34TH ANNUAL ISCEBS
Employee Benefits
Symposium

Pension Reform / Innovation Update

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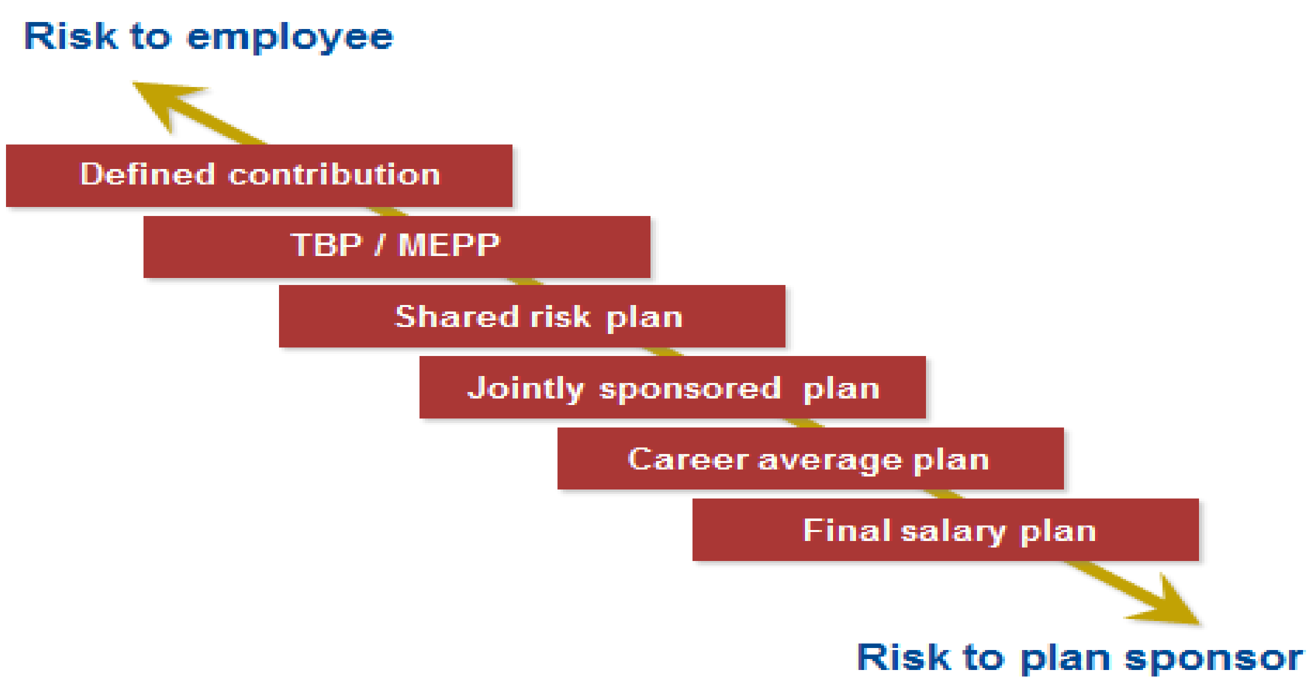
Overview

- Risk Management Context
- Pension Innovation
  - ORPP
  - PRPPs
  - DB Evolution
  - TBPs
- 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)



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 early retirement and other subsidized ancillary benefits;
  - *Ad hoc* or conditional indexation
  - 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 (e.g., extended solvency payment periods, letters of credit, etc.)
- Pooled registered pension plans
- DB evolution
- Shared risk plans/target benefit plans

Ontario Retirement Pension Plan (0RPP)

- July 2014 Ontario Budget
- Design features
  - 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)
- Individuals in Ontario who already participate in "comparable" workplace pension plan not required to enrol
- Anticipated introduction in 2017
- Two Bills so far

Ontario Retirement Pension Plan Act, 2015

- Bill 56, Ontario Retirement Pension Plan Act was introduced by the Ontario government on December 8, 2014 and received Royal Assent on May 5, 2015
- ORPP will supplement existing retirement benefit plans
- Plan will be established by January 1, 2017
- Employees and employers will contribute an equal amount, capped at 1.9% each (3.8% combined) on an employee's annual earnings up to $90,000
- Authorized Minister of Finance to request and collect specified information, including personal information

ORPP Administration Corporation Act, 2015

- Contained in Ontario Budget Bill 91

- The Bill will establish the ORPP Administration Corporation, responsible for administering the new pension

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) (cont'd)

- Federal government initiative
  - VRSPs (Quebec)
  - British Columbia
  - Ontario Budget
  - Other provinces
- 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

DB Evolution

- Solvency Reserve Account
  (Alberta, B.C.)
- Elimination of Solvency Funding/Reserve account (stability provision) requirement
  (Proposed in Quebec)
- Funding Policies

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 potentially better intergenerational equity
- TBPs/SRPs pool demographic, investment and longevity risk
- Potential for eliminating sponsor liability beyond contributions and eliminating solvency funding

New Brunswick SRP Model

<u>What are SRPs?</u>

- Developed by the New Brunswick Task Force on Pensions
- New Brunswick, *Pension 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 (cont'd)

- 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 re: wind-up

SRP Attributes (cont'd)

- 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 (cont'd)

- 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 following 20 years
    - 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

Federal TBP Consult Initiative

- Concluded June 23, 2014—intent is to move forward—this was reiterated in most recent budget
- Proposed to incorporate TBP provisions into PBSA
- Federal proposal would make TBPs available to federally regulated private sector employers and Crown Corporations.

Alberta/BC TBPs

- TPBs permissible in Alberta and will be in B.C. in September
- Not limited to collectively bargained workers
- Ability to adjust benefits
  - If there are funding concerns, plan must be amended to:
    - Reduce or eliminate ancillary benefits;
    - Reduce the targeted benefit, which reduction may apply to accrued target benefits; or
    - Increase contributions.

Alberta/BC TBPs

- Conversion
  - Alberta TBP rules do not permit conversion of accrued benefits
  - B.C. TBP rules will allow multi-employer negotiated cost plans to covert DB to TB provisions in a manner that reduces accrued benefits IF applicable trade union consents
- Risk Management
  - Adverse deviation (PfAD) approach
  - PfAD determined by 2 components:
    - A certain percentage based on the percentage of the fund that is invested in equities; and
    - The amount, if any, by which the assumed discount rate exceeds the benchmark discount rate

Alberta/BC TBPs

- Funding Requirements
  - Normal cost of TBs and PfAD funded
  - If underfunded liability, either
    - Actuarial valuation must show that expected contributions will be sufficient; or
    - A plan text amendment must be filed concurrently to reduce or eliminate benefits or increase contributions.
- Governance policy and funding policy required

TBPs Elsewhere in Canada

- Ontario and Nova Scotia—Target Benefit Plan legislation for collectively bargained workplaces (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?