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Risk Sharing Pension Plans: The Canadian Experience

Summary

This briefing note draws on the experience of running "defined ambition" style pension plans in Canada. The individual provinces in Canada are responsible for setting their own pensions legislation, and there are a number of existing pension plans already in operation that could fit within the legislative framework that the UK Government is establishing through the Pension Schemes Bill currently before Parliament. Therefore Canada provides an informative case study of how these plans could operate in practice.

There are a wide range of structures in place across the different provinces, but also across industries, sectors and by types of employer, with newer plans predominantly being set up in the public sector. In some cases rights in existing defined benefit (DB) plans are being converted across to different forms of shared-risk or target benefit plan structures, or new plans are being set up to replace existing DB plans (see page 4), while in other cases "specified" multi-employer plans (see page 12) have been in operation for decades under their own sections of the legislation.

There are a number of potential lessons for the UK in terms of the design and governance of these plans, their scheme rules, investment strategies and how they are communicated to members, funded, and run. Specific considerations for the UK (see page 13) include:

- the potential for shared-risk or collective benefit arrangements to extend to relatively small employers and pension plans if the significant governance overheads can be shared;
- the challenges in persuading employers to set up shared risk or collective benefit arrangements where they need to meet certain requirements (under UK legislation) to convert existing DB rights over to these new pension plans;
- the need to establish trust, transparency and inter-generational fairness between different groups of workers in a landscape where workplace pension participation is not compulsory (unlike in Canada and the Netherlands);
- the desire for "freedom and choice" from both employers and employees—with private sector employers likely to be attracted to different levels of contributions and benefits for their workers, and with employees likely to want to retain the option announced at Budget 2014 to access their pension savings from age 55 onwards;
- the appropriate tax and accounting treatment for these plans—with the tax treatment of target or collective benefits that can potentially be changed in future (subject to the funding position of the plan) yet to be confirmed.

Introduction

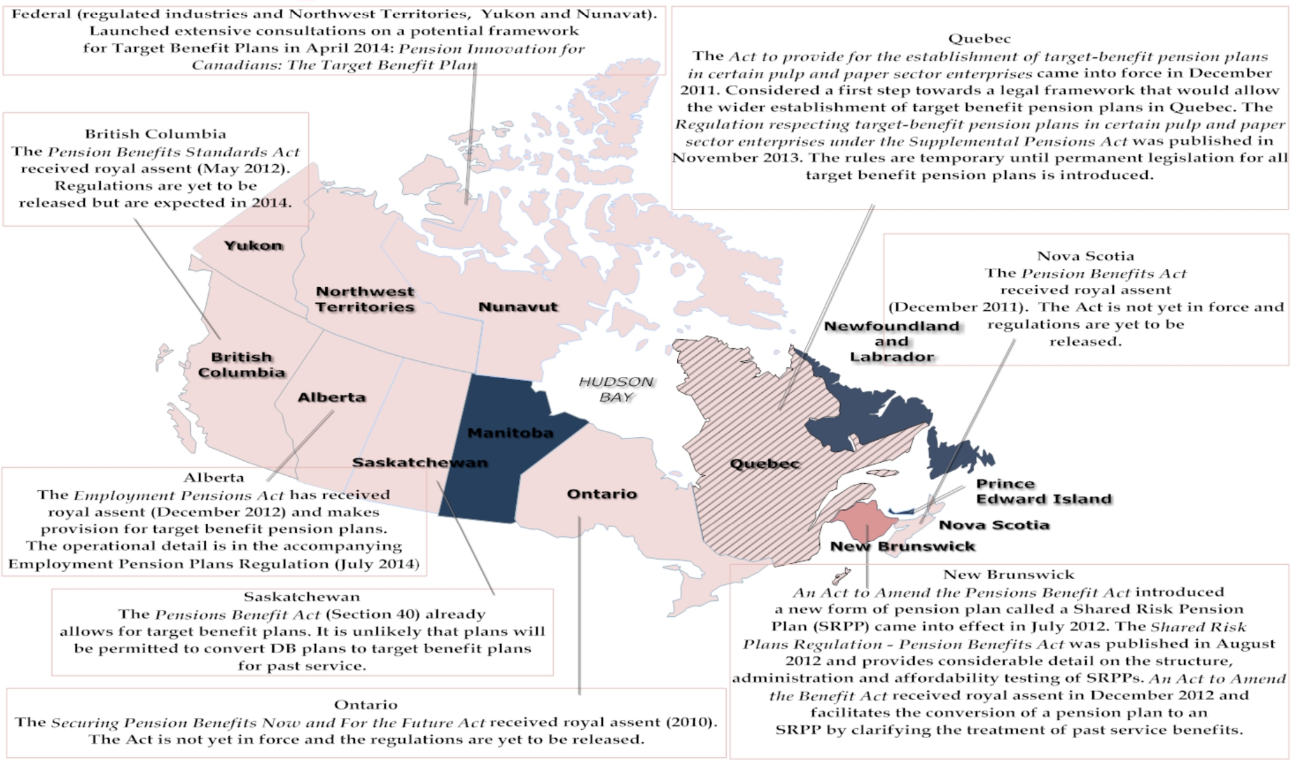
The Government is introducing new legislation to facilitate the development of **shared risk schemes and collective benefits** in the UK. This legislation was introduced to Parliament on 26 June 2014, following extensive joint working with the industry, discussion with consumer representatives and two consultations by the Department for Work & Pensions (DWP), with the intention being for the Bill to receive royal assent before the end of the current Parliament.

