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Investing in the Middle Class, Budget 2019 Pension, Benefit and Executive Compensation Highlights

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On March 19, 2019, Justin Trudeau's Government released its fourth budget - Investing in the Middle Class, Budget 2019.

Budget 2019 includes a number of policy initiatives that will impact employers, including:

- the treatment of pension and employment matters in corporate insolvencies;
- new executive compensation and related corporate governance policies;
- the introduction of new pension and retirement savings plan decumulation options;
- changes to the tax treatment of certain employee stock options;
- a national pharmacare initiative that will affect prescription drug plans; and
- new leave of absence and employment insurance benefits to support employee retraining.

This Sidebar summarizes the elements of Budget 2019 that will be of interest to employers.

Measures to Enhance Retirement Security

As we previously reported, in 2018 the Government undertook a consultation regarding retirement security. It published a consultation paper and requested stakeholder views on federal insolvency laws and corporate governance requirements as they relate to pension and benefit obligations, as well as questions relating to the funding of federally-regulated defined benefit (DB) pension plans. The consultation followed a number of high-profile corporate insolvencies, Sears being the most recent.

On the heels of this consultation, Budget 2019 lays out a number of proposed amendments to the *Companies' Creditors Arrangement Act*, the *Bankruptcy and*

Insolvency Act, the *Canada Business Corporations Act* (CBCA) and the *Pension Benefits Standards Act, 1985* (PBSA) to address retirement security. The measures noted in Budget 2019 include:

- Greater transparency in, and access to, insolvency proceedings by employees and pensioners through an express "good faith" requirement that will apply to all parties during such proceedings;

- Enhanced scope for courts to review payments made to executives in the lead-up to an insolvency;

- Changes to the CBCA to expressly permit employee and pensioner interests to be taken into account when making corporate decisions; and

- Enhanced disclosure of employee, pensioner and executive compensation policies for publicly-traded CBCA corporations and the implementation of non-binding shareholder voting on executive compensation matters.

Legislative amendments will need to be developed and passed into law before these measures come into effect. Notably, Budget 2019 does not address certain aspects of the consultation paper including the potential for DB pension plan deficits to be granted a super-priority in a corporate insolvency or changes to the funding regime for DB pension plans under the PBSA.

Budget 2019 also announced that eligible individuals who are age 70 and over and have not yet started a *Canada Pension Plan* retirement pension will be automatically enrolled. Enhancements to the Guaranteed Income Supplement available to employees who continue to work beyond age 65 were also announced.

The Government also announced funding for the National Pension Hub to support research focused on improving retirement savings outcomes for Canadians and developing solutions to pension challenges.

Proposals Specific to Federally-Regulated Pension Plans

Budget 2019 announced changes to the PBSA that will apply to federally-registered pension plans, which are similar to initiatives undertaken in other jurisdictions in relation to DB pension liability transfers and missing members.

Specifically, the PBSA will be amended to allow administrators of federally-registered DB plans to satisfy pension obligations through the purchase of annuities from a licensed insurance company. We expect the PBSA amendments to include a statutory discharge for administrators who complete buy-out annuity purchases similar to the

Ontario, Quebec and British Columbia discharge regimes. The substantive and procedural requirements to obtain a discharge and the scope of the discharge are not set out in Budget 2019.

Budget 2019 also announced amendments to the PBSA to address missing members. Plan administrators will be permitted to transfer unclaimed amounts held in *terminated* federally-registered pension plans to the Bank of Canada. The proposed amendments are consistent with proposals released for comment in 2018 and the current approach to unclaimed bank account balances. In contrast to the approach taken in other jurisdictions, the PBSA amendments will not address missing members in ongoing pension plans.

New Decumulation Strategies for Registered Plans

As defined contribution pension plans (DCPPs), registered retirement savings plans (RRSPs) and other types of capital accumulation plans (CAPs) mature, the pension and retirement savings industry has focused on developing payout (decumulation) vehicles that better meet retirement income needs.

