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# Recent New Brunswick Pension Reform (the “Shared Risk Pension Plan”)

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Retired FCIA

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# The New Brunswick “Players”

- Task force Chair, senior lawyer with extensive pension regulatory and “troubled plan” experience
- Prominent provincial economics professor specialist in public policy
- Supernumerary actuary (me)
- Government actuary and his associates
- Senior New Brunswick public servants
- Cabinet subcommittee chaired by the provincial Premier

# The 2011 Prior Pension Problems

- Almost all provincial pensions underfunded (many seriously)
- Public sector pension financial reporting standards made it difficult to measure problems / risks consistent with markets
- Out of date (and largely unknown recent) Canadian pensioner mortality data on rapid mortality improvements especially by education / income
- Lack of rigorous risk management by pension funds and regulators had led to serious underfunding after Great Recession
- Rapid aging of Canada's Maritime provinces leading to: falling population (New Brunswick already); higher spending; and lower tax revenues even though Canada as a whole has fastest population growth in G7
- Demographics (population already falling) might “eat the province alive” within 5 or so years without pension reform which might have added a decade for further action

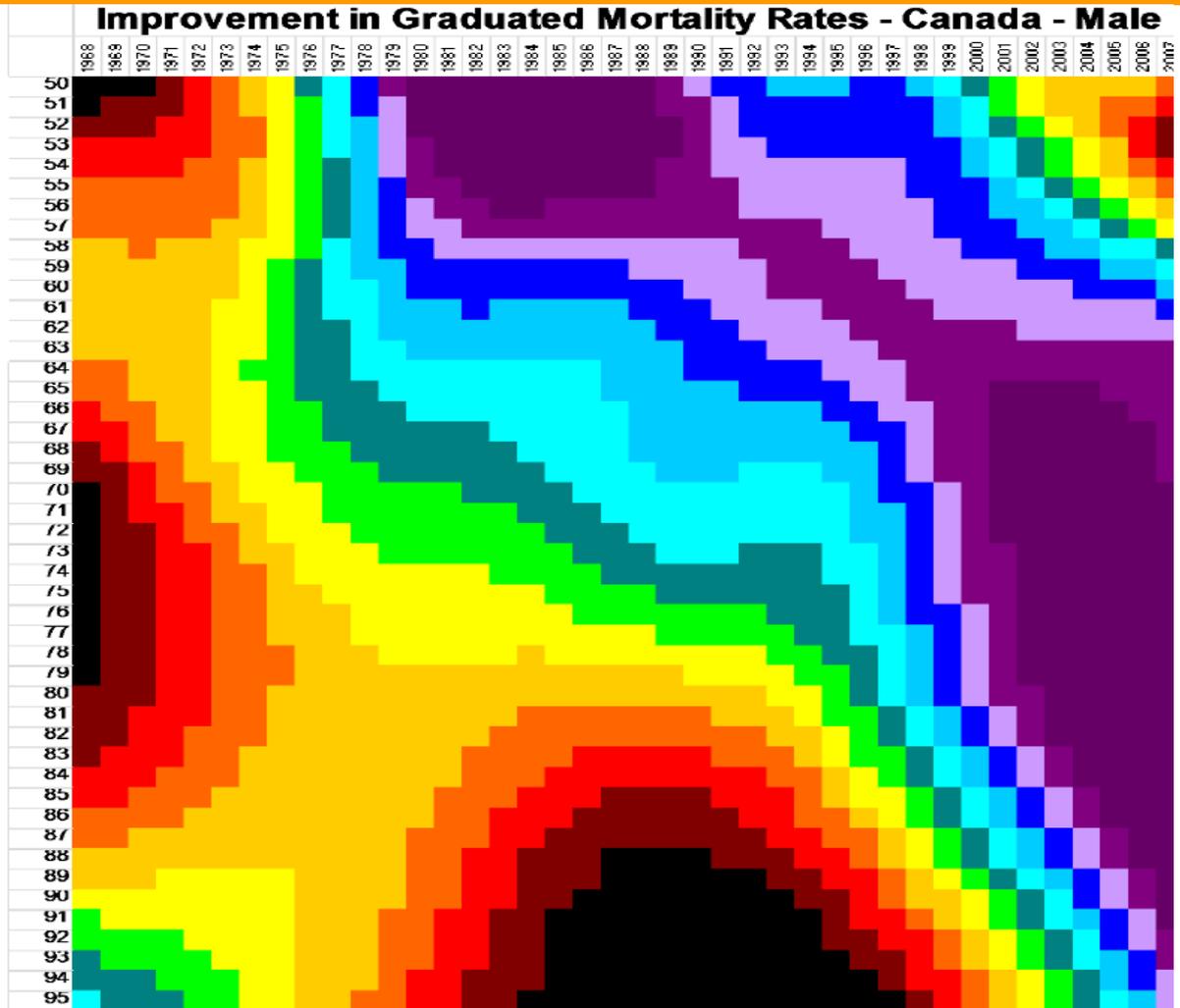
# 2007 IMF Warning to Canada on the Need for Pension Risk Management