The Bill defines three different categories of pension scheme based on the type of promise, i.e. the certainty, offered to members during the accumulation phase about the level or amount of their pension benefits when they come to access them. This promise will either refer to all of the retirement income payable from the scheme (defined benefits), some of the income or some or all of the pot (shared risk), or there will be no promise (defined contribution).

The Bill also includes measures to enable the provision of collective benefits. Collective benefits are provided on the basis of allowing the scheme assets to be used in a way that pools risks across the scheme membership.

Some forms of risk-sharing schemes do already exist in the UK, for example, hybrid schemes such as cash-balance schemes, and with-profit arrangements. The proposed legislation also allows for the de-

Chart 1: Legislative developments for risk-sharing pension plans in Canadian provinces



velopment of new structures offering collective benefits that allow for the pooling of investment, inflation and longevity risks between members within a workplace pension structure, and allows for pensions in payment to fluctuate.

These schemes already exist, or are in development, in a number of other countries, including The Netherlands, Denmark and Canada.

This briefing note is the first of two briefing notes and focuses on the Canadian experience of setting up risk-sharing schemes. The second briefing note will focus on the experience of the Netherlands over the last 10-15 years and the shift from traditional defined benefit (DB) schemes to more conditional, collective arrangements.

Risk-sharing across Canada

In Canada, the **"target benefit"** pension plan is one recognised form of collective benefit plan. Pension rules in Canada are established by the individual provinces, and by the Federal government for the territories in the North and federally regulated industries. It is therefore at the discretion of each province's government as to whether they wish to provide a legislative and regulatory framework for these plans. Currently, only the province of New Brunswick has a full legislative structure and regulatory framework in place to operate target benefit plans, which in New Brunswick are known as **Shared-Risk Pension Plans (SRPPs).**

However as Chart 1 shows, a number of other provinces, including Ontario, Quebec, Nova Scotia, Saskatchewan, British Columbia and Alberta have started to introduce legislation explicitly allowing for the set-up of target benefit plans. Those provinces are now considering the wider regulatory framework and the specific rules governing this type of pension plan.[1] The provinces are all at different stages of implementation. In Quebec, for example, a new plan was launched for the pulp and paper sector in January 2011. And in April 2014 the Federal government issued a consultation on new legislation for target benefit plans to be made available to over 1,200 federally-regulated pension plans. The proposals in the consultation had a similar level of ambition to the shared-risk pension plans in New Brunswick, including allowing for the conversion of accrued DB rights into target benefit structures.

Motivations for introducing risk sharing plans in Canada

Canada, like many other countries with a strong legacy of DB pension provision, has seen pension plan sponsors facing growing financial pressures in recent years. Long-term trends of increasing life expectancy and changes in the underlying scheme demographics (as increasing numbers of members reach retirement), combined with the volatile equity markets and very low interest rates that characterised the Global Financial Crisis from 2008, have contributed to rising deficits in DB pensions and associated increases in funding contributions for the sponsoring employers of these plans.

In recent years there have been growing concerns about the size of the deficits in the public sector plans, the sustainability of public finances, and the potential pressure of funding deficits on Canadian taxpayers. However, these affordability concerns are just as relevant to the private companies and not-for-profit organisations offering DB pension plans to their workers. A range of temporary relief measures (for example exempting some employers from the funding solvency requirements, extending deficit funding recovery periods, requiring higher contributions from active members and/or reducing future benefits) have been put in place across a number of provinces to help weather the impact of the global financial crisis. However, these are generally not considered a sustainable way of addressing all of the systemic problems that have been identified with DB pension plans.

Meanwhile, the shift to defined contribution (DC) pension plans in Canada, while removing solvency and contributions risks for the sponsoring employers, is considered by some parties as too uncertain for workers due to individual members bearing all the investment and longevity risk. There is currently no requirement to annuitise in Canada and only a minority of those reaching retirement with a DC pension voluntarily choose to annuitise (currently less than 20% of DC retirees are thought to annuitise). And, in addition, plans managing individual DC pension pots are considered less equipped to deliver the efficiencies of scale and lower associated investment fees of collective DC assets being managed by fiduciaries on a pooled basis, as they would be within a DB plan. Again, there are no statutory overrides for converting existing DB rights within the proposed UK Pension Schemes Bill so employers could only convert accrued rights if they met certain requirements already set out in UK legislation.

Against this background, supporters of target benefit plans have argued that they can combine the attractive elements of DB and DC pensions while addressing some of the key limitations of each. A target benefit plan has been described as a pension plan with the following characteristics:[2]

- The contribution amounts are fixed, or variable only within a narrow and predefined range, rather than subject to change to meet the traditional DB "going concern" or "solvency" funding standards.
- Plan members are offered a targeted defined-benefit type pension at retirement.
- Plan members' benefits may be adjusted (both up and down) to balance the plan's funding.