The standard decumulation options currently available to CAP members and DB pension plan members who elected commuted value lump sum transfers are registered retirement income funds (RRIFs) for non-pension assets, life income funds (LIFs) for pension assets, and the purchase of an annuity from a licenced insurance company. Under each of these vehicles, retirement income is required to commence by the end of the year the individual turns age 71. RRIFs and LIFs provide a measure of flexibility in the amount of retirement income that can be withdrawn each year, but there is a risk that retirement assets may not be sufficient to provide an income for the retiree's life. Standard pension annuities provide income for the retiree's life, but they do not allow for changes to the basic annuity payment amount made to an individual (other than cost-of-living adjustments) as an annuitant's lifestyle and health status changes over time.

Budget 2019 introduces two new types of annuities that will be available under certain types of registered plans, including DCPPs, RRSPs, deferred profit sharing plans (DPSPs), and pooled retirement pension plans (PRPPs) to address the above-noted challenges with RRIFs, LIFs and traditional annuities.

1. Advanced life deferred annuities (ALDA)

An ALDA is an annuity which does not have to start until the end of the year in which the individual attains age 85. Purchasing an ALDA will enable individuals to defer receiving a portion of their retirement savings beyond the current age 71 limit. An ALDA will allow individuals to preserve more of their retirement savings for later years and assist with longevity protection.

Individuals will be subject to two ALDA limits. Only 25% of a particular registered plan's assets can be used to purchase an ALDA. Also, there will be a comprehensive lifetime ALDA limit of $150,000 from all qualifying plans (this limit will be indexed to inflation for taxation years after 2020). If an individual purchases an ALDA contract that is in excess of their ALDA limit, a penalty tax may apply.

2. Variable payment life annuities (VPLA)

Budget 2019 proposes to permit a form of annuities, VPLAs, to be provided to members directly from a DCPP or PRPP. A VPLA offered under a DCPP or PRPP will be an annuity payable for a member's lifetime (with survivor benefits, where applicable). VPLAs will be adjusted for variations in the collective investment return and mortality experience of all VPLA annuitants. The VPLA will provide a measure of longevity risk protection to individuals, with overall positive and negative experience being borne by the group.

To acquire a VPLA, members will be required to transfer funds directly from their individual account under the DCPP or PRPP to the "VPLA annuities fund" within the plan. No employee or employer contributions may be made directly to the "VPLA annuities fund". In order for a DCPP or PRPP to offer VPLAs to its members, there must be a minimum of 10 retired members who will participate in the VPLA arrangement at the outset, and it must be reasonable to expect that at least 10 retired members will participate in the VPLA arrangement on an ongoing basis. Payments under a VPLA must start by the later of the end of the year in which the member attains age 71, and the end of the year in which the VPLA is acquired.

Draft amendments to the *Income Tax Act* (Canada) (ITA) and related regulations to provide for these two new types of annuities will be released for public comment at a later date. The Government intends to allow the new types of annuities to be offered beginning in 2020.

Budget 2019 does not require sponsors of CAPs to add these annuity options to their plans, and it is likely that amendments to the PBSA and provincial pension standards legislation will be necessary in order to allow them to be offered under DCPPs.

The introduction of such arrangements under CAPs will invariably give rise to other fiduciary and non-fiduciary considerations. By way of example, if members remain in DCPPs after age 71, it will be necessary for the administrator to evaluate whether the investment line-up should be modified to ensure the range of investment choices is prudent for those members.

Other Registered Pension Plan Proposals

Budget 2019 contains two other income tax measures relating to specific types of DB registered pension plans: (1) specified multi-employer pension plans (SMEPs) which are plans in which several non-related employers participate pursuant to collective agreements, and (2) individual pension plans (IPPs).

Budget 2019 proposes to align the ITA contribution rules for SMEPs with the requirements applicable to single employer DB plans by disallowing contributions after the end of the year in which the member attains age 71 or while they are in receipt of a pension.