- “OSFI and the provinces should ensure that the regulatory framework for pension funds focuses increasingly on the adequacy of risk management practices and resources, in addition to the traditional solvency approach. “
- “These developments require continued reinforcement of risk management skills in pension funds and their supervisors. Poor risk management and large losses by pension funds could lead to political pressure for bailouts. The large number of medium and small defined benefit pension funds may find it costly to operate in this environment ... The regulatory framework for pension funds will need to focus increasingly on the adequacy of risk management practices and resources, in addition to the traditional solvency approach.”

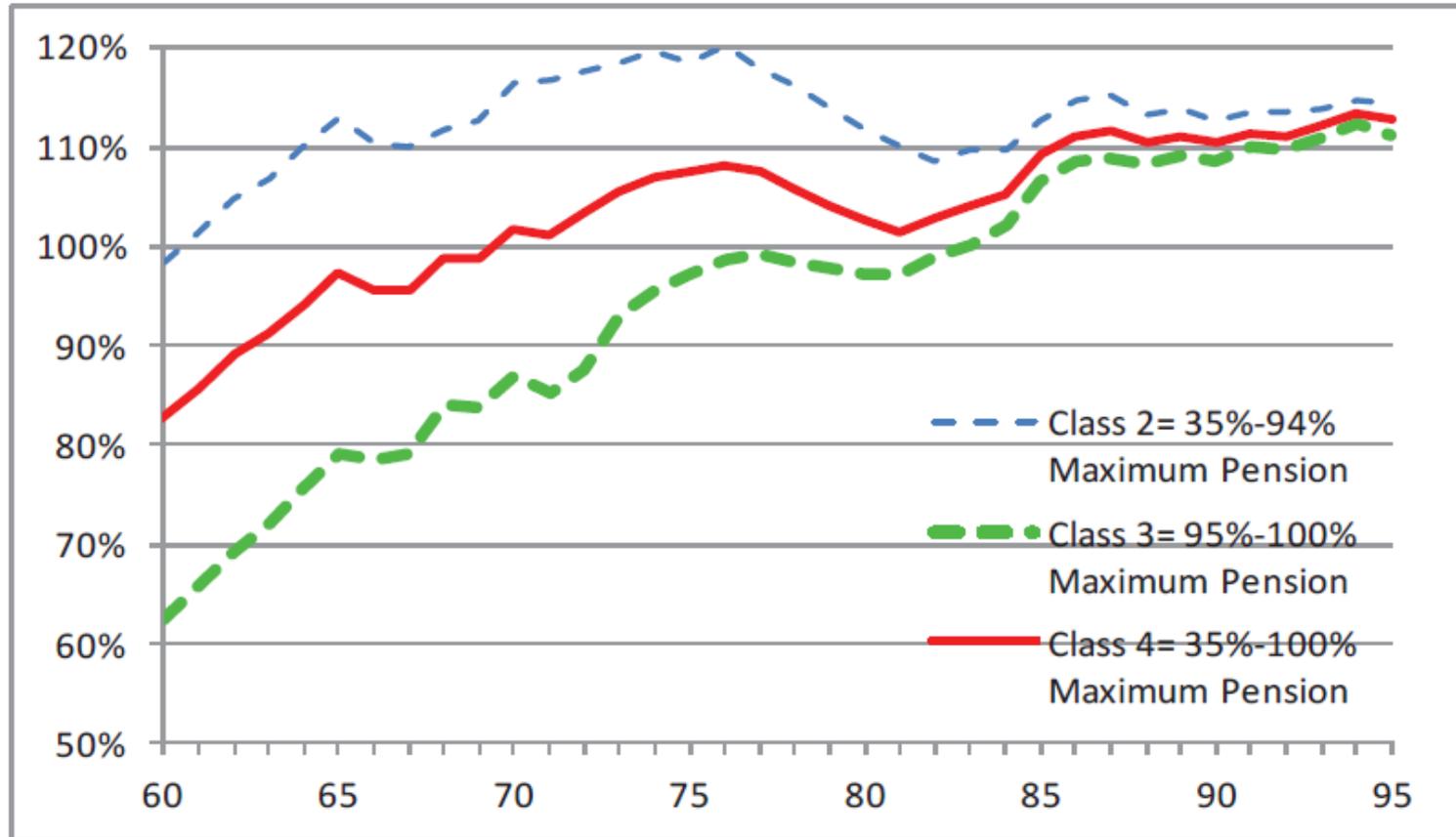
# Canada-wide Rates of Mortality Improvement (all working males)