The aim of target benefit plans is to avoid the volatility in contributions for plan sponsors that have been associated with running traditional DB plans, by allowing both future and accrued benefits to be reduced if the funding position worsens. At the same time, target benefit plans can deliver some of the cost savings and risk pooling advantages of DB plans because the benefit structure is established on a pooled basis and members' assets are being collectively invested by a trustee board.

Chart 2: Some examples of Target Benefit Plans in Canada

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- **University of British Columbia (UBC) Staff Pension Plan** – structured as a career average DB plan but states that *"the Plan helps protect against inflation by making annual cost of living adjustments (COLA) after your pension payments begin, subject to the Plan's ability to pay"*. In addition, the University cost commitment is a fixed percentage of earnings, and the Plan has a written funding policy that calls for the Plan's actuary to perform certain funding tests. If the financial health of the Plan falls below certain level, benefits may be reduced until adequate funding is restored. Similarly, if after building up contingency reserves the Plan has excess funds, they must be used to provide benefit improvements of cash distributions. The Plan had just under 10,000 active, deferred and pensioner members in 2010.

- **City of Saint John Pension Plan** – converted to a Shared Risk Model (under the New Brunswick framework) in December 2012 when the municipality and its four unions (representing police, firefighter, inside and outside workers all singed a memorandum of understanding. Under the shared-risk model the city and its workers will share the risks for future deficits, with their benefits conditional on meeting certain financial parameters. The Plan had around 1,700 active, deferred and pensioner members in 2013.

In practice, there are a wide range of risk sharing and target benefit pension plans currently operating across the Canadian provinces (see Chart 2 for some real examples). Some of these have been operating for many years as multi-employer pension plans offering a form of target benefit (for example, some of the Universities staff pension plans) while others have been newly established alongside recent legislative changes as existing DB schemes have been closed or converted. The more recent New Brunswick plans, for example, are reported to currently include 2 municipal plans (c1,400 members), 4 public sector plans (c42,800 members) and 6 private employer plans (c4,200 members).[3]

Target benefit plans are typically structured around delivering member benefits that are separated into two components:

- **"Base benefits"** – these are determined by a base pension formula and are typically based on a career average formula.
- **"Ancillary benefits"** – these are additional plan features such as cost-of-living increases or adjustments (COLA), early retirement subsidies, and improvements in the normal form of the pension.

In a target benefit plan, the risk–sharing from the employer or plan sponsor's perspective generally takes place through some allowance for increases in contributions from both employers and employees if the scheme is under-funded (and subsequent decreases if the schemes funding position subsequently improves), and through the absence of any contribution holidays if the plan becomes overfunded (the assets in the scheme are entirely owned by the plan members). It is worth noting that, under the draft legislation in the UK's Pension Schemes Bill, collective benefits arrangements will not require there to be any contingent liability upon the employer (beyond the pre-agreed level of contributions).

The risk-pooling from the scheme members' perspective comes through the pooling of their investment, longevity and inflation risk with other members, which is exercised through the ancillary benefits being conditional and, if the scheme is seriously underfunded, through potential reductions in base benefits. However, scheme members also stand to benefit from the upside risks if the plans perform better than expected.

Risk Sharing Pension Plans in New Brunswick

The remainder of this briefing note focuses primarily, though not exclusively, on the recent pension reforms that have taken place in the province of New Brunswick. While target benefit plans already exist in other Canadian provinces (e.g. Quebec), New Brunswick is widely recognised as having gone the furthest of all the provinces by introducing a comprehensive legislative and regulatory framework for target benefit plans to operate in.

The legislation also explicitly allows, via an amendment to the Pensions Benefit Act, for an existing pension plan to be amended for the purpose of converting the plan to a Shared Risk Pension Plan. As of the conversion date, pension benefits can be converted to "base benefits" and accrued or "vested base benefits" can also be reduced. Again, there are no changes proposed within the UK's Pension Schemes Bill for the conversion of accrued DB rights into collective benefits that can, as a last resort, be reduced.[4]

The reforms in New Brunswick are still in their early stages, with the legislation enacted in 2012 and an Effective Date for the new legislation of 1 January 2014, however the design, risk

Chart 3: Principles for the reformed New Brunswick pensions

Rebuilding New Brunswick: The Case for Pension Reform

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1. Pension plans must be subject to robust risk management, and be checked annually, including stress tests, to ensure that the plan complies with that task.

2. A pension plan must provide benefit security. This means:
   - Risk management targets are focused on delivering a high degree of pension security for members and retirees; and
   - The Plan must be governed by an independent trustee(s) who can force employers and employees to increase (or decrease) contributions when appropriate, subject to realistic and manageable limits.

3. A pension plan should be able to demonstrate that it will be sustainable over the long term.

4. A pension plan must be affordable, which means that contributions must be stable and affordable for both employer and employees.