Currently, the ITA allows transfers from DB pension plans to IPPs on a tax-deferred basis, whereas transfers from DB pension plans to locked-in retirement accounts or LIFs are tax-deferred transfers up to a dollar limit (with any additional amounts being subject to tax in the hands of the member at the time of the transfer). IPPs will continue to be available; however, after March 19, 2019, IPPs will generally not be permitted to accept asset transfers for past service entitlements earned under another employer's DB pension plan.

Proposal to Limit the Preferential Tax Treatment of Employee Stock Options

Budget 2019 announces the Government's intent to limit the preferential tax treatment applicable to employee stock options granted to employees of "large, long-established, mature firms".

Under the current rules, when an employee receives a stock option grant there is no inclusion in the employee's income so long as the options' exercise price is no less than the fair market value (FMV) of the underlying shares on the grant date. Upon exercise, the amount by which the share price exceeds the exercise price represents a taxable employment benefit, which is included in the employee's income and taxed at his/her marginal tax rate. Where the underlying shares are in a Canadian-Controlled Private Corporation (CCPC), taxation of the employment benefit can be postponed to the year in which the CCPC shares are sold.

Provided that certain conditions are met, the current tax rules allow the employee a deduction equal to 50% of the taxable employment benefit. This deduction effectively accords capital gains treatment to the stock option employment benefit. The deduction applies irrespective of the age or size of the company the shares of which are subject of the grant, and there is no limit on the deduction that may be claimed.

Budget 2019 proposes to apply a $200,000 annual cap on employee stock option grants in respect of which the 50% deduction is available. As noted, this cap would apply to options on shares of “large, long-established, mature firms”, and would be based on the FMV of the underlying shares.

Further details regarding this proposal will be released before the summer of 2019. Any changes would apply on a go-forward basis only and would not affect stock options granted prior to the forthcoming legislation required to implement the proposal.

The proposed restrictions on preferential treatment for employee stock options may result in changes to the types of share-based executive compensation plans made available by employers.

Preliminary Steps Toward the Establishment of a National Pharmacare Program

Earlier this month, the Government received the Interim Report of its Advisory Council on the Implementation of National Pharmacare.

Following the Interim Report’s findings, Budget 2019 announces the Government’s intent to move ahead with foundational steps toward the establishment of a national pharmacare program as a means to improve access to prescription drugs on a sustainable basis. The Government intends to create the Canadian Drug Agency, the mandate of which will include development of a coordinated approach to assessing the efficacy of, and negotiating lower prices for, prescription drugs for both public and private benefit plans. The Agency will also be tasked with developing a national prescription drug formulary, and working with provincial and territorial governments and other partners to develop a strategy on high-cost drugs for rare diseases.

The Advisory Council’s final report is expected this Spring and should provide more information on the intended direction vis-à-vis national pharmacare, and allow employers to evaluate how the national pharmacare initiative will impact employer-sponsored group benefit plans that include prescription drug coverage.

Encouraging Lifelong Learning

Budget 2019 announces measures designed to encourage employees to keep their skills current by subsidizing up to 50% of the cost of professional development and skills training programs through the new Canada Training Credit (earned at the rate of $250 per year, up to a lifetime maximum of $5000) and introducing a new type of Employment Insurance (EI) benefit known as the Training Support Benefit.

The Training Support Benefit will provide up to four weeks of EI benefits for qualifying employees every four years, and is expected to come into effect in late 2020. Budget 2019 anticipates amendments to the *Canada Labour Code* to ensure that training leaves are provided on a job-protected basis and announces the intention to work with provincial and territorial governments to encourage similar leaves to be incorporated into provincial employment standards legislation. The terms of such leaves are not addressed in Budget 2019 (for example, whether pension participation must continue during the unpaid leave).

If you have any questions regarding these aspects of Budget 2019 please do not hesitate to call a sidebar with any of us – we're here to help.

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