Knowledge & Insights

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COVID-19 pandemic brings unpaid leaves into focus

In light of the COVID-19 pandemic, a number of Canadian jurisdictions have introduced new unpaid job-protected statutory leaves for employees who are required to take time off work due to quarantine, care for family members, personal illness, or orders relating to public health. In addition, certain existing unpaid statutory leave periods may also apply to COVID-19 related absences by employees. Employers will want to be aware of these rights and the impact they may have on pension and retirement plans.

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Federal

The federal government has amended the *Canada Labour Code* (the "Code") to create a leave related to COVID-19 of up to 16 weeks, or, if another number of weeks is fixed by regulation, that number of weeks. The COVID-19 leave will be in place until October 1, 2020, at which time it is scheduled to be removed from the Code.

The federal government has also created a new 16-week quarantine leave under the existing medical leave of absence provided under the Code, effective October 1, 2020.

Ontario

Ontario has created a new form of job-protected leave for employees affected by a designated infectious disease, such as COVID-19. The leave is also available to employees who need to be away from work to care for children due to school or daycare closures, or for the care, assistance and support of "specified individuals" which are specific relatives prescribed in the new legislation.

Alberta

The government of Alberta initially provided 14 days of unpaid job-protected leave for employees to cover the self-isolation period that is being recommended by Alberta's chief medical officer of health.

Alberta's government subsequently extended access to this unpaid job-protected leave for a flexible duration, which is based on the circumstances of each case. The leave is also available to employees caring for children affected by school and daycare closures or illness, or for quarantined family members.

British Columbia

British Columbia has provided a job-protected leave for employees unable to work for reasons relating to COVID-19. The leave may be taken for as long as the circumstance requires them to be away from work.

In an effort to address job-protected illness or injury leave beyond the COVID-19 crisis, British Columbia also now allows employees to take up to three days of unpaid job-protected leave each year due to illness or injury after 90 days of consecutive employment with the same employer. If requested by the employer, the employee must provide reasonably sufficient proof that the employee is entitled to take the illness or injury leave. This change would bring British Columbia in line with other provinces in Canada.

Manitoba

Manitoba has announced an unpaid public health emergency leave for employees who require time away from work for reasons related to the COVID-19 pandemic. The leave applies as long as the circumstances set out in the legislation apply.

Saskatchewan

Saskatchewan has enacted a new unpaid job-protected public health emergency leave.

Newfoundland and Labrador

Newfoundland has created a new communicable disease emergency leave in response to COVID-19. The leave applies as long as the circumstances set out in the legislation apply.

New Brunswick

New Brunswick has also created a new COVID-19 emergency leave. The leave applies as long as the circumstances set out in the legislation apply.

Pre-existing leaves may apply

In addition to the new forms of leaves set out above, pre-existing employment standards legislation relating to matters such as emergency leave, illness, or the care of a family member, among others, may apply to COVID-19 related absences by employees. Employers should be cognizant of these obligations when faced with an employee who is unable to work due to a COVID-19 related reason.

Pension and benefit coverage

Depending on the jurisdiction and whether the employee is obligated to contribute to a pension plan, an employer may be required to continue to continue pension and benefit coverage during the employee's leave period.

Temporary lay-offs

Employers are also considering issues relating to the use of temporary lay-offs in light of the impact of COVID-19 on their businesses. In general, the treatment of pension plan members during temporary lay-offs will depend on the circumstances of the lay-off, relevant employment standards legislation and/or collective agreements, and any applicable provisions in the pension plan documents. Employers should also note the potential risk of constructive dismissal claims under the common law.

Comment

Issues relating to the rights of employees during the COVID-19 pandemic can be complex and raise considerable difficulty. As governments move to re-open the economy, employers will want to be aware of the rights of employees under employment standards legislation and the impact those rights may have on their pension and other retirement plans.

It is important to note that the circumstances qualifying employees for COVID-19 related leaves vary and each particular case must be considered in light of the legislation. Also, the usual requirements for advance notice to employers, written evidence of medical conditions and a minimum period of employment before taking a leave have been waived in most jurisdictions that have established special COVID-19 related leaves.

Canada Revenue Agency suspends minimum contribution rule for DC pension plans

The Canada Revenue Agency has announced that it has suspended the minimum contribution rule for defined contribution (DC) pension plans in 2020. The minimum contribution rule provides that a DC pension plan must have terms that require employers to contribute at least 1% of the total pensionable earnings of all active members participating under the provision each year.

