Goodmans LLP Update

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New Brunswick's innovative answer to pension reform

New Brunswick's shared-risk pension model, which went into force in July, is new and innovative and promises great potential.

This new model is the first of its kind in Canada and the New Brunswick Nurses Union, the New Brunswick Union, the Canadian Union of Public Employees (CUPE) Local 1252 and the New Brunswick Pipe Trades have said that this new model will be adopted for specific plans.

The history

The shared-risk model adopted in New Brunswick was, in part, developed based on the highly-regarded Dutch pension regime. The shared risk model was recommended by New Brunswick's Pension Task Force, which consists of Susan Rowland, Paul McCrossan and Pierre-Marcel Desjardins.

DB plans across the country have faced significant issues in recent years, including low interest rates, changing demographics (such as longer life expectancy and an aging population) and unstable capital markets. All of these factors threaten the long-term sustainability of plans.

The shared-risk model seeks to address these issues with a regime where there is a focus on robust risk management to promote benefit security and pension plan sustainability.

The legislation implementing the model forms a second part to the existing *Pension Benefits Act* (New Brunswick) (PBA) and was proclaimed in force as of July 1, 2012. The new legislation was enabling legislation and detailed regulations were filed in August, which were also deemed to have come into force on July 1, 2012.

Benefit formula

The new rules allow existing New Brunswick registered pension plans to convert to the new model or for a new shared-risk pension plan to be created. When a plan converts, the accrued benefits up to the conversion date become part of the member's "base benefit." The benefit formula from the date of establishment of the shared-risk plan is essentially a target benefit, usually based on an enhanced career average earnings formula.

The benefit that accrues year by year based on the career average formula provides part of the member's base benefit before the funding policy is applied with respect to making enhancements of accrued benefits. The base benefit has an extremely strong probability of being satisfied.

In addition to the base benefit, ancillary benefits may be provided under the plan terms. One such ancillary benefit is indexation, or cost of living adjustments (COLA). Under the shared-risk model, COLA is usually not guaranteed. Instead, it is granted each year if there are sufficient funds and where granted in a year the COLA augments the base benefits for all members (whether active, deferred vested or retired).

Administration

Shared-risk pension plans may be administered by a trustee, board of trustees or a non-profit corporation. There is no requirement under the current rules for joint governance or employee participation. However, given the nature of these plans, some form employee representation is generally a good idea.

The legislation provides that the administrator is immune from liability under Part 2 of the PBA and the regulations, if the administrator has exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances.

Contributions

Contributions to shared-risk plans are determined taking into account the prescribed minimum security level of funding for both the base benefits (97.5%) and the enhanced benefit objectives (75%), a portion of normal expenses related to administration and include an amount expected to be sufficient so that risk management goals are met. In this way, contributions are set to exceed normal cost for the base benefits and build in a funding buffer with which to provide enhanced benefits.

Contributions are set when the plan is established or when a permanent benefit change is made (other than a change permitted under the funding policy). The funding policy (discussed below) will contain parameters within which the administrator may increase or decrease contributions under the funding deficit recovery plan or funding excess utilization plan.

Funding

Shared-risk plans, while exempt from solvency funding and solvency valuations, must meet a 15 year "open group" funding requirement. These plans are required to annually file a funding policy valuation. This valuation is performed to determine the benefit security levels and whether any actions set forth in the funding policy must be taken. In addition, a going concern valuation must be performed at least once every three years to determine the maximum permissible contributions under the *Income Tax Act*.

Governance and risk management

Shared-risk plans have additional requirements to ensure the adequacy of risk management. The plans are required to have a funding policy and an investment policy (which is deemed to be the statement of policies and goals for purposes of the legislation).

The funding policy provides the rules under which the administrator must manage the contributions and benefits under the shared-risk plan. The regulations set out certain requirements for funding policies, including the requirement for a funding deficit recovery plan and a funding excess utilization plan. These plans dictate how funding excesses and deficits must be addressed by the administrator and set out the priorities.

For example, with respect to the funding deficit recovery plan, if there is a funding issue that requires action by the administrator, it may be that first certain ancillary benefits are adjusted or that contributions are increased by a specified amount.

The last action that may be taken is a reduction in past base benefits. Any such reduction would apply to all plan members. Similarly, if there is an excess that can be used, it must first be applied to re-instate any previously reduced past base benefits and future base benefits.

The regulations require that if the open group funded ratio for a shared-risk plan falls below 100% in two successive funding policy valuation reports, the funding deficit recovery plan set out in the plan's funding policy must be implemented. This is so that where funding issues arise they are addressed in a timely manner in accordance with the funding policy to ensure the robust funding and long term sustainability of the pension plan.

From a risk management perspective, shared-risk plans are required to have annual asset liability modelling completed. The regulations require that the ALM that is used produces at least 1000 series of simulations of economic parameters for at least 20 years. In addition, the economic assumptions that are used must take into account the current economic environment and future expectations, reflect a reasonable distribution of future economic scenarios and use a stochastic methodology.

The tests that are run must ensure that there is at least a 97.5% probability (two standard deviations) that past base benefits at the end of each year will not be reduced taking into account the funding deficit recovery plan and the funding excess utilization plan in the funding policy. This is the primary risk management goal for shared-risk plans. There are also secondary risk management goals in the regulations related to ancillary benefits.

Disclosure

The regulations set forth increased disclosure obligations. These include the requirement to inform members in a clear, plain language statement that the contributions are limited to those allowed under the funding policy, that benefits of members and former members may be reduced if the assets are insufficient and that reduction may apply to past and future base and ancillary benefits.

Wind up and anti-avoidance

Funds under a shared-risk plan belong to the plan members on wind up. Surplus issues are avoided because any excess funds on wind up are shared by the members. Similarly, if there is a deficiency the members' entitlements are reduced.

The regulations contain anti-avoidance provisions to prevent underfunded pension plans from converting to the shared-risk model and then winding up as a shared-risk plan. If a DB plan is converted to a shared-risk plan that is voluntarily wound up within five years after the conversion, the conversion will be void and the plan will be wound up as a DB plan.

It is encouraging to see a province make significant pension law changes that are aimed at ensuring the long-term sustainability of pensions. The shared-risk model in New Brunswick may be used for private or public sector plans and works whether a plan is a multi-employer plan or a single employer plan. The focus of the model is robust risk management, using reasonable assumptions, to promote benefit security and long term sustainability of the pension plan.

Currently the legislation only applies to New Brunswick registered pension plans. Other jurisdictions in the country considering pension reform should take a close look at the New Brunswick model.

This article, by Jana Steele of our Pensions Group, was originally published on BenefitsCanada.com.

If you have any questions regarding this model, please contact any member of our Pensions Group.