Fiscal Pulse

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New Brunswick's *Shared Risk Pension Model*

The Need …

New Brunswick, similar to other developed economies, is grappling with private- and public-sector pension plans encumbered by large unfunded liabilities which may prevent the plans from fully meeting their promises[1]. As workers retire earlier and life expectancy increases, their retirement is lengthening to a quarter century. As well, economic and financial market volatility plus an extended period of ultra-low interest rates has eroded investment income.

New Brunswick argues that traditional relief measures such as extending deficit funding periods, scaling back future benefits or raising contributions implicitly assume that pension plans' current challenges are temporary, when in fact they are systemic. Yet the frequent solution of converting a defined benefit plan to a defined contribution framework, while solving the funding risk for employers, leaves members to individually bear all the risk.

The Action …

In October 2010, New Brunswick announced a Task Force on Protecting Pensions, whose initial mandate to examine the condition of the province's private-sector pensions was subsequently expanded to cover public-sector pensions. With the belief that a variation of the status quo was no longer an option, the Task Force re-assessed N.B.'s entire pension framework.

The Result …

The Task Force presented its *Shared Risk Pension Model* in May 2012 and it was enshrined in legislation in July. While the *Model* draws from the Netherlands' pension system and the risk management process of Canadian banks and life insurance companies, it is a "made-in-New-Brunswick" model that also relied heavily on collaboration with union leadership whose pension plans were at considerable risk.

The Task Force recommended that each public-sector pension be converted into a Shared Risk Pension, and then made subject to Part 2 of the Province's *Pensions Benefit Act* to operate on the same statutory basis as private-sector plans, under the regulatory oversight of N.B.'s Office of the Superintendent of Pensions. A new environment for pension plan regulation will evolve in New Brunswick. In addition to overseeing an increased number of plans, the Superintendent will have greater responsibilities and authority stemming from the considerable discretionary powers within the *Model,* underscoring the importance of establishing a consistent regulatory framework.

The Province is moving forward in a collaborative way to roll out the *Model,* given the extensive consultations required to consider the various plan designs. The *Model* to date has been adopted by the nurses union, the CUPE Employees of the New Brunswick Hospital Pension Plan and the New Brunswick Pipe Trades Pension Plan. Other groups, such as the City of Saint John, are discussing Shared Risk Plans.

The Details …

The Shared Risk Pension Model offers no absolute benefit guarantees, but its focus on detailed oversight, transparency and strict risk management is intended to minimize the risk for members. Investment risk is equally shared by the employer and the employees. The *Model* is underpinned by a clear definition of the benefits, adequate contribution rates, specific rules on surplus and deficit management, the role of an independent trustee or board of trustees, and liability-based asset management with an investment mix selected to limit volatility. The trustees are

[1] New Brunswick, *Rebuilding New Brunswick: The Case for Pension Reform,* http://www.ppforum.ca/pension_reform.

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responsible for arm's length management, ensuring annual actuarial reviews, reassessments of the investment policy and desired security levels and stress testing. The latter is key to addressing any emerging issues early to avoid larger problems later. The calculation of actuarial liabilities will be based on prudent assumptions such as a 4.5% discount rate.

Outlined below are some specifics to better understand the *Model.*

- **The benefits** consist of two parts. **"Base" benefits** (that also include "ancillary" vested benefits) are to be strongly funded with a 97.5% likelihood that they will not need to be reduced. In the unlikely situation that a base benefit must be trimmed, the decrease is to be equally born by all beneficiaries (active members, deferreds and retirees). Benefits for existing retirees will not decrease at conversion, but they will be subject to the same future risk as the benefits for all other plan members.

- **"Ancillary" benefits**, such as cost-of-living increases or early retirement subsidies, can only be improved in a situation of excess funding after all past indexing of the base benefit has been provided. These benefits have a 75% likelihood that they will not need to be reduced.

- **For a plan's funded ratio**, a general target would be 110% to 120% over 15 years to offer a three-standard deviation security for base benefits and a two-standard deviation security for other benefits.

- **Contribution increases** are not assumed in the *Model,* but if needed, increases will be capped at 2% of earnings or 25% of the initial contribution rate.

- **Contribution holidays** are not permitted for either employers or employees unless required under federal taxation rules.

- **The accrued final average benefit** will be frozen, but will be converted to an enhanced career average benefit prospectively.

- **Contingent indexing** replaces automatic cost-of-living indexing. A pre-established funding policy will guide when the financial position of a pension fund is sufficient to proceed with indexing or other ancillary benefits.