5. The Plan must be equitably designed – no single age cohort should unduly subsidise another, and no one should be able to 'game' the system.

6. The Plan must be transparent. The pension goals and risks must be clearly stated up-front; who shares the risks and rewards and by how much most be clear and pre-established.

7. Benefit changes as a result of conversion will apply only in the future; everyone keeps the amount that has already been credited.

8. There should be no sudden shocks to members and retirees' retirement plans.

9. All groups of employees should be treated consistently, including part-time employees.

10. At inception, the actuarial assumptions must be closely related to market benchmarks, such as International Accounting Standards (IAS) #19.

management and governance of the new Shared Risk Pension Plans offer a potential example of 'good practice'. In addition, the approach to establishing consensus between provincial government, plan sponsors and the unions around the need for radical reforms to their DB pension plans is likely to be of interest to other governments and plan sponsors, including those private sector employers in the UK who may be reviewing their DB pension provision in light of changes to the state pension and the abolition of contracting-out from April 2016. It is also a topic of current interest in the US.[5]

The first commitment to public and private sector pension reforms in New Brunswick was made on 28 October 2010 when Premier Alward announced a three member *Task Force on Protecting Pensions* with a broad remit to examine the state of private pensions.[6] The remit was subsequently extended to include public sector pension plans. The Task Force undertook an extensive engagement process, working closely with the unions, private sector leaders and the provincial government, to identify the key principles (see Chart 3) they believed should form the basis of a new pension model. These were based on the conviction that the status quo was no longer an option for New Brunswick, given the concerns around the sustainability of existing DB plans and the affordability concerns for employers and New Brunswick taxpayers.

The Task Force then put forward a new model, based on these principles, for the Province to consider. After reviewing a number of alternative plan designs against the principles they concluded that all of the traditional DB and DC Canadian pension designs were not suitable if long-term sustainability of pension plans was to be achieved. However, they believed that there were features of each of the different plan designs that were positives. The Task Force, alongside the union leadership of those pension plans with the most serious deficits, researched, developed and tested what then became known as the 'Shared Risk Pension Model'. The model sought to combine the pensions design experience of the Netherlands in setting up conditional DB/CDC schemes with the robust risk-management processes developed in Canada for their banks and insurance companies. The IMF had previously recommended that the regulatory framework in Canada should focus on the adequacy of risk management practices in addition to traditional solvency funding approaches.[7]

Development of the model

The testing of the Shared Risk Pension Plan (SRPP) included costing a range of different benefit options to estimate the level of contributions that would be required (in light of the proposed investment strategy) and determining the range of benefit options that would meet all of the three objectives of the Task Force (Sustainability, Stability and Affordability), as well as the broader benefit objectives of the plan sponsors and members.

First, a small number of preferred benefit options were identified and the performance of the plan was simulated under 1,000 different economic scenarios (a process known as stochastic modelling) over a period of 20 years, with the aim of identifying the optimal asset mix that would provide the best risk management results. Second, the level of contributions were identified for each of the benefit options in line with the required risk management goals that were agreed by the Task Force (see Chart 4). The aim was to select the option that met all of the risk management goals *and* met the three objectives set out in the original task force mandate.

Risk Management Procedures

These risk management procedures have formed part of New Brunswick's ongoing regulatory framework for SRPPs that require a "stress test" (or stochastic modelling of assets and liabilities) to assess the financial position of the plans and their ability to pay target benefits in future. This approach for assessing financial strength has been commonly used in Canadian banks and insurance companies, as well as internationally, and is rapidly gaining traction in The Netherlands with "feasibility tests" required in the new Financial Assessment Framework (see the forthcoming PPI briefing note for more detail). Each plan is required (at the outset, and then on an annual basis) to run 1,000 20-year simulations using reasonable estimates of a set of relevant financial parameters. The simulations should demonstrate that over a 20-year time horizon the risk management requirements will be met.

Chart 4: Risk Management Requirements in the New Brunswick Shared Risk Pension Plan

New Brunswick SRPPs are required to undergo annual stress testing using asset liability modelling. At the outset of the plan the contribution levels are set such that the plan can satisfy the legislated risk management requirements.

The specific requirements that must be met when the plan is first set up are that:

- **there is a 97.5% certainty that base benefits will not be reduced over a 20 year period (the primary risk management goal); and**
- **there is a 75% certainty that certain ancillary benefits will be paid over a 20 year period (the secondary risk management goal).**

If, after these simulations, plans fail this test the trustees will have to review their investment, funding or benefit rules until they pass. Whilst these enhanced risk management procedures will incur administrative costs, the aim of the annual reviews is to produce earlier and smoother responses to potential changes in future financial conditions and minimise the size of any adjustments required by identifying them well in advance. For example, in order for Cost of Living Adjustments (COLA) to be paid in a given year the primary risk management goal must first be met, because the future base benefit is affected by paying the COLA for that year. Whenever a permanent benefit change is made both the primary and secondary risk management requirements have to be met.

