Session 121: Global Pension Reform Update

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2019 ANNUAL MEETING & EXHIBIT

Global Pension Reform Update
Session 121, October 29, 2019

Carmen Fernández, Speaker

Rob Brown, Speaker

Steve Eadie, Moderator

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Global Pension Reform Update Mexico

Carmen Fernández

Session 121

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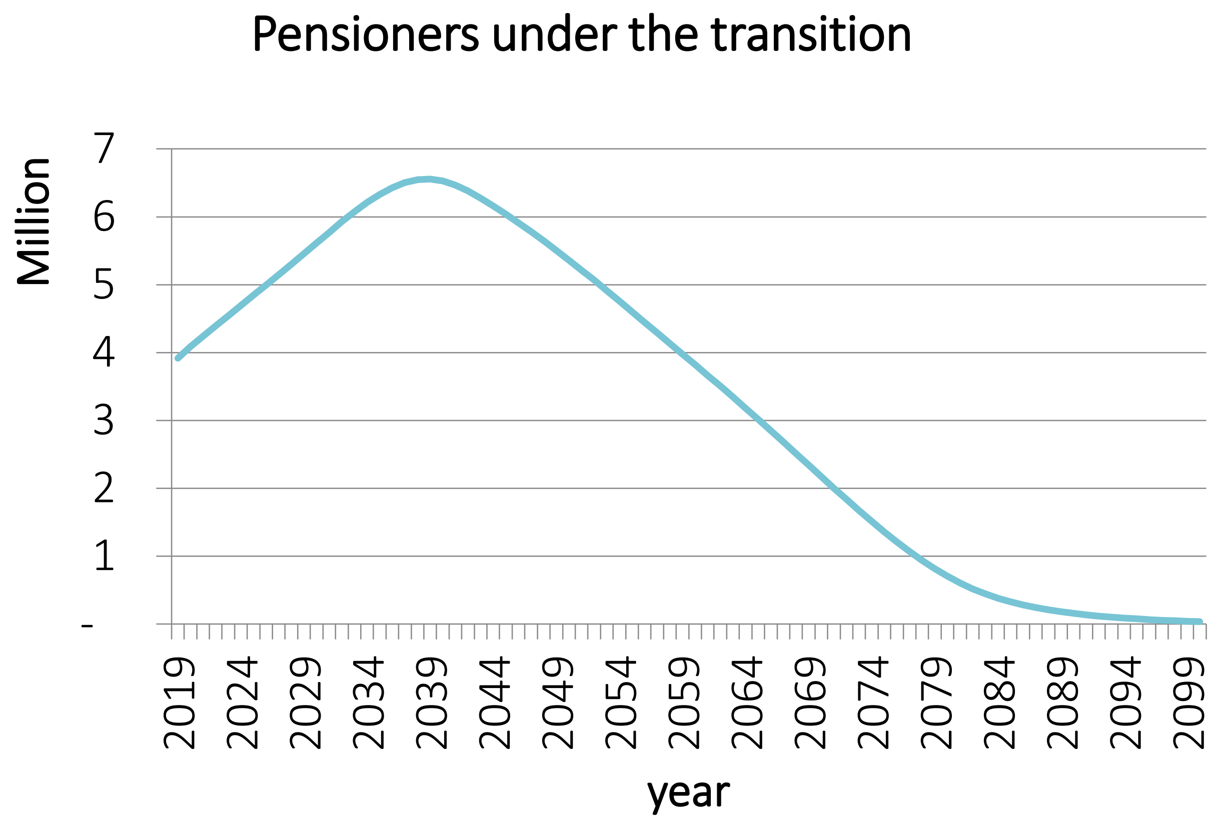
Key elements of the pension reform

Before	Reform (1997)
Old Age, Survivor's and disability	Separate Old Age pensions
Defined Benefit	Defined contribution
Pay-as-you-go	Fully funded
Final salary pension (5 years average)	Depending on the worker’s individual account balance
Managed by IMSS	Introduction of private pension funds and annuity companies

Transition

- All workers registered prior to July 1st 1997, as well as their beneficiaries, may choose between the benefits described in the repealed law, and the ones on the new pension scheme.