Note both purple diagonal centered at YOB 1935 and post 60's

Band	Colour
0.00%	Black
0.25%	Dark Red
0.50%	Red
0.75%	Orange-Red
1.00%	Orange
1.25%	Yellow-Orange
1.50%	Yellow
1.75%	Light Green
2.00%	Green
2.25%	Light Blue
2.50%	Blue
2.75%	Light Purple
3.00%	Dark Purple
More	Dark Purple



# Canada-wide Male Mortality Rates (above and below median income)



# The “Key” Political Question

- In a democratically elected government, can steps be taken to head off a problem while there is still time when the voting population is largely unaware of the emerging problem and solutions are “painful”
- The Premier’s approach “What is the *right thing* to do?”

# The Mandate of the New Brunswick Pension Task Force

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- Three Objectives:
  - Stability
  - Sustainability
  - Affordability
- Two Principles:
  - Transparency
  - Inter-generational equity

# The Process

- Review regulatory filing of large New Brunswick pension plans adjusting for current mortality and market consistent asset / liability measurement
- Use large mature municipal pension plan's request for substantial funding relief as a test case – threat of “municipal insolvency”
- Consider how to modify the “Dutch pension (defined ambition) model” as a foundation from which to deal with severely underfunded pension plans when strengthened by rigorous risk management including security objectives for both base benefits” and “target benefits”
- Reflect unpublished / largely unrecognized mortality rate and mortality improvement data
- Seek up to date risk management information from retired Dutch ABP personnel (including Euro crisis central bank “problems”)
- Find an appropriate “market consistent” liability measure and a proxy to risk based capital (“the 15 year open group funded ratio”)

