

AMERICAN ACADEMY *of* ACTUARIES

Objective. Independent. Effective.

Retirement for the AGES Assessment

Forward Thinking Task Force

Proposal: New Brunswick Shared Risk Model

Grade: A-

The *New Brunswick Plan Shared Risk Model* provides for defined benefits in an annuity form that is divided into two categories as agreed upon by the parties involved in establishing the shared risk plan: “base benefits,” which are funded so that there is at least a 97.5% likelihood that base benefits need not be reduced over a 20-year period using actuarial modeling; and “ancillary benefits,” which are funded with a 75% likelihood of eventual payment.

The first two shared risk plans designated the pre-shared risk plan benefit formula based on career average earnings payable at normal retirement age (along with vested “ancillary benefits” payable at transition date) as the “base benefits,” while all of the other plan features, including the benefit formula based on final average earnings (as well as cost of living increases, early retirement subsidies, along with any improvements in the benefit accrued under the normal form of the pension) were designated as ancillary benefits. Ancillary benefits may only be improved after all past cost-of-living increases on base benefits have been provided. Increases in base benefits in the future are dependent on investment earnings and performance of plan, as determined each year. Future accruals are determined based upon adjustments for future mortality improvement and the agreed-upon contribution level. Base benefits reductions are possible, but will be borne by all participant classes in the same proportion.

Current adopters of the shared risk model program include the pension plans for union workers in various governmental employers and in New Brunswick’s hospitals.

Annual actuarial stress testing is required to demonstrate that funding meets the likelihood thresholds (97.5% and 75% respectively). There are requirements for pre-determined actions to adjust future benefits, contributions, and asset allocations in response to changes in the plan’s financial condition. The model seeks to fund liabilities using a target “open group funded ratio” of 110% to 120% over 15 years. Employee contributions may be increased automatically to secure payment of base benefits, but annual increases are capped at the greater of 2% of earnings or 25% of the initial contribution rate. Stress testing also measures the market value of a plan’s assets plus the value of planned future contributions in excess of current service costs on an “open-group” basis, to fund a market-consistent value of the plan’s liabilities over no more than 15 years. Investment policy is set recognizing that employers and employees share the investment risk and must be tailored to achieve desired confidence levels.

The model’s funding policy requires plans to determine an adequate financial position in normal times. The model’s funding policy must meet minimum standards to address underfunding situations, and must include explicit deficit recovery and surplus utilization plans. A plan operates at arm’s length from the employer and is administered by an independent trustee or board of trustees. The trustees’ role is: to review the statement of investment policies and goals in view of the desired security levels; to ensure that an actuary values the pension plan; and to oversee action on the basis of the funding projections and stress testing.

Source Material

- *New Brunswick's New Shared Risk Pension Plan*, Center for Retirement Research at Boston College, by Alicia H. Munnell and Steven A. Sass, August 2013. Available at: http://crr.bc.edu/wp-content/uploads/2013/07/slp_33.pdf.
- *Rebuilding New Brunswick: The Case for Pension Reform*, A Government of New Brunswick Report, February 2013. Available at: http://ppforum.ca/sites/default/files/NB_Pension%20Reform%20Case_EN.pdf.

New Brunswick Shared Risk Model

Alignment

A-

Description

- Aligns each stakeholder's role with their skills.
- Redefines employer's role by placing responsibility for important roles with those appropriate entities.
- Helps individuals by structuring their choices to be well-defined and enhance good decision-making.
- Develops systemic ways to enhance financial security through appropriate levels of laws and regulations .

Application of Principles

- + Plan is managed by independent trustees.
- + Benefits are paid as annuities (provides lifetime income).
- + Plan has several safeguards designed to protect security of beneficiaries.
- + Once in operation, employee and employer responsibility is limited to contributions.
- Complexity of benefit structure (base vs. ancillary benefits) and frequent changes thereto may cause confusion for participants.

Legend

(+) feature meets principles

(-) feature does not meet principles

(*) feature where there is not enough information to determine impact or actual impact may depend on stakeholder actions

New Brunswick Shared Risk Model

Efficiency

A-

Description

- Allows smaller plans to group together, with standard and transparent fees to lower plan costs.
- Provides consistent opportunities to accumulate assets during working lifetime to enhance participation and coverage.
- Minimizes leakage for non-retirement benefits during accumulation and payout phases.
- Encourages pooling and effective risk sharing so funds can provide lifetime income.
- Incentivizes narrowing the variability of benefits by fostering risk hedging and allowing for pricing benefits and guarantees.

Application of Principles

- + Plans cover multiple employers of any size that are in the same industry.
- + Provides lifetime income, with pooled longevity risk and limited non-retirement leakage.
- + Benefit design allows for variability in adverse market conditions.
- + Well-defined “ancillary benefits” only paid if funding is sufficient.
- + No opportunity for “trapped surplus” as pre-defined mechanism exists for distributing a reasonable portion of any “excess” that develops within the plan.
- The need to manage the plan’s investment strategy to achieve confidence levels required by the stress tests could result in frequent adjustments to investment strategy that may not optimize the efficiency of the portfolio.

Legend

(+) feature meets principles

(-) feature does not meet principles

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New Brunswick Shared Risk Model

Governance

A-

Description

- Clearly defines roles and responsibilities, and acts in accordance with them.
- Reduces real and potential conflicts of interest.
- Recognizes and manages competing needs.
- Staffs boards with financial and other professionals who possess relevant expertise.

Application of Principles

+ The trustees must be independent.

+ Assets are invested by investment professionals.

+ Rules specify actions when deficits or excess assets occur.

- Trustees need to understand the complexities of the multiple stress tests for base and ancillary benefits, deficit recovery plan, excess utilization plan, asset liability modeling requirements, changes in risk profile, etc. Plans cover multiple employers of any size that are in the same industry.

Legend

(+) feature meets principles

(-) feature does not meet principles

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New Brunswick Shared Risk Model

Sustainability

A

Description

- Promotes intergenerational equity.
- Allocates cost properly among stakeholders.
- Withstands market shocks.
- Maintains balance between sustainability and adequacy.

Application of Principles

+ Risks are shared between all beneficiaries, including retirees.

+ Stress testing is done regularly to make sure plans can withstand market shocks.

+ Pre-determined rules specify what will occur in the event of a future market shock that is outside the thresholds being testing with reductions that are spread equally among various participant classes.

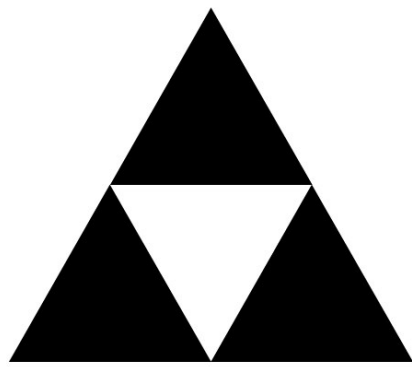
* Open group valuations require additional involvement of the employers and ongoing scrutiny, to make sure the assumptions regarding future participants appropriately reflect anticipated changes to the current demographic characteristics of the group.

Legend

(+) feature meets principles

(-) feature does not meet principles

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