In light of the COVID-19 pandemic, the Canada Revenue Agency will waive the 1% rule for the remainder of 2020 if the plan is amended to suspend accruals under the plan for the year, meaning that there will be no employer or employee contributions made to the plan or provision following the plan amendment. This measure only applies for the remainder of 2020 for plans that submit an amendment to the Canada Revenue Agency.

Comment

Employers in many DC pension plans have already contributed amounts that would satisfy the minimum contribution rule for 2020, but the Canada Revenue Agency announcement provides additional comfort that the minimum contribution rule will not be applied in 2020. Any suspension of contributions to a DC pension plan will require advance notice to members and an amendment to be filed with the Canada Revenue Agency and the applicable pension regulator.

Several pension regulators have confirmed that such amendments are permitted under pension legislation, but have pointed out that employers must be cognizant of collective agreements and labour and employment law matters when considering such amendments. The minimum contribution rule only applies to DC pension plans and does not apply to pension plans with defined benefit provisions, group registered retirement savings plans, and deferred profit sharing plans.

Morneau Shepell's May 2020 *Pension Risk Bulletin*

Morneau Shepell's Pension Risk Transfer Team publishes a periodic *Pension Risk Bulletin* to provide pension risk transfer and risk management updates and views to defined benefit pension plan sponsors in Canada. The May 2020 edition of the *Pension Risk Bulletin* addresses the impact of the COVID-19 pandemic for plan sponsors and for their risk management and risk transfer strategies.

Key highlights

- As a result of the pandemic, several risks faced by defined benefit (DB) plans have materialized in the first quarter of 2020. The current crisis greatly exceeds any prior perfect storm from the standpoint of DB plans. Some of the economic risks for DB plans in the current context include equity risk, interest rate risk, credit risk, liquidity risk and funding risk.
- The effectiveness of risk management strategies is being tested. Interest rate risk hedges, such as Liability Driven Investment (LDI) strategies, may become less effective given the current level of interest rates.
- Pension regulators across Canada have announced a variety of temporary measures, such as relief measures on solvency special payments and suspension of buy-out transactions.
- With quantitative easing and the accommodating policy of the central banks, risk free rates are slowly converging to 0% across the yield curve, creating a potential issue for pension plan assets that may yield significantly less than inflation.
- The makeup of a pension plan's discount rate (and liabilities) has changed over the last 4 months. Government of Canada bond yields have declined and corporate credit spreads have widened, affecting solvency and accounting liabilities differently.
- Pension plan setbacks in funded status and the markets' illiquidity have contributed to reduced demand for pension risk transfers even though the supply from insurers is steady for the most part. Most insurers are still open for business and actively providing quotes when requested. They have adapted their quoting methodologies to deal with the large intra-day movements in spreads and liquidity issues seen at the end of the first quarter.
- In the short term, plan sponsors and administrators should be asking themselves some important questions:
  - Has my pension risk budget changed?
  - Am I spending my risk budget efficiently?
  - Can I still transfer some or all of my pension risk?
  - Do I have the right governance structure to supervise, manage and administer my pension investments?

FSRA releases additional COVID-19 update

On April 24, 2020, the Financial Services Regulatory Authority of Ontario (FSRA) published additional information setting out its response to the COVID-19 pandemic. The additional information updates the information discussed in the April 2020 *News & Views* article.

Actuarial valuation report disclosures

Given the impact of the significant stock market and economic decline that occurred in the first half of 2020 on the outlook for plans' funded status, FSRA has indicated it considers the decline to be a "subsequent event," which provides additional information about the pension plan as it was at the calculation date.

Therefore, FSRA recommends that administrators preparing actuarial valuation reports as at December 31, 2019 should treat the 2020 economic decline as such a "subsequent event". FSRA notes that the Canadian Institute of Actuaries' (CIA) Pension Standards requires disclosure of "subsequent events," and asks that plan actuaries, "exercise professional judgement to establish the best estimate assumptions for the valuation," in accordance with CIA Pension Standards.

The CIA Pension Standards also require disclosure based on "plausible adverse scenarios" or "PAS". FSRA's states that the PAS should reflect plan-specific risks and be developed recognizing all known events such as the market shock and its potential financial impact on the pension plan as well as, in some circumstances, considering financial stresses to the employer that may affect its ability to make contributions when due. FSRA expects the following disclosures to be included in the valuation report based on any PAS that have been identified:

- The impact on a plan's funded status, including going concern, solvency, and wind up bases, and solvency and transfer ratios
- The impact on the required contributions to the pension plan in respect of the normal cost, going-concern and solvency special payments

Filing extensions for off-cycle valuations

FSRA's usual policy is not to provide extensions for off-cycle valuations. However, FSRA has indicated that, due to the COVID-19 situation, it will provide filing extensions to defined benefit (DB) plans seeking to make an off-cycle valuation with an original due date during the 2020 calendar year. This includes valuations with a December 31, 2019 measurement date.

