.
- The proportion of public sector employees participating in RPPs increased from 84% to 86% from 2006 to 2016 (with 3.3 million active public sector RPP members in 2016), while private sector RPP coverage decreased from 26% to 23% from 2006 to 2016 (with 3.0 million active private sector RPP members in 2016).
- The proportion of active RPP members in defined benefit (DB) plans decreased from 80% to 67% from 2006 to 2016. This decrease was far more drastic in the private sector (67% to 41% from 2006 to 2016) compared to the slight decrease in public sector DB plan coverage (93% to 91%).
- In 2016, there were 1.6 million members of employer-sponsored group Registered Retirement Savings Plans (RRSPs) and/or Deferred Profit Sharing Plans (DPSPs), excluding active RPP members also participating in a group RRSP and/or DPSP. If this group of plan members is combined with active members of RPPs, the proportion of employees covered by a tax-assisted plan in Canada in 2016 is 47%. The proportion of employees who are active members in an RPP is 38%.
- The number of tax filers who contributed to an RRSP decreased from 6.2 million to 5.9 million (from 27% to 23%) from 2006 to 2016. This decrease was observed across all age groups. There is a trend for this percentage to increase for higher-income earners – 60% of tax filers earning $80,000 or more in 2016 contributed to RRSPs.
- The number of tax filers who contributed to a Tax-Free Savings Account (TFSA) increased from 4.5 million to 7.8 million (from 19% to 30%) from 2009 to 2016.

Comment

The proportion of active employees covered by RPPs in Canada has remained similar from 2006 to 2016, but coverage by DB plans has decreased significantly in the private sector. Public sector coverage by DB plans has declined only slightly over the same period. Overall, nearly half of employees in Canada are covered by an employer-sponsored pension or tax-assisted retirement savings plan.

The statistics published in the fact sheet are consistent with the ongoing trend of many private sector employers finding ways to manage their costs and de-risk, often converting the plans they sponsor from DB RPPs to another form of tax-assisted savings for their employees. Given the fact that these statistics are based on data up to 2016, it will be interesting to see how these trends continue to develop in response to recent reforms to pension funding rules, which have relaxed DB pension funding requirements for many employers.

New Ontario government postpones implementation of *Pay Transparency Act*

The Ontario government has delayed the implementation of the *Pay Transparency Act*, 2018 (the Act), which would have required provincially regulated employers in Ontario to begin disclosing compensation information in public job postings and prohibited inquiries into an applicant's compensation history.

The Act was originally scheduled to come into force on January 1, 2019. However, following the 2018 Ontario election, the newly elected provincial government amended the Act so as to come into force "on a day to be named by proclamation of the Lieutenant Governor." The government has indicated that it would postpone the implementation of the Act in order to conduct consultations, which the government says its predecessor failed to do prior to adopting the Act. No timeline has been given for further consultations.

Under the Act, Ontario employers would be prohibited from seeking compensation history from applicants who are not current employees of the employer. However, job applicants would be permitted to disclose their compensation history to prospective employers voluntarily. Additionally, the Act would require Ontario employers to include either the expected compensation or a range of expected compensation for the advertised position in publicly advertised job postings. The previous government argued that the Act would promote gender equality in the workplace.

Provincially regulated employers of 100 or more employees, and certain other prescribed employers, would be required to collect certain information on employee compensation and produce an annual pay transparency report. The report would have to contain information on the composition of the employer's workforce and on differences in compensation with respect to gender and other designated characteristics. The report would be made publicly available.

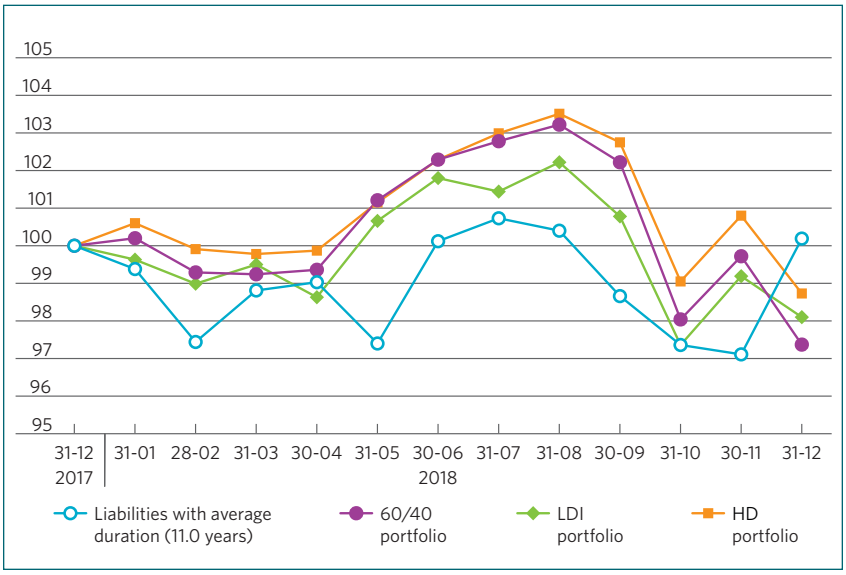
Comment

If the Act is eventually implemented, either in its current or in revised form, it will impose significant changes to the hiring process in Ontario and require additional reporting to the Ministry of Labour. We will advise you of any further developments in this area.