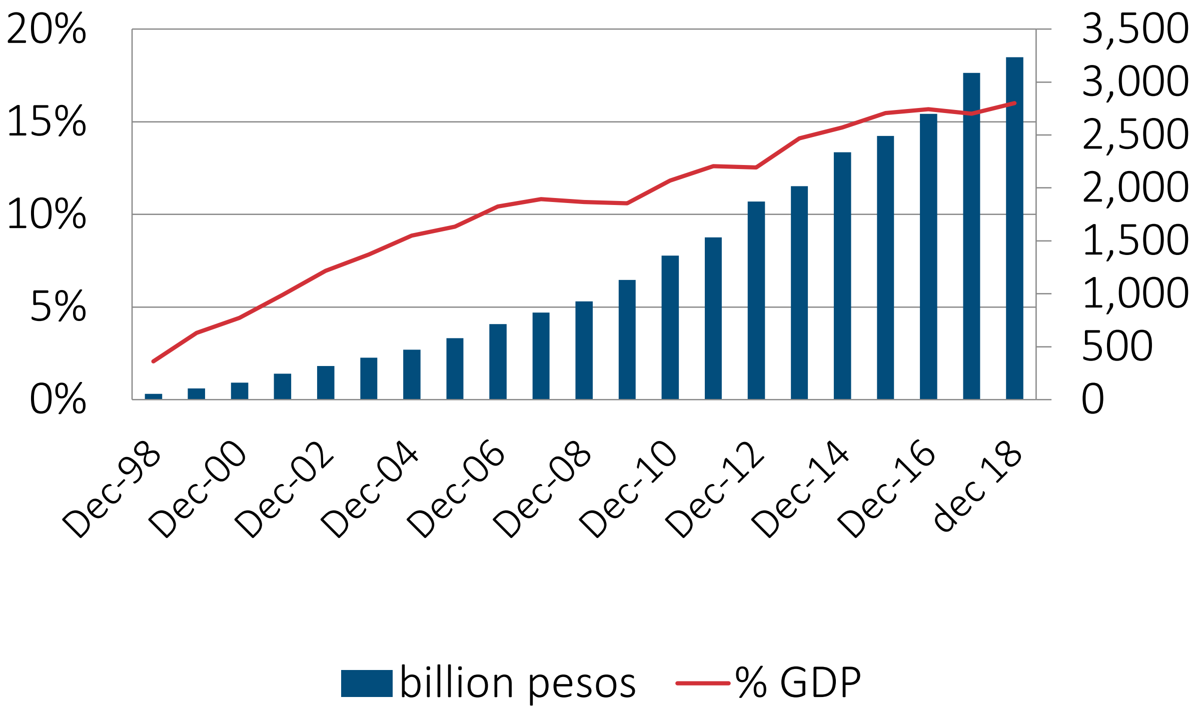
Transition demographics



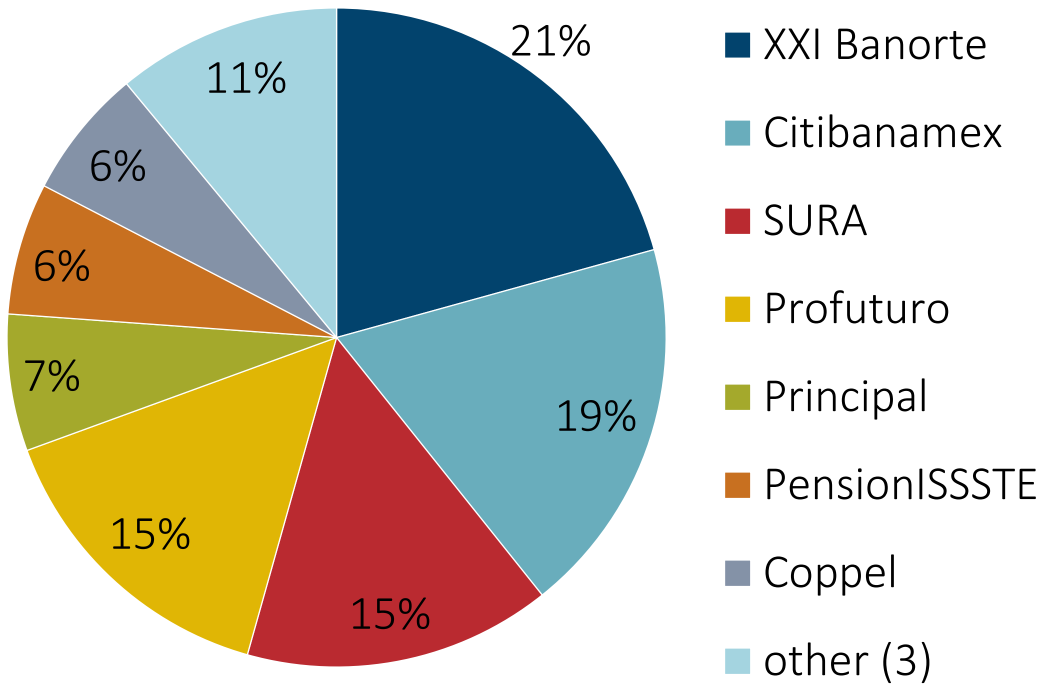
	Pensioners	Workers
Number (million)	3.2	5.9
Average age	69	47
Annual salary or pension (USD)	2,781.20	6,510.94