Funding policy and dealing with changes in the financial position of the plan

In addition to the testing, and despite not being subject to traditional funding requirements, SRPPs are required to carry out annual actuarial funding policy valuations. The plan's 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 annual contributions and the normal cost of the base benefit) is taken into account, assuming a stable base population within the plan. Similar to the funding valuations carried out for DB schemes in the UK, the assumptions in the valuation include the selection of a discount rate that should be consistent with the plan's objectives and risk-management goals. The assumptions should also be consistent with prior plan experience, future plan expectations and accepted actuarial practice.

To complement the stress testing and annual funding valuations, under the SRPP each plan must have a funding policy in which the plan sponsor agrees the protocols for how to respond to a change in the plan's financial position. So, in any year when the plan is underfunded, there must be a recovery plan that sets out whether and how to increase contributions, change asset allocations, and reduce ancillary and base benefits. Likewise, in any year when the plan is overfunded, there must be a funding excess utilisation plan that sets out whether and how to reduce contributions, change asset allocations, restore benefits (including restoring previous benefit reductions that have been made and providing for ancillary benefits).

Within the SRPP, plan sponsors have the flexibility to stipulate the benefit formulae that determine what benefits are base benefits and what benefits are ancillary benefits. For example, the early adopters of the New Brunswick SRPP (3 public sector employers and 1 private employer) who were converting their DB plans all used career average salaries rather than final salaries for the calculation of the "base benefits". The "ancillary benefits" then allow for increases over time by indexing employees earnings to wage growth or inflation when the plan is sufficiently well funded and according to the agreed benchmarks and funding requirements.

A sequence of actions is then pre-agreed to determine how the trustees should respond to any changes in the financial position of the plan. The specific sequence of actions can be determined at the outset of the plan by the sponsor in discussion with scheme members and their representative unions.

Under the *Shared Risk Plan Regulations* in New Brunswick the reduction of past base benefits is always the action of last resort to be taken to address a position of underfunding. Similarly, in a position of overfunding, the first priority must always be the reversal of any prior reductions to base benefits or ancillary benefits that have not yet been reversed. These requirements therefore set some limits around the funding policy and sequence of actions that can be operated by the trustees and plan administrators. One example of a plan's sequence of actions, as agreed for the New Brunswick Hospital's Plan, and listed in priority order, is shown in Chart 5.

The lack of pre-agreement of a clear funding policy and a sequence of actions has been identified by some commentators as one of the main weaknesses of the existing conditional DB/CDC schemes in the Dutch system. This is now being partly addressed through the proposed revisions to the Financial Assessment Framework which will clarify how and when trustees should apply cuts to members' benefits when a scheme is underfunded.

Establishing consensus and converting from a DB plan to the SRPP

The SRPP received immediate support from four of the major unions who had been involved in the Task Force, together representing more than one-third of the New Brunswick government's bargaining employees who would be participating in the new plan. These covered workers represented by "Certain Bargaining Employees" of New Brunswick Hospitals and the Canadian Union of Public Employees, New Brunswick Hospitals. In addition the union workers in the New Brunswick Pipe Trades Plan, a private sector plan, were included.

A specific feature of the New Brunswick legislation is that it allowed for the conversion of accrued DB rights into the new SRPP, facilitating the switch in the plan design for the sponsoring employers, and thereby providing a stronger incentive for them to commit to a SRPP instead of a DC plan where all the balance sheet risk is taken off the table for the employer.

In this regard New Brunswick has gone further than the other Canadian provinces: to date no other provincial pension standards legislation allows for the conversion of accrued DB rights to shared risk or target benefits when a plan is introduced. Under the target-benefit legislation now being proposed in most other provinces (with the possible exception of Federal proposals for the federally regulated industries) it does not appear that this conversion of rights will be allowed.

Chart 6 provides a summary of the scheme benefits in the New Brunswick Public Service Superannuation Plan. To deliver this level of benefits the initial contributions to the Public Service Shared Risk Plan have been set at 19.5% of pensionable earnings. The aggregate 19.5% contribution rate is split between employees and the employer. Employees make a contribution rate of 7.5% of pensionable earnings up to the "Year's Maximum Pensionable Earnings" (YMPE, see Chart 6) and 10.7% of pensionable earnings above it. This gives an average employee contribution rate of 8.25% of pensionable earnings based on the membership demographics as at April 1 2012.

Meanwhile the employers make a contribution of 11.25% of pensionable earnings. Within the Memorandum of Understanding[6] (MOU) there is also a requirement that, if there is an increase or reduction in the number of employees employed by the employer of greater than 5% in a given year, the initial contribution rates will be re-calculated. This is intended to guard against any significant changes in the underlying plan demographics that could destabilise the scheme.

When explaining the implications of the new plan to members a segmented approach was taken. This focused on key messages around the protection of accrued and future benefits (relative to remaining in an unsustainable DB plan or shifting to a DC plan); the likely timing of retirement and the need for younger age groups to retire a bit later than anticipated; and the small increases in contributions required to keep the plan secure over the longer term.