# The First Test Case (Province-wide professional hospital workers)

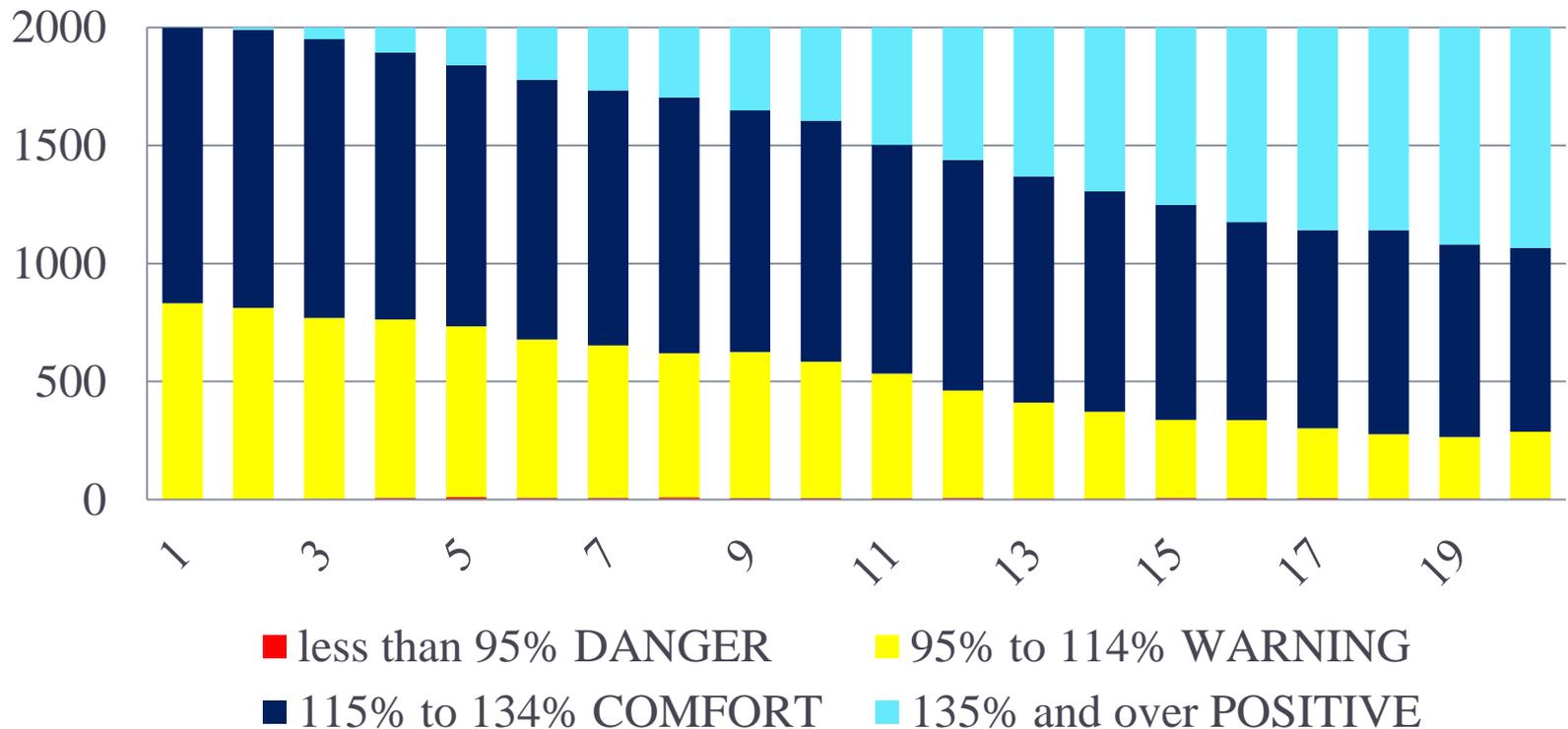
- Trustees had sought court direction as to their fiduciary duties due to inadequate funding
- Court judgment mandated large increase in contributions or large reduction in benefits, or both
- Using up to date mortality and market consistent measures, the situation was much worse than the trustees had imagined
- Unions trusted task force Chair with whom it had a long relationship
- Over 5 months of “transparent” meetings, a solution acceptable to the major professional hospital employees and the government was found.
- Complete sharing of communications between government and unions with unions having the primary role in member communications

# The Shared Risk Pension Plan Template Emerges

- Unions played a major role in shared risk template design reflecting membership concerns for a secure pension
- “Defined ambition” template acceptable only with strong base benefit (97.5%) and target benefit (75%) security constraints as stated under investment management policy and funding policy
- All prior earned benefits preserved in base benefits except for adopting conditional indexing in place of final averaging and COLA
- **Base benefits could be reduced in the future but only if their restoration became the plan’s top priority**
- Future member / sponsor contributions increased with very small pre-determined changes in future contributions also allowed -no future contribution holidays unless mandated by Income Tax Act
- **Future service unreduced retirement age and future service early retirement discounts increased (but not quite to actuarial neutrality)**
- All part time and casual workers covered by new plan
- Future indexing shared by actives, deferred vesteds and retirees

