



NEW BRUNSWICK SHARED RISK PLAN: THERE'S MORE TO THE STORY

The relatively new New Brunswick Shared Risk Plan (NB SRP) model has received a lot of attention and positive publicity over the past year, not only in NB and the rest of Canada, but also around the world. However, amidst these accolades, there are a number of significant shortcomings that have thus far not been particularly well identified, understood, or communicated.

The full story is one of broken promises, a flawed model, and misleading communication – a recipe for disaster. In a recently released report by PBI Actuarial Consultants Ltd., a number of significant and fundamental concerns are identified.

At the core of the issue is that the government of NB abrogated its statutory obligation regarding pension benefits to its current and former employees by unilaterally changing the law and “legally” allowing itself to override its own significant and longstanding pension promises. They did this by changing the law retrospectively, i.e. in respect of service and benefits already earned, rather than just prospectively – essentially, they changed a “*guarantee-to-pay*” to a “*hope-to-pay*”, an alarming change for both current and future retirees who are depending on their pension for financial security in their retirement years. Can you imagine the impact on our society if private citizens could simply decide not to honour their contractual obligations?

In defense of its action, the government will say that it received the consent of the unions and retirees to this new plan. The reality, however, is that the “consent” was far from unanimous and, more importantly, the consent that was received was based on incomplete disclosures and misleading information. Furthermore, it is clear in public statements made that even the politicians, who were responsible for championing the new legislation, did not fully understand what was being forced on plan members.

Not only did the government do this to its own employees, but they also enabled other employers in the province of NB to likewise adversely affect their most valuable asset, their employees.

Leaving aside this unprecedented action, there are significant fundamental flaws in the so-called *Shared Risk Plan* itself, what was communicated (or not), and how it was implemented, as to make it a potentially dangerous model for use in the pension industry in Canada.

In order to better understand the operation of the NB SRP model, PBI performed an in-depth review and analysis of the risk management goals and measures of success pertaining to the conversion – effective January 1, 2014 – of the pension plan under the NB *Public Service Superannuation Act (PSSA)* to the NB Public Service Shared Risk Plan (PSSRP). Specifically, the appropriateness of the actuarial model and underlying assumptions and input parameters used to determine and communicate the likelihood of success of the new PSSRP were evaluated. The following is a summary of the report’s key findings.

Stochastic Projection Modeling Has Significant Limitations

Stochastic projection modelling (SPM) – central to the operation of the NB SRP model – is a sophisticated and costly actuarial technique for looking into the future and evaluating different probabilistic outcomes. However, the results of the model are very dependent on the inputs, i.e. the underlying actuarial and economic assumptions about the future. Currently, there are no standards governing SPM, in particular the inputs, although they are in the process of being developed by the Canadian Institute of Actuaries.

As will be demonstrated below, without the appropriate disclosure of the range of variability and uncertainty and other shortcomings, SPM and the associated risk management goals and measures of success are **not** appropriate as either a regulatory criterion or, more importantly, for the communication of likely benefit levels to plan members.

Based on the plan's selected set of assumptions, the NB PSSRP passes the regulatory tests of success for both the base benefits (primary goal: 97.5% likelihood of success) and the ancillary benefits (secondary goal: 75.0% measure of success).

However, based on an alternative set of equally-valid assumptions, the PSSRP achieves only 72.5% success with respect to the primary goal (pertaining to base benefits) and 47.0% with respect to the secondary goal (pertaining to the key ancillary benefits) – i.e. the plan **fails** both tests of success. There is therefore a huge range of uncertainty and subjectivity involved that doesn't appear to have been disclosed or adequately explained to the members/unions when seeking their consent to the new arrangement.

Furthermore, the projected *level* of failure (27.5% versus 2.5%, representing more than 10 times the risk of base benefit cuts, and 53.0% versus 25.0%, representing more than double the expected further ancillary benefit reductions) is significant based on this alternative set of reasonable assumptions, causing one to question whether the member/unions would have supported the new plan, had they known this information at the time of the plan's introduction and conversion.

