

Innovations in Pension Design

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Overview

- Risk management context
- Pension innovation
 - ORPP
 - PRPPs
 - TBPs
- The federal TBP consult initiative
- New Brunswick's experience
- TBPs elsewhere

Risk Management Context

- Broad spectrum of risk management tools
 - Risk Transfers—Plan Design Options—Risk Mitigation
- Plan design options (risk sharing)

Risk to employee



Pension De-Risking

- Pension de-risking falls on a continuum:
 - Risk transference (buy-out/buy-in annuity)
 - Risk sharing (plan re-design)
 - Risk mitigation (LDI investing)
- Appropriate strategy depends upon plan sponsor's aims
 - Risk transference focused on reducing or eliminating funding risk
 - Plan re-design can shift how the plan apportions risk between sponsor/members (within statutory limits)

Risk Transference Strategies

- Buy-In Annuities
- Buy-Out Annuities
- Longevity Insurance
- Lump Sum Transfers

Risk Mitigation

- Liability Driven Investments (LDI)
 - Investments made based on current and future liabilities
 - E.g., increasing bond portfolios and investing in long bonds that match liabilities

Plan Design Options

- Middle of the spectrum, many sponsors have already implemented some form of plan redesign, such as:
 - Conversion to future service DC
 - Changing future DB benefit accrual formula
 - Closing DB to new hires
 - Cessation of future service DB accruals (with or without a pensionable earnings freeze)
 - Reducing the future service DB benefit formula;
 - Reducing or removing expensive early retirement and other subsidized ancillary benefits
 - DB plan termination and wind up

Pension Innovation

What “Solutions” Have Been Proposed?

- Enhance the “second pillar”—i.e., mandatory government programs (e.g., Canada Pension Plan, Ontario’s proposed ORPP)
- Temporary solvency funding relief
- Pooled registered pension plans
- Shared risk plans/target benefit plans

Ontario Retirement Pension Plan (ORPP)

- July 2014 Ontario Budget
- Design features
 - Pooled longevity and investment risk
 - Indexing benefits to inflation
 - Contributions shared between employers and employees (up to 1.9% each) on earnings up to \$90,000 (to increase each year)
- Publicly administered arm's length from government
- Individuals who already participate in "comparable" workplace pension plan not required to enrol
- Anticipated introduction in 2017
- Further technical details to come later this year before legislation

Pooled Registered Pension Plans (PRPP)

- PRPP—DC Plan
- Administered by a 3rd party
- PRPP intended to operate largely outside of the realm of employment relationship—more in the nature of a "financial product"
- Role of employer under PRPP is more limited than under registered pension plans—intended to make it easier to extend to self-employed/small business
- "Low cost" requirement

Pooled Registered Pension Plans (PRPP) *(continued)*

- Federal government initiative
 - VRSPs (Quebec)
 - Ontario Budget
- Remains to be seen whether will increase retirement savings in Canada
- Like other DC arrangements, does not provide a pension
 - DC drawbacks (e.g., longevity risk, inflation risk) remain

What Are TBPs?

- TBPs provide:
 - Fixed contributions, or target contributions with minimal deviation
 - Targeted, DB-type pension benefit at retirement
 - Ability to adjust benefits
- SRPs are a type of TBP

Why TBPs?

- Debate between DB vs. DC does not provide a comprehensive solution
- Target benefits—e.g., multi-employer pension plans
- TBPs/SRPs allow for flexibility of benefits and better intergenerational equity
- TBPs/SRPs pool demographic, investment and longevity risk
- Potential for eliminating sponsor liability beyond contributions and eliminating solvency funding

Federal TBP Consult Initiative

- Concluded June 23, 2014—intent is to move forward
- Proposal to incorporate TBP provisions into PBSA
- Federal proposal would make TBPs available to federally regulated private sector employers and Crown Corporations.

Federal Framework Objectives & Principles

- Objectives
 - Pension sustainability
 - Benefit security
- Guiding Principles
 - Transparency
 - Equity

Administration and Governance

- Administered by a Board of Trustees or similar body with fiduciary duty to the plan
- Proposed governance structure
 - Involve participation of members, retirees, other plan beneficiaries and allow for employer/sponsor and independent participants
 - Level of representation negotiated
- Governance policy requirement
- Role of BoT to administer plan and make decisions in accordance with plan documents
 - BoT would not have the power to amend plan documents, but could recommend amendments

Funding Policy

- Requirement to establish a funding policy and file with regulator
- Based on going concern valuation
 - While not required to fund on solvency basis, TBPs should provide solvency valuations for disclosure purposes
- 2 funding test approaches proposed:
 - *Margin*: going concern funding requirement with PfAD; or
 - *Probabilistic*: going concern funding requirement with primary and secondary management risk goals
- Periodic valuations for disclosure purposes would include the results of stress testing

