NEW BRUNSWICK'S PENSION CHANGE: THE SHARED RISK PENSION PLAN MODEL

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Last year the province of New Brunswick introduced new legislation and regulations related to shared risk plans (SRPs). Currently New Brunswick is the only province that permits shared risk plans, however various other provinces (including Nova Scotia, Ontario, Quebec, Alberta and British Columbia) either have recently or are in the process of introducing certain target benefit legislation for single employer plans. It is unclear at this time which unique aspects of the SRP model, if any, will be introduced in the target benefit legislation of other provinces.

WHAT ARE SRPS?

Shared risk plans have components of target benefit plans as generally the base benefits under a shared risk plan are based on a targeted pension formula (usually a career average formula). Ancillary benefits (benefits such as COLA, bridge benefits and early retirement subsidies) will only be provided where there are sufficient funds in the plan. However, all benefits (base benefits and ancillary benefits both past and future) under a shared risk plan may be reduced if there are insufficient funds.

The shared risk plan is designed to be flexible and self-correcting. Where there are excess funds, more money can be spent on benefits and protections. Where the funding of the plan is less robust, less money will be spent. In the most dire of economic circumstances, benefits will be reduced. SRPs are required to have a funding policy, which is used each year by the administrator as a roadmap to determine whether actions must be taken under the plan. These actions may include increasing or decreasing contributions by up to a specified amount, decreasing benefits for all members, granting indexation in the year for all members, or other base or ancillary benefit enhancements. In this way, SRPs are designed to be flexible and address various economic and other circumstances facing the plan as they arise.

UNIQUE ASPECTS OF SRPS

There are many aspects of shared risk plans that are unique - I will focus on the following:

- Conversion of accrued benefits;
- Prescribed risk management requirements;
- No solvency funding; and
- Removal of the administration function from the employer.

Conversion of Accrued Benefits

The legislation in New Brunswick permits the conversion of all accrued benefits (including accrued benefits of both active and retired members) when a plan is converted to a shared risk plan. At the time of conversion, a member's accrued benefits (whether DB or DC) become his or her base benefits under the SRP. All benefits under the plan become subject to conditional COLA when it is granted and are also subject to benefit reduction should it be necessary in the future. This is one of the more controversial aspects of the model; however, it was deemed to be an important aspect by the New Brunswick task force in order to help attain intergenerational equity.

Prescribed Risk Management Requirements

SRPs are also required to undergo annual stress testing (asset liability modelling). The preliminary stress testing is done when the plan is established. Contribution levels are set such that the plan can satisfy the risk management requirements under the legislation. Specifically, at the time the plan is set up, the testing must illustrate that there is a 97.5% certainty that base benefits will not be reduced over a 20 year period and a 75% certainty that certain ancillary benefits will be paid over such period. These risk management requirements have to be attained at certain other times, such as where a permanent benefit change is made. In addition, the annual stress testing is done in conjunction with the annual funding policy actuarial valuation to determine whether actions under the funding policy must, or may, be taken in any given year.

No Solvency Funding

Instead of being subject to the solvency funding requirements and valuations required by DB plans, SRPs are required to file annual funding policy valuations. The funded level is measured on a 15 year open group basis, which means that in determining the plan's "assets", the present value of the next 15 years of excess contributions (the difference between the contributions and the normal cost of the base benefit) are taken into account, assuming the plan's population is stable. The assumptions used for valuation purposes include a discount rate that should be consistent with the purposes of the plan and the risk management goals. The assumptions must also be consistent with plan

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experience, future plan expectations and accepted actuarial practice.

Employer is Not the Administrator

The legislation requires that the administrator for an SRP must be a trustee, a board of trustees or a not for profit corporation. There is no requirement for joint governance on a board of trustees; however, the plans that have converted to date have opted to have some form of joint governance. A trustee is required to act independently of the party that appointed him or her and cannot be removed by the appointing party (only the regulator may remove a trustee from the board). The legislation requires that there be a dispute mechanism built into the plan documents. This may include, for example, a third party facilitator who is appointed to resolve any deadlocks that may arise. This mandated third party administrator removes the administration of the pension plan from the employer's control and responsibility.

CONCLUDING REMARKS

Shared risk plans are based on New Brunswick legislation and regulations and therefore are currently only applicable to pension plans that are registered in New Brunswick. The plans that have converted to date have included public and private sector and both defined benefit and defined contribution components.

From an employer's perspective SRPs, like other target benefit plans, provide cost certainty, because contributions are fixed (subject to narrow adjustments in accordance with the plan's funding policy). From a member's perspective, SRPs and other target benefit plans are often viewed as less desirable than DB plans, but more desirable than DC plans as they continue to pool both investment and longevity risk. From the perspective of employers and members, the risk management requirements of SRPs, including annual stress testing and valuations, are intended to enhance benefit security and perform a vital role in ensuring the targeted benefits can be attained in the majority of economic scenarios. However, some view the increased regulatory requirements as more burdensome on the plan administrator and an increased cost to the plan.

Innovations in plan design such as the SRP are a welcome change on the Canadian pension landscape. It is another option, outside the DB/DC world, for employers and employees to consider. Hopefully the unique design aspects of the SRP will be considered as other provinces design their legislation and regulations related to target benefits.