Tracking the funded status of pension plans as at December 31, 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 Canadian Institute of Actuaries (CIA) guidance for valuations effective September 30, 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



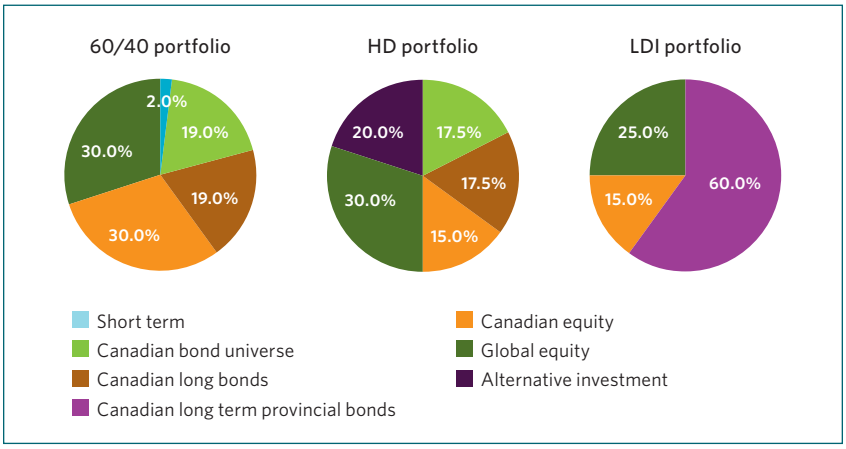
During the month of December, Canadian universe bonds, Canadian long-term bonds and Canadian long-term provincial bonds showed positive returns while the Canadian equity markets, the global equity markets (CAD) as well as alternative investments showed negative returns. With a return of -1.1%, the low volatility portfolio (LDI[1]) outperformed the highly diversified portfolio (HD) (-2.0%) and the 60/40 portfolio (-2.3%).

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 3.2% for a medium duration plan. For this type of plan, an investment in the 60/40, the LDI or the HD portfolio resulted in a decrease 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, 2017. The graph shows the asset allocation of the three typical portfolios.

Initial solvency ratio as at December 31, 2017	Evolution of the solvency ratio as at December 31, 2018 for three different portfolios		
	60/40 po rtfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	97.2%	97.9%	98.5%
90%	87.5%	88.1%	88.7%
80%	77.8%	78.3%	78.8%
70%	68.0%	68.5%	69.0%
60%	58.3%	58.7%	59.1%



Since the beginning of the year, driven by negative returns in Canadian long-term provincial bonds, Canadian equity markets as well as global equity markets, the 60/40 portfolio, the LDI portfolio and the HD portfolio returned -2.6%, -1.9% and -1.3% respectively. The solvency liabilities fluctuated over that same period from 0.0% to 0.7% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at December 31, 2018 stands between -2.8% and -0.9%.

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

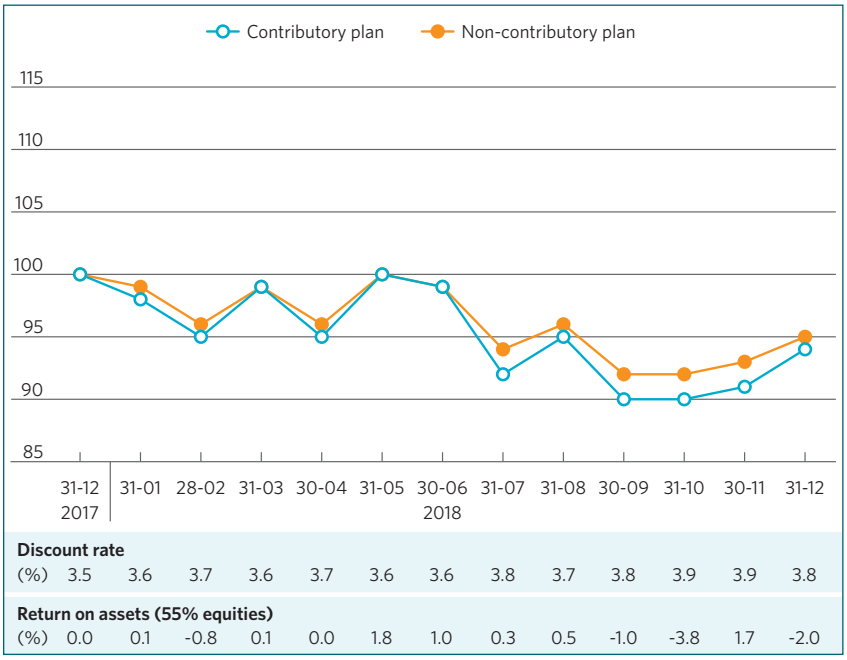
Comments

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 December 31, 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 2018	December 2018	Change in 2018
11	3.39%	3.72%	+33 bps
14	3.48%	3.81%	+33 bps
17	3.53%	3.87%	+34 bps
20	3.57%	3.90%	+33 bps

Since the beginning of the year, the pension expense has decreased by 6% (for a contributory plan) due to an increase in discount rates despite the low 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, 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).

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