Administrators are asked to inform FSRA of their intention to file an off-cycle valuation report and request any extensions at least two weeks in advance. A typical extension is granted for 60 days.

If a longer extension is required, FSRA will consider such requests on a case-by-case basis. Request for additional extensions can be made by email to the Pension Officer and should include a description of the reason why an additional extension is required.

FSRA reminds administrators that it may order the preparation of a new valuation report if it deems the assumptions or methods used in the preparation of the report to have been inappropriate or inconsistent with accepted actuarial practice.

Reducing or suspending DC contributions

FSRA reminds defined contribution (DC) pension plan sponsors that, in order to reduce or suspend contributions, they must amend the terms of the pension plan.

Plan sponsors will need to determine if contributions must continue when an employee is on a form of leave or layoff where there are reduced earnings or no actual earnings being paid. The determination of the requirement to continue contributions (or not) will depend in part on employment law considerations, the specific facts involved and the terms of the plan text. Plan sponsors and administrators should obtain the necessary employment law and pension law advice in this regard.

Although it has the power to do so, FSRA states it will not order the wind up of a plan solely because it has been amended to suspend contributions temporarily for a portion of 2020 as a result of the COVID-19 disruption.

PBGF assessments

Where COVID-19-related disruptions have caused a plan to be unable to file its Pension Benefits Guarantee Fund (PBGF) certificate of assessment, FSRA may consider granting a 60 day extension of this deadline. A longer extension may be granted in extraordinary cases, provided no person will be prejudiced by the delay.

Additionally, on April 30, 2020, the Ontario government filed Ontario Regulation 187/20, amending Regulation 909 made under the *Pension Benefits Act* to reduce the penalty for late payment of a PBGF assessment. Under the amended regulation, plan sponsors that fail to pay PBGF assessments due between April 30, 2020 and December 31, 2020 are only required to pay interest from the date the amount is due to the actual payment date at a rate of 3% plus the chartered banks' rate on prime business loans on the payment due date. To qualify for this reduced penalty, the sponsor must pay the amount owing with interest by December 31, 2020.

Ordinarily, an employer that fails to pay a PBGF assessment by the assessment date would be required to pay 120% of the past due amount, plus interest equal to the chartered banks' rate on prime business loans (as of the date the amount is due) plus 3%.

Electronic communications

FSRA advises that it does not have discretion over the requirements of the *Pension Benefits Act* as it relates to electronic communications. Administrators are still expected to comply with all applicable legislative requirements with respect to electronic communications.

Signature witnessing requirements

Some pension unlocking and family law forms require a witness to sign the form in the presence of the person signing the form. FSRA says that it will not object to proceeding without a witness for unlocking forms and family law forms, provided there is no evidence on record that the signatory does not understand what he or she is signing.

FSRA suggests that administrators and financial institutions may also consider using alternative processes for witnessing, such as follow-up correspondence or virtual witnessing using electronic means. However, anyone attempting to satisfy a signature requirement through alternate means should obtain appropriate legal advice before doing so.

Federal government announces solvency payment moratorium

On April 15, 2020, the government of Canada announced that it will provide immediate, temporary relief to sponsors of federally regulated defined benefit pension plans. This relief will be in the form of a moratorium through the remainder of 2020 on solvency payment requirements for defined benefit plans.

The government is also planning on consulting with stakeholders over the coming months on options to provide relief from 2021 funding obligations, as necessary.

As of publication date, the government has not published regulations implementing the announcement.