Contributions

- Excess contributions required to allow for a margin meant to help plan withstand shocks
- Permitted increases/decreases in employee contributions
- Fixed or variable employer contributions
- Flexibility allowed for contribution model which is set out in plan text
- Temporary contributions

Benefit Structure

- 2 classes of benefits:
 - Base benefits: high level of protection (benefits reduced only as last resort)
 - Ancillary benefits: lower protection level (reduced before base benefits)
- Plan text set out which benefits classified in each category
- Possible to reduce accrued benefits if provided in the plan text

Funding Deficit Recovery Plan

- Required, either as a standalone document or part of the plan text
- Filed with regulator
- Certain required elements
- Measures must be set out and their order of priority.
Measures may include:
 - Increase in contributions
 - Employer special payments
 - Reverse past benefit increases
 - Reduction of past/future ancillaries
 - Reduction of past/future base benefits
- Once measures triggered, BOT must implement

Funding Surplus Utilization Plan

- Required, either as a standalone document or part of the plan text
- Filed with regulator
- Certain required elements
- Requirement to set a threshold in the surplus utilization policy for access to surplus
- Actions that may be taken and priority set out.

Disclosure and Communications

- Disclosure rules would follow the existing rules in the PBSA plus additional disclosure rules
- Plan administrator required to provide information to members and retirees at certain times:
 - Prior to conversion from a DB plan
 - During membership
 - In the event of membership termination or death
 - In the event of plan termination or wind-up
 - To new members upon enrolment

Conversion to TBP Model

- Would require consent (not defined) of plan members and retirees
- Conversion provisions would allow for a reduction in accrued benefits
- Plans required to be fully funded on a going-concern basis upon conversion
 - Any going concern deficit to be made up by the employer at the time of conversion
- Accrued benefits at conversion become base benefits
- Future indexation would be ancillary
- Anti-avoidance provision

Termination Value

- TV calculation
 - Account for the accrued value of the individual's target base benefit on a going-concern basis
 - Adjusted by the funded ratio of the plan at the time of the most recent valuation
 - Uses normal retirement age and same discount rate and other assumptions used to calculate plan's funding liabilities
 - Plan text to determine if including buffer margin
- As in the SRP model, value of TV connected to overall plan performance

New Brunswick SRP Model

What are SRPs?

- Developed by the New Brunswick Task Force on Pensions
- New Brunswick, *Pension and Benefits Act* Part 2 and regulations
- May apply to multiple plan “types”
 - Public/Private sector
 - Union/Non-union
 - Single Employer/Multi-employer
- Self-correcting model
- Benefits aligned with funding

SRP Attributes

- Conversion from existing DB Plans
 - Can convert existing accrued liabilities
 - Past service liabilities become part of base benefits
 - Conditional indexation
 - Risk management tests apply
- Enhanced Disclosure
 - Shared risk plan disclosure to members
 - Potential for benefit reductions
 - Specific disclosure requirements on conversion
 - Specific disclosure obligations after each valuation

SRP Attributes *(continued)*

- Funding
 - NB exempts SRPs from solvency funding, but requires annual funding valuations on an “open group” basis
 - Includes present value of 15 years of future contributions in excess of cost of benefits
 - Going concern valuations for tax purposes every 3 years
 - Anti-avoidance regarding wind-up

SRP Attributes *(continued)*

- Administration
 - Board of trustees, trustee or non-profit corporation
 - Trustees required to act independently of the appointing party
 - Superintendent can remove a trustee/appointing party cannot
 - Dispute resolution process required
- Member Money
 - Members own any surplus if a surplus exists on plan wind-up
 - Termination value reflects plan position
 - Equity

SRP Attributes *(continued)*

- Governance and risk management
 - Prescribed risk management requirements that must be attained when plan is established and at certain times:
 - Primary risk management goal: at least 97.5% probability that base benefits will not be reduced over 20 years following inception
 - Secondary risk management goal: at least 75% certainty of certain ancillary benefits being paid over 20 year period
 - Annual compliance requirements
 - Superintendent may require additional tests at any time
 - Asset liability model and actuarial assumptions

New Brunswick SRP Experience

- How many
 - Public/Private?
- Benefits before/after changes?

TBPs Elsewhere in Canada

- Ontario and Nova Scotia—Target Benefit Plan legislation for collectively bargained workplaces (not in force) and no regulations
- BC and Alberta—Target Benefits Plan legislation (not in force) and no regulations
- Quebec—Legislation for Target Benefit Plans in pulp and paper sector
- Saskatchewan—Rely on existing legislation
- PEI—Legislation not yet passed
- Nothing yet in Manitoba or Newfoundland

Thank you

Questions?