While there has been some opposition to the proposals (for example, the "Pension Coali-

Chart 5: Example of a Sequence of Actions when there is a change in the plan's funding position

New Brunswick Hospital's Plan (Canadian Union of Public Employees Local 1252)

If the funded ratio falls below 100% for two consecutive years or the plan fails to meet the risk management goals of a Shared Risk plan:

- Increase contributions by up to 1 per cent of earnings, split evenly between workers and the employer.
- Change the rule for calculating retirement benefits, for those not currently eligible for such benefits, to a full actuarial reduction.
- Reduce "base benefit" accrual rates for future service up to 5 per cent.
- Reduce base benefits for all members, including benefits based on past and future service, in equal proportion until the plan meets the risk management goals.

If the funded ratio rises above 105% a portion of the surplus can be used as follows, if the plan can still meet the risk management goals:

- Reverse previous deficit-recovery measures in the following order:
  - Reverse any increase in contributions
  - Reverse any reduction in base benefit
  - Reverse any reduction in early retirement benefits.
- Index pensions and base benefit accruals up to the full Consumer Price Index (CPI).
- Increase individuals benefits, as needed, so that all retirees receive a benefit based on final five-year average salary, indexed to the CPI.
- Provide lump-sum payments to offset past shortfalls relative to a benefit based on final five-year average salary, indexed to the CPI.

If the funded ratio remains above 140% of plan obligations even after these changes the plan could establish a reserve to cover 10 years' conditional indexation, then start to reduce contributions by up to 2 per cent of earnings, then improve other benefits such as early retirement benefits.

tion" for New Brunswick[9], representing public sector retirees and their families, is raising legal funds to challenge the proposals) the unionised environment and mandatory participation means that, in practice, scheme members have little alternative but to accept the deal negotiated by the unions with the New Brunswick government and the sponsoring employers. Notably however, measures that have had to be taken in other provinces to ensure DB plans are affordable have been met with much greater resistance. In Quebec, for example, a consultation has just closed on a new Bill to make amendments to the municipal (local government) DB plans to put them on a more sustainable footing. These changes include capping the contributions into the scheme at 18%, amending the accrued and future benefits of active members, suspending the indexation of retired members and increasing the employer contributions, in order to improve the financial health of the scheme.[10]

Governance and Investment in the New Brunswick Shared Risk Plans

SRPPs in New Brunswick must have independent administration, through a trustee, board of trustees or not-for-profit corporation. The plan administration is therefore completely separate from the plan sponsor. Whilst the constitution of the boards of trustees are not hard-wired into the regulations, in practice many of the plans that have converted to shared risk plans have jointly sponsored boards of trustees, with unions and employers appointing equal numbers of trustees to ensure a balanced board.

For the New Brunswick Public Service Shared Risk Plan, the MOU sets out that the Board of

Chart 6: Benefits and Contributions in the Public Service Shared Risk Plan

Taken from Scheme Documentation: At-A-Glance February 2014

Contribution Rates (YMPE = Year's Maximum Pensionable Earnings = $52,500)	**For Employees,** Effective April 1, 2014: 7.5% of your eligible earnings up the YMPE*, 10.7% of your eligible earnings above the YMPE. **For Employers,** Effective April 1, 2014: 12.5% of eligible earnings until December 31 2018, 12.0% until December 31 2023, and 11.25% of earnings until 31 December 2028. From January 1 2029 employer and employee contribution rates will be re-determined and will become equal.
Target (Base) Benefits	1.4% of annualised pensionable earnings up to the YMPE for the year PLUS 2% of annualised pensionable earnings in excess of the YMPE for the year.
Ancillary Benefits	All future Cost of Living Adjustments and other ancillary benefits (e.g. early retirement reduction factors) will be provided only to the extent that funds are available for such benefits.
Retirement Age	Normal retirement date is the first day of the month following your 65th birthday. Early retirement date is the first day of any month between the month following your 55th birthday and the month of your 65th birthday (permanent early retirement reduction of 5% per year).

Trustees will be comprised of ten trustees; five appointed by the Province (including one retiree) and five appointed by each of the Unions involved in the Plan. For the Public Service Shared Risk Plan the Board of Trustees are responsible for:

- All measurements and reporting required by the Pensions Benefits Act including regular actuarial valuations and stochastic modelling of the assets and liabilities of the Public Service Shared Risk Plan;
- Establishing an investment policy subject to annual review for the purpose of ensuring that the desired security for both base benefits and the ancillary benefits are expected to be achieved;
- Administering the plan in accordance with the Funding Policy and, for greater clarity, this includes the power to increase or decrease contributions and benefits in accordance with the Funding Policy; and
- All other requirements of an administrator under the Pension Benefits Act.

