

SHARED RISK PENSIONS

A NEW MODEL FOR NEW BRUNSWICK

Task Force on Protecting Pensions

What's wrong with the system?

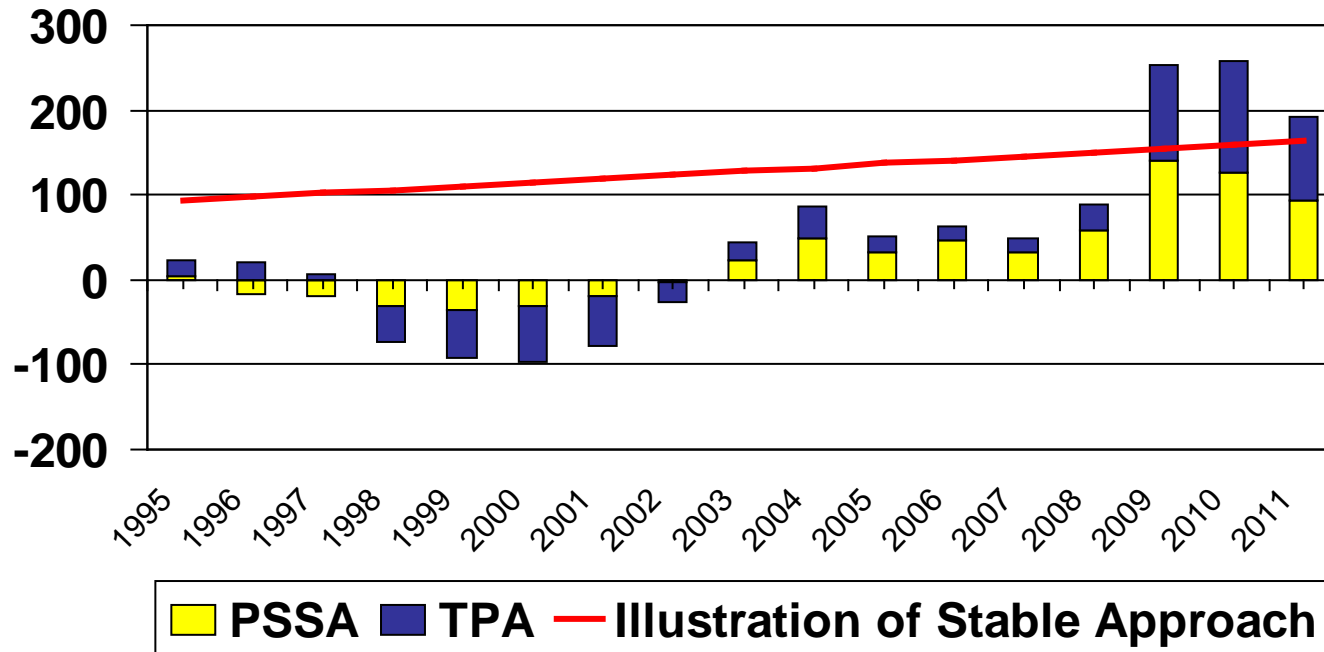
- Designed at a time when:
 - Interest rates were high;
 - Stock market was strong;
 - Businesses were expanding; and
 - People retired later and did not live as long as they do now.
- It was reasonable to believe pensions were safe in the 1980s economy

What has changed since then?

- Recent events (Fraser Papers, St. Anne's-Nackawic etc.) have shown that pensions are not as safe as once thought
- Interest rates are at lowest levels in 60 years
- Stock markets move up and down very quickly (global financial stress)