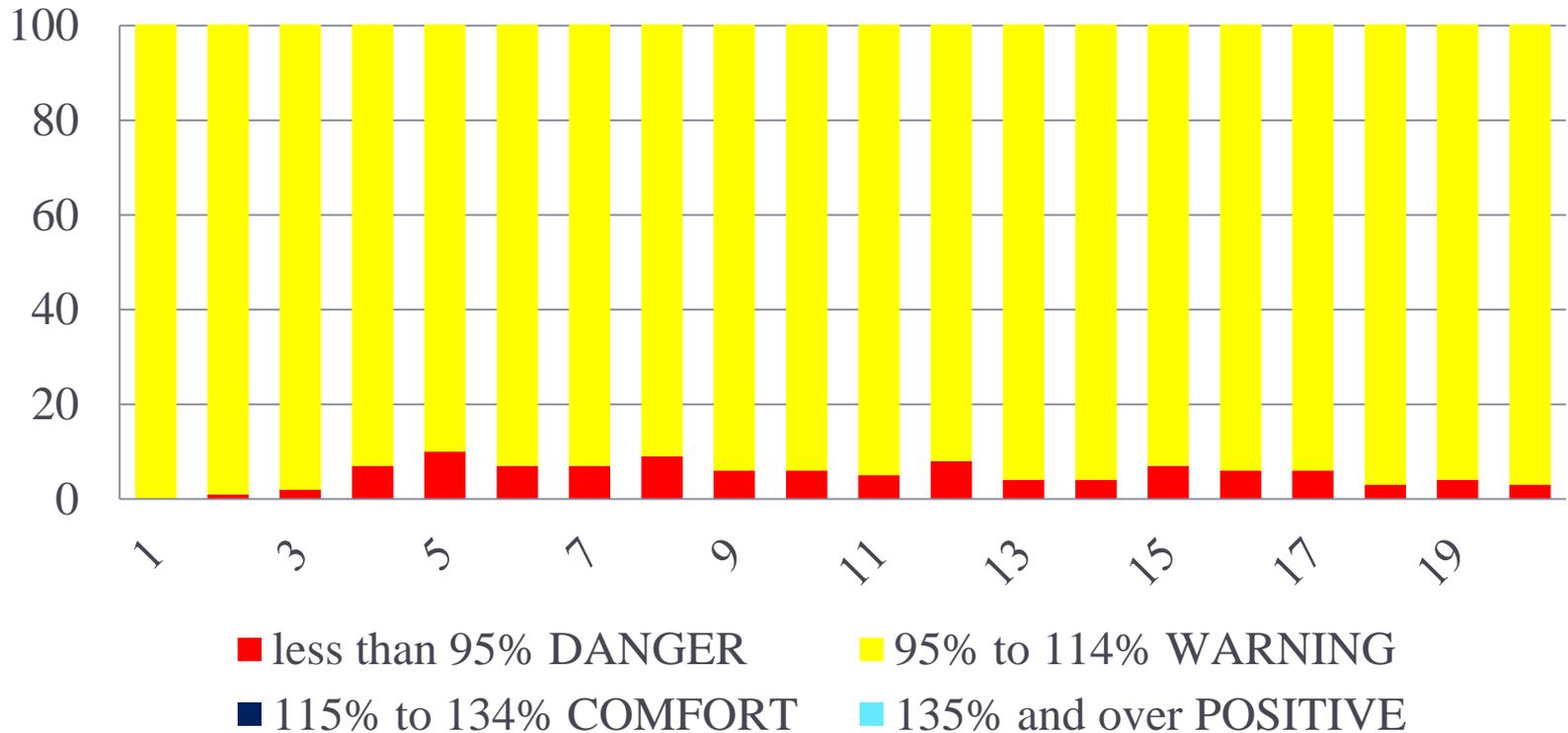
# Sample Expected 15 Year Open Group Funded Status

