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New Brunswick tackles pension sustainability

Shared-risk plans could provide road map for pension design for all firms

In 2012, New Brunswick introduced a new pension design: the shared risk plan (SRP). Shared risk plans and other target benefit designs are the pension plans of today and the future. New Brunswick is among the leaders in this significant change in the pension landscape in Canada.

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Guest Commentary

Why SRPs?

New Brunswick recognized there were sustainability issues with certain defined benefit (DB) pension plans in the province that had to be addressed. The sustainability issues resulted from many factors including low interest rates, changing demographics and increasing life expectancy.

The province created a task force to examine the issue and make recommendations, and the Pension Benefits Act (PBA) was amended to create a new type of pension plan: SRPs.

As a result of the changes to the PBA, SRPs are now available as a design option for single employer pension plans in New Brunswick in addition to traditional DB and defined contribution (DC) models. Existing pension plans in the province (public or private sector; single employer or multi-employer; unionized or non-unionized) may convert to a shared risk plan or a SRP may be established anew by an employer.

What are SRPs?

SRPs can best be thought of as a type of target benefit plan — the plan provides members with a "defined benefit" (it is not DC) — but benefits can be modified or reduced if the plan is underfunded.

In the case of SRPs, benefits are generally based on a career average formula, contributions are fixed (subject to minor adjustments within a permissible range) and benefits may be reduced in the event the plan fails the prescribed funding tests in two consecutive years. All future cost-of-living adjustments (COLA) under SRPs generally become conditional on there being sufficient funds in the plan. That is, COLA will only be paid in a given year if the plan can afford it.

SRPs also have prescribed risk management goals and procedures. When a plan is converted to a SRP, the primary risk management goal and secondary risk management goal must be attained and the risk management procedures must be followed.

The primary goal? There must be at least a 97.5 per cent probability that past base benefits will not be reduced over a 20-year period. The secondary goal? Seventy-five per cent of certain ancillary benefits (such as COLA or early retirement subsidies under the SRP) should be paid over that same period. These risk management goals are also required to be attained at certain other times.

SRPs are required to have a funding policy. This document is used as a road map for actions the plan administrator must or may take over time. For example, if a SRP fails the required funding tests, the funding policy would require the administrator to take action, which may include increasing contributions by a specified amount, decreasing future benefit accruals or decreasing base benefits for all members, including retired members.

The action taken depends on the priorities set out in the funding policy. If the plan has excess funds in a year, the funding policy would first require they be used to reverse any prior benefit reductions with respect to future payments.

If there were further excess funds available, the funding policy would set out further actions the administrator may take, such as enhancing certain ancillary benefits, decreasing contributions by a specified amount or setting aside a reserve for future COLA payments.

Each year, in order to determine whether COLA may be paid or other actions should be taken under the funding policy, SRPs have more annual requirements than traditional plan designs.

For example, SRPs are required to have a funding policy valuation performed each year. In addition, certain key plan documents, such as the investment policy and funding policy, are required to be reviewed and updated.

Under a SRP, contributions are used for the benefit of members. If there are excess funds, these may be used in accordance with the funding policy to enhance various ancillary benefits or decrease contributions for the members and the employer.

If a SRP is terminated and there are excess funds, the members are entitled to such excess funds (no surplus disputes).

If a member ceases employment and elects to transfer his entitlement out of the SRP, the termination value is the amount that may be transferred — this amount is calculated as the greater of the member's contributions plus interest and the member's share of the assets based on the termination value ratio of the plan.

This calculation ensures that a member who leaves the plan will not be able to "game" the plan, where it is underfunded.

SRPs are not administered by the plan sponsor, as is often the case with traditional models. Instead, SRPs are required to be administered by a trustee, board of trustees or not-for-profit corporation. In this way, the pension administration function is separated from the employer.

The employer's obligations are limited to making the required contributions. The administrative decisions fall upon the independent administrator.

The plans that have converted in New Brunswick have boards of trustees acting as administrators. These boards of trustees generally have appointees from the employer and various employee groups.

Conversions

One element of SRPs that has garnered attention is the ability to convert accrued pensions where a plan is converted from DB to a SRP. On conversion, all the benefits under the plan become subject to the SRP regime. Accordingly, future COLA becomes conditional for all members. In addition, if a benefit adjustment is ever required with respect to past base benefits, it would affect all members.

One of the primary reasons for including this element is to ensure better inter-generational equity among plan members and former members (as opposed to active members having to bear the full cost through increased contributions or significantly reduced benefits).

SRPs outside New Brunswick?

SRPs and target benefit plans can generally be viewed as a design option plan sponsors should be able to adopt if desired. However, for this to happen, amendments must be made to pension legislation in the applicable governing province permitting such plans. Without such specific legislation, pension standards legislation generally prevents target benefit plans in the single

employer context, because it prohibits the reduction of accrued benefits.

Currently, SRPs are only permitted for pension plans registered in New Brunswick. Some other provinces are at various stages of introducing target benefit designs that would apply to single employers, but it remains to be seen what aspects of the New Brunswick SRP model will be adopted in these other jurisdictions.

In addition, certain provinces may limit the availability of target benefit plans to workforces that have collective agreements, thereby limiting the single employers that could select this design option.

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