The effects of market swings

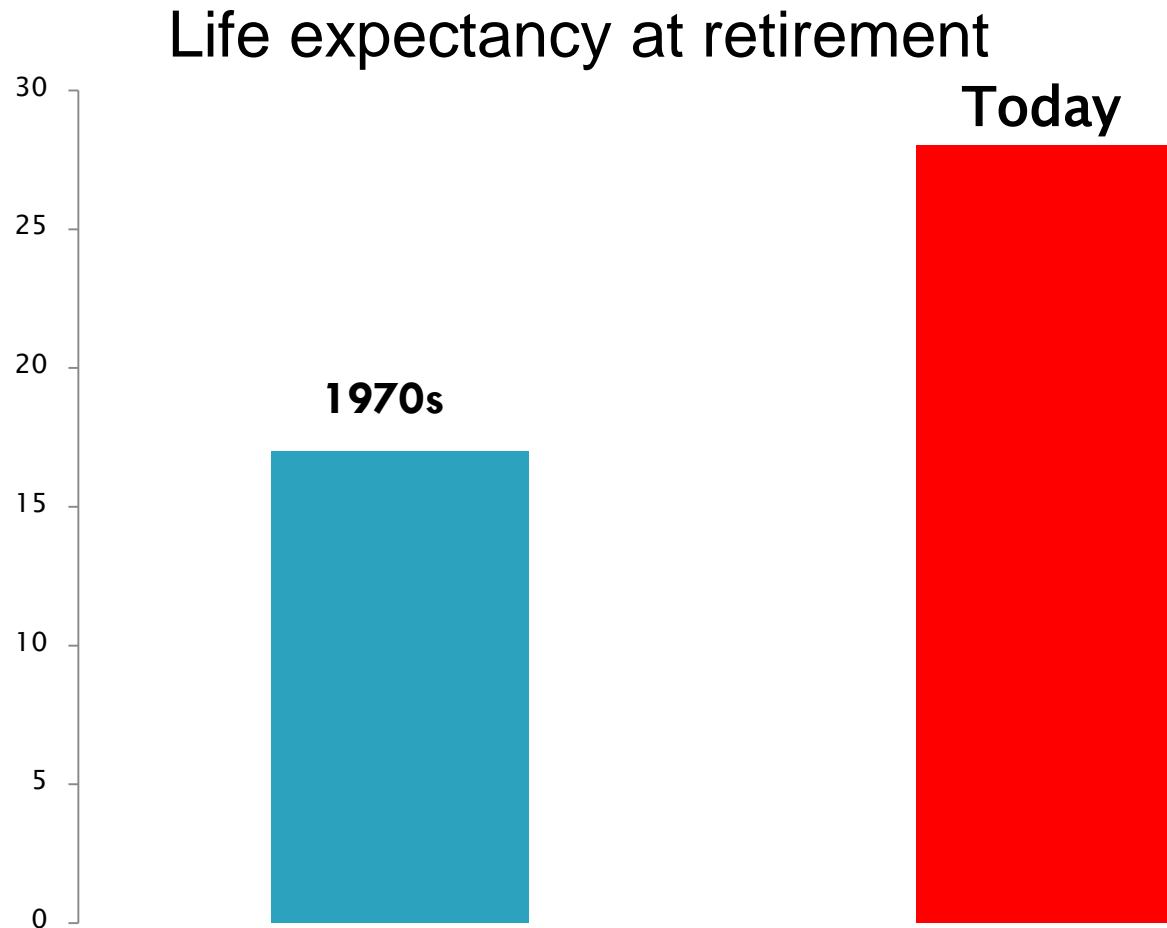
Booked Pension Expense in \$ Millions



What has changed since our pension system was designed?

- People live longer
- Retiree life expectancy has been rising at about 1 year per decade – and is expected to continue to do so
- Baby Boomers are now retiring in increasing numbers
- Many pension plans have promised more than they can pay

Working shorter, living longer



Government identifies problems and acts

Situation	Problem
Defined benefit pension plan members think pensions guaranteed by law.	<ul style="list-style-type: none">▪ Reality is different.▪ Guarantee only as good as sponsors' <u>willingness</u> and <u>ability to pay</u>.
Required contributions high and deficits exist.	<ul style="list-style-type: none">▪ Employers and employees look to Province for relief.
Province faces similar challenges with own plans.	<ul style="list-style-type: none">▪ Swings in costs very high<ul style="list-style-type: none">▪ hurt in both directions; and▪ will only get worse

Task Force on Protecting Pensions

Mandated to revise the pension system to achieve:

- **Security**
- **Sustainability**
- **Affordability**

Task Force Principles

Principles established	What do they mean?
Security, Sustainability, and Affordability	<ul style="list-style-type: none">▪ High degree of pension security for members▪ Stable contributions for employers and members▪ Robust risk management
Transparency	<ul style="list-style-type: none">▪ Pension goals and risks clearly stated up-front▪ Who shares in risks and rewards and by how much is pre-established in the pension plan documents▪ Everybody knows what the “pension deal” is
Equity	<ul style="list-style-type: none">▪ No party can game the system at the expense of another▪ All groups of members treated consistently

Accepted recommendations from the International Monetary Fund for Canadian pension plans

Task Force on Protecting Pensions

- Public consultation
 - received many briefs
 - identified troubled pension plans
- Conducted research to find best regulated pension systems in the world
- Adopted worldwide best pension practices

Task Force on Protecting Pensions

Building and testing a solution:

- Developed a shared risk pension plan and stress-tested it thoroughly on many levels with many pension plans over one year
- Tests show that NB shared risk plan works in all but the most severe depressions

Moving to a shared risk pension plan

- Changes are incremental over 40 years and go-forward
- Past pension amounts do not change
- Introduce legislation to allow pension plans to offer much higher benefit security
 - *base benefits* are very strongly funded (97.5%)
 - *extra benefits* like cost of living increases are strongly funded (75%)
- Shared risk pension plans must do annual in-depth stress-testing

Change to “secure risk / reward sharing” from “guaranteed wishful thinking”

- If investment markets are bad,
delay benefit increases
- If investment markets are excellent,
make up for missed benefit increases
- Contributions are designed to be
stable over the long term

Establishing stability

- Plan deficit funding over 15 years is a priority
- May require higher contributions
- Extra benefits no longer “automatic” but paid as money available
- Shift retirement age up gradually over next 40 years as life expectancy increases
 - no sudden shocks