## Distribution of Funding Levels by Year

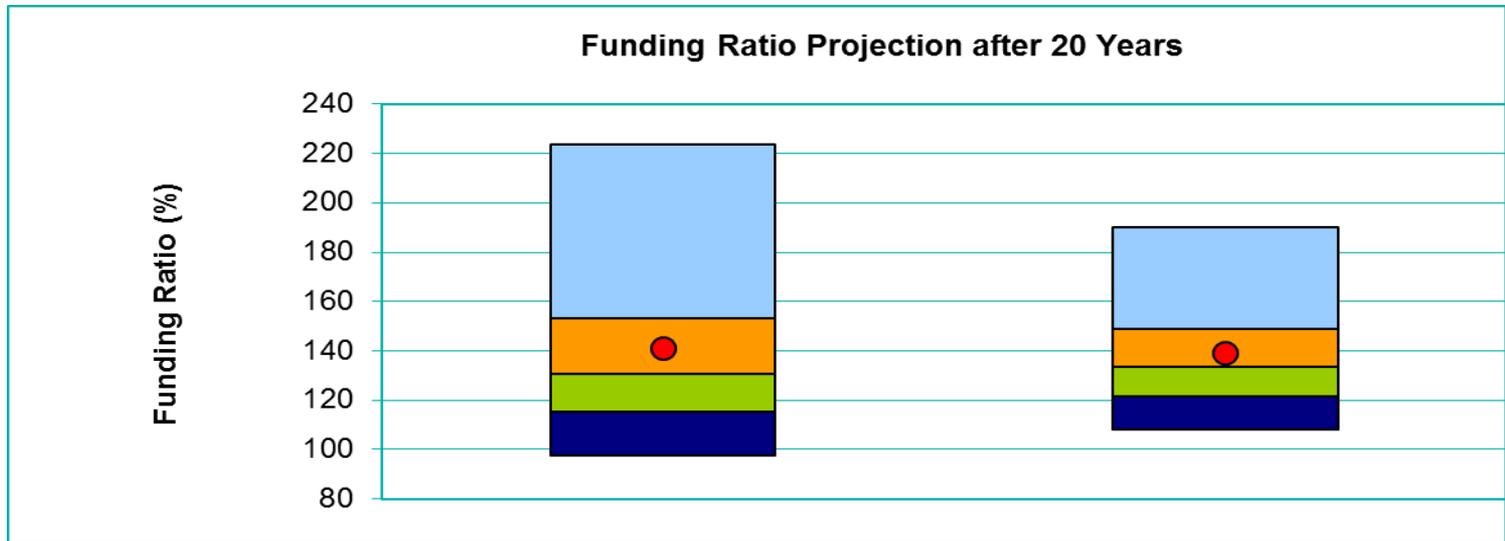


# Worst 5% Sample Distribution of Future Benefit Reduction Possibility

Distribution of Funding Levels by Year



# Funding Ratio Projections



	Current Asset Mix	Optimized Asset Mix
<b>Mean</b>	<b>140.9%</b>	<b>138.9%</b>
5th Percentile	223.6%	190.3%
25th Percentile	153.0%	148.9%
Median	130.8%	133.3%
75th Percentile	115.4%	121.7%
95th Percentile	97.8%	108.1%

# Subsequent Conversions to Shared Risk Plans

- Province-wide non-professional hospital workers -CUPE
- Two large troubled municipal employees' pension plans (CUPE, fire, police)
- Province wide Pipefitters (plumbers) plan
- Members of the Legislative Assembly (MLA's) plan
- Public Sector Superannuation Act employees (public service and key crown corporations)
- Provincial teachers' pension plan conversion to new hybrid plan (raise future service retirement age + 75% target COLA immediately with reserves)
- Start of conversion by several private sector DB plans

# Emergence of Opposition to Shared Risk Conversion

- Led by union representing highest paid professional employees (PIPSC) and some of most senior retired public service employees
- “A past deal is a past deal” and no contingent or upgraded career average benefits could be contemplated to replace previously guaranteed indexed final average benefits earned
- Government legislated PSSA changes with significant but not unanimous union support
- And corresponding MLA changes too!

# Back to “The Key” Political Question

- Can a government take action to avert a serious financial problem about which voters are largely unaware?
- Conventional wisdom is that the “political solution” is to “kick the can down the road” until the problem becomes critical rather than inflict any voter “pain”.
- New Brunswick had a fixed election date in September, 2014 – gov’t narrowly lost the election
- Canadian governments (both provincial and federal) have identified the cost of “entitlements” and low pension coverage as critical.
- CAPM has endorsed TBP structure – not detail.