One of the arguments put forward in support of collective schemes is that, by pooling assets of active members and retirees, they facilitate a longer-term investment perspective than would be appropriate for members in an individual DC plan approach. Whilst some advocates of CDC schemes have argued that these schemes can afford to take a lot more investment risk than individual DC plans,[11] the MOU for the Public Service Superannuation Plan in New Brunswick explains that the plan was modelled on a more cautious target asset allocation with a combination of fixed income and real assets: 39% fixed income; 41% equity; 5% private equity; 5% hedge fund/absolute return strategy and 10% real estate and infrastructure.[12]

This initial target asset allocation is considered by the Board of Trustees to be consistent with the Statement of Investment Policies for the plan (see Chart 7) and will be reviewed in future. The asset allocation can be changed by the Board of Trustees provided the changes do not adversely impact the results of the risk management framework tests, or lead in an increase in the contribution rates that are necessary to meet the funding goals. This still provides significant discretionary powers for the Board of Trustees to adapt the investment strategy, particularly in times of under or over funding and creates a tension between maximising long-term returns and matching the liabilities (in the form of future target benefits) and reducing the volatility of the plan. The New Brunswick Investment Management Corporation has been appointed by the Board of Trustees as the sole discretionary manager of the Public Service Shared Risk Plan for the time-being.

Outstanding issues for New Brunswick and other Canadian provinces

The landscape for risk sharing and target benefit plans across Canadian provinces will continue to evolve in the coming years. For example:

- In New Brunswick, more groups of workers are expected to enter negotiations to convert into a SRPP. For example, in March 2014 legislation was introduced to move members of the legislative assembly (MLA) into the Public Service Shared-Risk Pension Plan for their future service and to make their future cost of living adjustments conditional.
- In Quebec, the Government is consulting on a new action plan to address the sustainability of DB plans, but is not currently considering conversion to target benefit plans for the public sector.
- The Federal Government closed its consultation on target benefit pension plans for federally-regulated employers and employees on 23 June 2014 and is now considering its response.

It remains to be seen whether target benefit plans will really take off in the private sector, in single-employer plans, and in situations where the sponsoring employers do not have the added incentive of being able to convert the existing accrued DB rights into a risk-sharing structure. Some outstanding areas of contention are listed below.

Multi Employer and Single Employer Pension Plans—Multi-employer pension plans (MEPPs) in Canada involve a number of participating employers and are union-negotiated, collectively bargained schemes with targeted benefits, contingent on the plan's financial position, and with members bearing 100% of the risk on a collective basis. These schemes have existed in their various guises across different provinces and sectors since the 1950s and 1960s and are recognised separately within the Income Tax Act (ITA) as 'specified' MEPPs. They provide the foundation for the design of target benefit plans—however the new legislation being introduced by the different provinces looks to go beyond this by enabling target benefit plans to be set up for single employers and without the involvement of a union. The contributions and benefits may also be expressed differently to MEPPs (e.g. often being expressed as a percentage of salary rather than as a fixed contribution and a targeted $benefit in retirement).

Tax Treatment— The Income Tax Act (ITA) applies across Canada and there are currently no specific plans to make amendments for the new breed of target benefit plans (MEPPs already have their own tax treatment which treats them as DC schemes). Target benefit plans are in operation under the current framework, however there are some areas that would benefit from clarification around pension adjustment rules and the appropriate tax treatment when retroactive changes are being made by Trustees to the member benefits. The different tax treatment of MEPPS within Canada means they are less affected by these issues and can operate as true target benefit plans.

Accounting Treatment—One of the strong incentives for an employer to switch to a shared risk or target benefit plan is to

Chart 7: Statement of Investment Policies for the Shared Risk Pension Plan

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The Statement of Investment Policies for the Plan sets out the Board of Trustee's objectives in line with achieving their Risk Management Goals:

- **In the long term, the objectives will be to not only preserve the capital value of the Pension Fund, but also to provide the best possible long-term real return on investments while continuing to achieve the Risk Management Goals. It is understood that the policy portfolio may experience uneven returns from year to year consistent with general economic and investment cycles, but a diversified portfolio of long-term assets will partially mitigate the variability of the returns.**

- **Over shorter time periods, the objective will be to achieve competitive rates of return on each major asset class while avoiding undue investment risk and excessive market volatility.**

- **Over the medium term, New Brunswick Investment Management Corporation is expected to provide rates of return in excess of those achieved by passive management of the policy portfolio. A value-added contribution of 42 basis points, after deducting all investment management costs, is the portfolio's target four-year moving average rate of return.**

remove the volatility of a DB pension plan off their balance sheet. Ideally from the employer's perspective, and particularly where there is no suggestion of any additional employer contributions being made, target benefit plans would be treated for accounting purposes as DC plans, with any underfunding managed by reducing the member's benefits paid from the plan. However there is still some ambiguity within the audit community as to how these plans should be treated, especially if the plan allows for some variation in employer contributions. This issue is not unique to target benefit or CDC plans. Other forms of hybrid plans suffer from the same ambiguities and these issues have been discussed, but not yet fully addressed, by the International Accounting Standards Board (IASB). MEPPs in Canada are again treated as DC schemes for accounting purposes. In December 2013 the Office of the Auditor General agreed with the New Brunswick Government that the accounting treatment of the new SRPPs as DC plans was appropriate at the time, however they noted that "an assessment on a plan-by-plan basis is required to determine the appropriate accounting treatment of any pension plan conversion."[13]

Funding Valuations and the Actuarial Profession — An associated area that has been identified as work in progress is the professional standards around the funding valuations for these plans. As yet there have been no specific standards developed by the Canadian Institute of Actuaries to guide the selection of the assumptions and the specific risk management modelling that is required under the new legislation. The development of professional guidance in relation to shared risk plan funding valuations across Canada should ensure there is greater consistency between the different designs of plans in operation and should give greater comfort to those administering the plans.