Choices	What do you need to accept?	Satisfies all stated principles
1. Status quo current Defined Benefit (DB) plans	<ul style="list-style-type: none"> ▪ Serious challenges for hospitals plans ▪ Very high pension contributions at times ▪ Large swings in pension costs ▪ Not sustainable under certain scenarios ▪ Potential negative impact on credit rating 	
2. Convert to Defined Contributions (DC)	<ul style="list-style-type: none"> ▪ High conversion costs because of large pension liabilities ▪ All risks to plan members ▪ Insufficient pensions for some members 	
3. Shared Risk Plan	<ul style="list-style-type: none"> ▪ Take best features of DB and DC ▪ Shared risks with plan members ▪ Remove future indexing guarantees ▪ High degree of benefit security but no absolute guarantees 	

Testing and financial implications

- Significant research and analysis behind the Task Force recommendations
- 1,000 potential scenarios tested over next 20 years for 4 plans with a range of parameters

Critical testing goals	Results
1. Minimum of 97.5% probability that base pension benefits never have to be reduced	EXCEEDED
2. Average Indexation of at least 75% of CPI	EXCEEDED
3. Stable contributions with no required increases above 1% of payroll and decreases above 2% of payroll in total (shared 50/50)	MET while delivering on two critical goals above

If your plan is underfunded,
a secure plan does cost more

How much more?

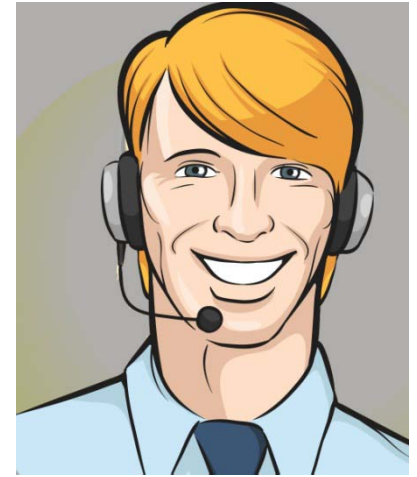
For employees

- between 1.2% and 2.8%

For employers

- between 1.2% and 3.9%

What the new model looks like in practical terms



Alice: aged 70, retired



Because all changes are incremental and on a go-forward basis, the amount I presently receive **will not decrease** by moving to the new model.

Future cost of living increases are no longer capped, but are conditional on plan investment performance.

My pension is protected better than ever before.

The system is built to provide increases over time.

Bob: Late-career

58 with 28 years experience



These changes are incremental, so the effect on me is quite small.

As with Alice, my future cost of living increases will be dependent on plan investment performance.

If I was planning to retire tomorrow, I will notice no difference.

If my planned retirement is still a little ways off, I can retire when I planned to with only a very small pension reduction

OR

I can work a little bit longer and receive the same pension.

Carole: Mid-career



Everything I have earned up to now is protected at transition.

To ensure the long-term security of the plan, I will likely be paying increased contributions and working somewhat longer.

I am investing in my retirement.

I have time to plan and can have confidence in the security of my pension.

Donald: Early career



I am not subsidizing someone else's pension.

I will probably pay larger contributions towards my pension and will be working longer.

I can have confidence that my pension will be there when it is time for me to collect it, and for as long as I need to collect it.

Change in retirement age needed to keep pension retirement \$ constant

Employee status	Delay in retirement	Pension lifetime
Late-career	1 year or less	About 26 years
Mid-career	2 or 3 years	About 26 years
Early career	3 to 4 years	About 26 years
New employee	About 4 years	About 26 years

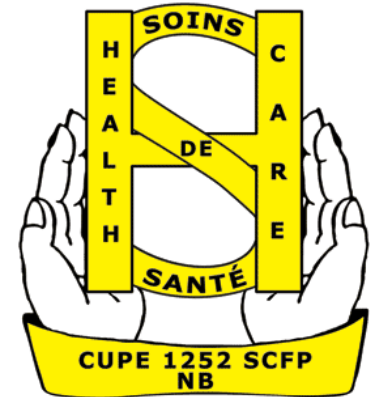
How do benefits under the new model compare to the benefits under the old model?

Depends on many factors and actual economic performance, different between groups and between age cohorts within those groups, etc.

Best estimates are:

- Between **99.8%** and **105.5%**

Specific plans moving to new model



Features of the new model

- Shared contribution – known in advance
- Clear funding guidelines
- Sound investment policy
- Robust risk management
- Clear disclosure to members
- Managed by independent board of trustees

Bottom line: employees

- Contributions will be stable, but may increase
- Later retirement for younger employees
- Conditional indexing
- High degree of benefit certainty
- but no absolute guarantees
- Fair to employees of all ages

Bottom line: taxpayers

- Reduced future risk
- Known and stable pension costs
- Avoid reductions in programs and services because of pension costs



Q & A

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