Tracking the funded status of pension plans as at April 30, 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 new preliminary CIA guidance for valuations effective March 31, 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

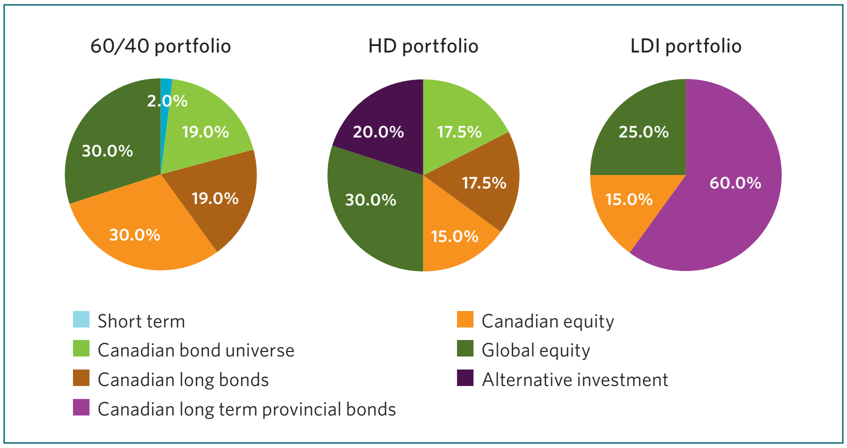
During the month of April, Canadian universe bonds, Canadian long-term bonds, Canadian long-term provincial bonds, Canadian equity markets, global equity markets (CAD) as well as alternative investments showed positive returns. With a return of 8.2%, the low volatility portfolio (LDI[1]) outperformed the 60/40 portfolio (7.7%) and the highly diversified portfolio (HD) (6.6%).

[1] Liability driven investment

The prescribed CIA annuity purchase rates decreased while the commuted value rates used in the calculation of solvency liabilities decreased for the first 10 years and increased after ten years during the month. As a result, the solvency liabilities increased for a medium duration plan. For this type of plan, an investment in the LDI, in the 60/40 and in the HD portfolio resulted in an increase of the solvency ratio.

The table shows the impact of past returns on plan assets and the effect of interest rate changes on solvency liabilities of a medium duration plan, based on the plan's initial solvency ratio as at December 31, 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 April 30, 2020 for three different portfolios		
	60/40 portfolio	Low volatility portfolio (LDI)	Highly diversified portfolio
100%	90.9%	94.7%	91.2%
90%	81.8%	85.3%	82.1%
80%	72.8%	75.8%	73.0%
70%	63.7%	66.3%	63.9%
60%	54.6%	56.8%	54.7%



Since the beginning of the year, driven by negative returns in the Canadian equity markets, global equity markets as well as alternative investments, the LDI portfolio, the HD portfolio and the 60/40 portfolio returned 0.7%, -3.0% and -3.3% respectively. The solvency liabilities fluctuated over that same period from 5.9% to 6.3% depending on the duration of the group of retirees. The variation in the plan's solvency ratio as at April 30, 2020 stands between -9.1% and -3.2%.

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

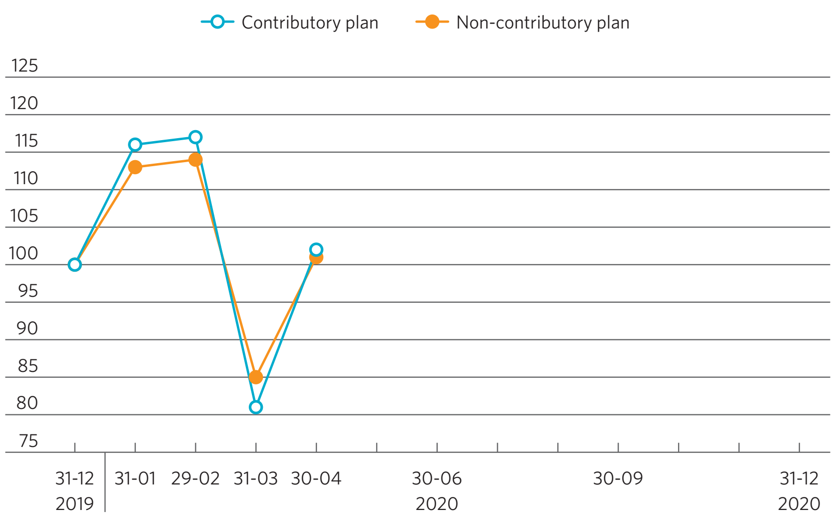
Comments

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 April 30, 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



Discount rate (%)	3.2%	2.7%	2.7%	3.8%	3.1%
Return on assets (50% equities) (%)	0.0%	2.6%	-2.8%	-8.2%	7.3%

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	April 2020	Change in 2020
11	3.06%	2.95%	-11 bps
14	3.13%	3.10%	-3 bps
17	3.17%	3.19%	+2 bps
20	3.20%	3.25%	+5 bps

Since the beginning of the year, the pension expense has increased by 2% (for a contributory plan) mainly due to the bad 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, 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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