Regardless, communicating a 97.5% probability of success of anything – as with the primary goal – without the appropriate disclosures conveys virtual certainty, which is not the reality and is very misleading.

Regulations Open to Interpretation

The Regulation in respect of the secondary goal for key ancillary benefits (pre-retirement earnings escalation and post-retirement indexing) is open to interpretation, leading to a substantial difference in the measure of success and related benefits. Even different staff at the office of the Superintendent of Pensions had different interpretations of its meaning.

At this point, it is unclear as to what benefits are actually going to be paid and how that compares to what was communicated to the members/unions.

This additional layer of confusion points to a further problem with the NB SRP model, its complexity and cost, and how members may be affected.

Significant Reduction in Benefits Going Forward

Even if everything goes as planned, there will be a significant reduction in benefits going forward for a number of key reasons.

First of all, for “final averaging” purposes, pre-retirement earnings are escalated at the rate of inflation (CPI) rather than at actual salary increase rates. Over a typical person’s working lifetime, actual salary increase rates will exceed CPI by an average of at least 0.5% to 1.0% per annum, which represents the equivalent average overall reduction in benefits of the order of at least 15% to 25% or more.

Secondly, there was an increase in the earliest unreduced retirement age (from 60 to 65) and associated reduction in early retirement subsidies. Depending on actual retirement age, the reduction in the value of the benefits received could be as much as another 30% which, combined with the reduced earnings escalation rate, could easily result in an effective benefit reduction of the order of 50%.

Finally, the *objective* for the new plan’s ancillary benefits is only 75% of the already-reduced target benefits, therefore representing a reduction layered on a reduction, with the outlook for the future being a significant decrease in post-conversion *target* benefits relative to pre-conversion *guaranteed* benefits.

Shifted, Not Shared, Risk Plan

The so-called *Shared* Risk Plan is **not** shared in the sense of equal sharing of risk between employer and employees. Its very name is inappropriate and misleading.

The members bear far more of the risk in a SRP than the employer and, in the ultimate, bear 100% of the risk. The *sharing* is actually among the members, with the employer/government having effectively *shifted* the risk to the members. The only type of plan that can properly be classified as “shared risk” is a jointly-sponsored pension plan (JSPP), wherein risks/rewards and gains/losses are shared 50/50 between employer(s) and members. This “SRP” is not such a plan and should therefore not be referenced to as *shared* risk. This “shared” risk plan is really a target benefit plan (TBP).

Pension Plan Reform in the Name of Sustainability

Often this sort of change is done conveniently, but unnecessarily, in the name of pension plan *sustainability*. In reality, it’s done for two main reasons: to drive down benefits (and costs) and to transfer the risk from the employer to the employees.

This plan was close to 90% funded on a going-concern basis just prior to this unprecedented overhaul, clearly not in such bad shape as to make it unsustainable without radical changes. Some structural and plan design changes – including some combination of benefit reductions (and/or conditionality) and contribution increases going forward – could have quite nicely sufficed and not necessitated the plan being turned completely upside down.

Opportunity to Fix the Problem

In light of the independent report's findings, it is of paramount importance that the NB PSSRP (and indeed the entire NB SRP model spreading throughout NB) be revisited and that the new government, as per its pre-election campaign commitment, be open to change and be willing to work together transparently with the unions and retirees' coalition to find a solution that meets the objectives of all the key stakeholders.

ABOUT PBI

PBI Actuarial Consultants Ltd. is a dynamic independent and growing Canadian company providing actuarial, administrative, and investment consulting services for pension and benefit plans, as well as other trust funds, in both the private and public sectors. PBI serves clients across Canada from offices in Toronto, Vancouver, and Montreal and is a recognized industry leader in the design of retirement objectives, funding policies, and risk management strategies.

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