Considerations for the UK

The experience across Canada, and in the province of New Brunswick in particular, is of direct relevance to the development of shared-risk and collective benefit CDC pension schemes in the UK. We highlight some key issues for policy makers, industry, employers and other stakeholders below:

i) Scale and Governance— While the governance overhead of running a risk-sharing scheme in line with best practice is substantial that does not necessarily make it inaccessible to smaller employers and groups of employees within a multi-employer setting— employers with hundreds (rather than thousands) of active members have adopted shared-risk plans in Canada.

ii) Conversion of DB rights— UK legislation currently only allows for conversion of existing DB rights into CDC schemes if certain requirements are met. For example, the Pensions Act 1995 requires statutory indexation of DB rights, and scheme benefits cannot be modified in private sector schemes (for example, by converting them into defined contribution benefits) without informed member's consent or satisfying actuarial equivalence requirements. This could reduce the incentive to set up these schemes for UK employers, who for accounting purposes will still have the volatility of existing DB rights on their balance sheet, along with the associated governance, even if they restructure the scheme going forward. However, for those employers who are committed to offering a more secure retirement outcome for their workers some form of shared-risk or collective benefits plan may still prove an attractive option.

iii) Intergenerational fairness— In the UK participation in a workplace pension is not mandatory as individuals can choose to opt out. This is likely to place even more onus on the need for the risk-sharing mechanisms to be fully transparent and for there to be no inherent intergenerational unfairness in the design of the scheme at the outset. Otherwise, groups of workers (for example younger workers, or lower paid workers) could perceive that it is not personally beneficial for them to stay in the scheme and opt out, destabilising the scheme. The fair pricing of pension contracts between groups of workers and well defined property rights is an area of current debate in The Netherlands.

iv) Freedom and choice for employers— The Canadian risk-sharing schemes do allow considerable flexibility in the design of the scheme and, in particular, the level of target benefits and associated contributions, the levels of risk and over- and under-funding that will be tolerated before changes are made, and the agreed funding policy for addressing a position of over and under-funding. This could lend itself to a multi-employer CDC arrangement with overarching governance where different sections of the scheme offer a different design structures for different groups of employers.

v) Freedom and choice for employees — Within the UK individuals have the right to transfer their DB or DC pot into another pension scheme and, from April 2015 onwards, will have total freedom as to how to use their DC pot from age 55 onwards. This is not necessarily a fundamental issue for risk-sharing schemes unless property rights are unclear or it presents opportunities for scheme members to game the system and, as a result, could destabilise the scheme. In Canada members are able to take a 'termination value' from their plan which is calculated as the greater of the members' own contributions to the plan and the return within the scheme or the value of the member's accrued benefits multiplied by the funding level of the plan at the time (much like the Cash Equivalent Transfer Value (CETV) approach for converting DB benefits in the UK). Regular monthly valuations can also be used to ensure there is not significant scope to game the system when the funding position worsens or improves.

vi) Tax and Accounting Treatment of Risk Sharing Plans— These issues are not fully resolved yet in Canada but are being explored. The challenges faced are likely to be similar to those in the UK—clarifying how the benefits being built up in these schemes are assessed for tax relief purposes and whether they are treated as DB or DC like, and agreeing an approach to setting assumptions for funding valuations within the actuarial profession. These challenges are significant but should not be insurmountable.

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1 See Aon Hewitt's website on target benefit plans in Canada, (http://www.aon.com/canada/products-services/human-capital-consulting/consulting/target_benefit_plans/)
2 Target-Benefit Plans in Canada—An Innovation Worth Exploring, C.D. Howe Institute (2014)
3 Information supplied by Aon Hewitt via their offices in Canada.
4 Bill 20—An Act to Amend the Pension Benefits Act, New Brunswick Government website (2012)
5 New Brunswick's New Shared Risk Pension Plan, Center for Retirement Research at Boston College (2013)
6 Rebuilding New Brunswick: The Case for Pension Reform, Government of New Brunswick (2013)
7 Canada: Financial Stability System Assessment —Update , IMF (2008)
8 Memorandum of Understanding for the Shared Risk Pension Plan (November 2013), Government of New Brunswick website
9 http://www.pensioncoalitionnb.ca/
10 Bill 3—An Act to Foster the Financial Health and Sustainability of Municipal Defined Benefit Plans, Quebec Government website (2014).
11 Building the Consensus for a People's Pension in Britain, RSA (2010)
12 Statement of Investment Policies of the Public Service Shared Risk Pension Plan (January 2014), Government of New Brunswick website
13 News Release, Office of the Auditor General (2013)

For more information on this topic, please contact
Mel Duffield, 020 7848 3751
mel@pensionspolicyinstitute.org.uk