Pension funds (AFORES)

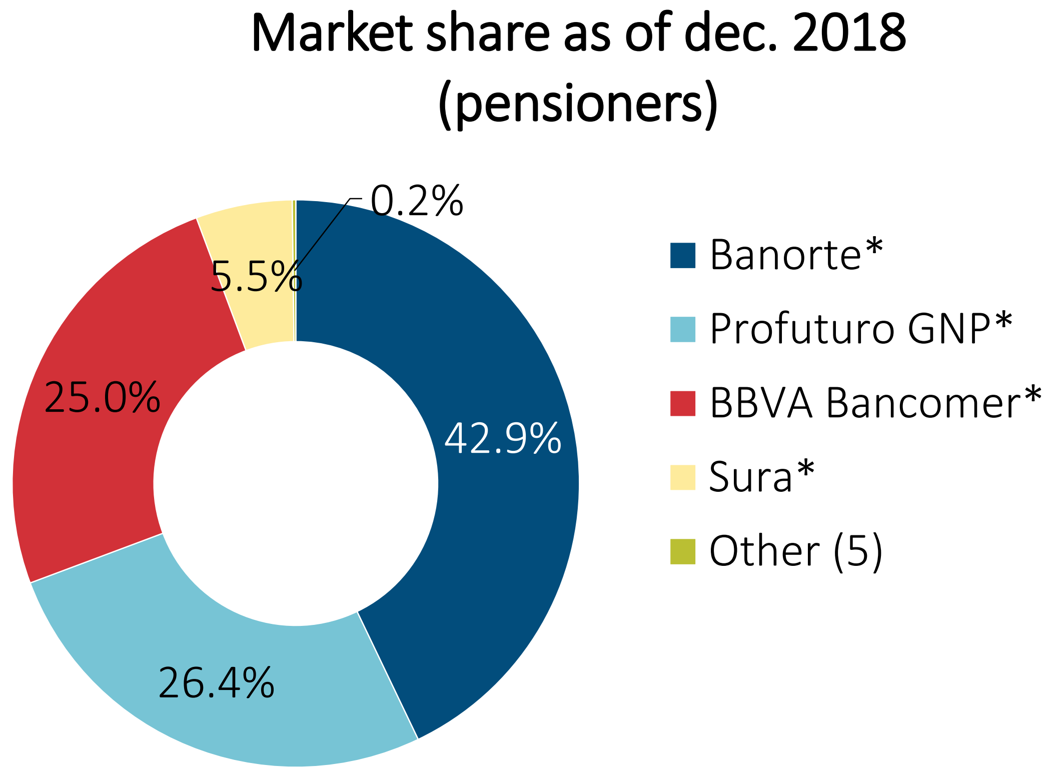
Assets under management at AFORES – (1998-2018)



Market share (assets)



Annuities



- Accumulated reserves for annuities equal to 25.5% of the total reserves of the insurance companies.
- 305 billion pesos (15 billion USD) as of December 2018.

Evolution. Reforms and amendments

1973
- Parametric reform

1992
- Retirement Savings System (SAR) begins operation

1997
- New pension system

2001
- 11% increase to pensions
- Pensions update by CPI

2002
- Unfreeze SAR and Housing subaccounts for pensions under the repealed Law

2007
- Reform to federal government employees' pension system

2009
- Revision to contribution

2010
- Supreme Court determines last salary ceiling for pensions at 10 x the min. wage

Challenges

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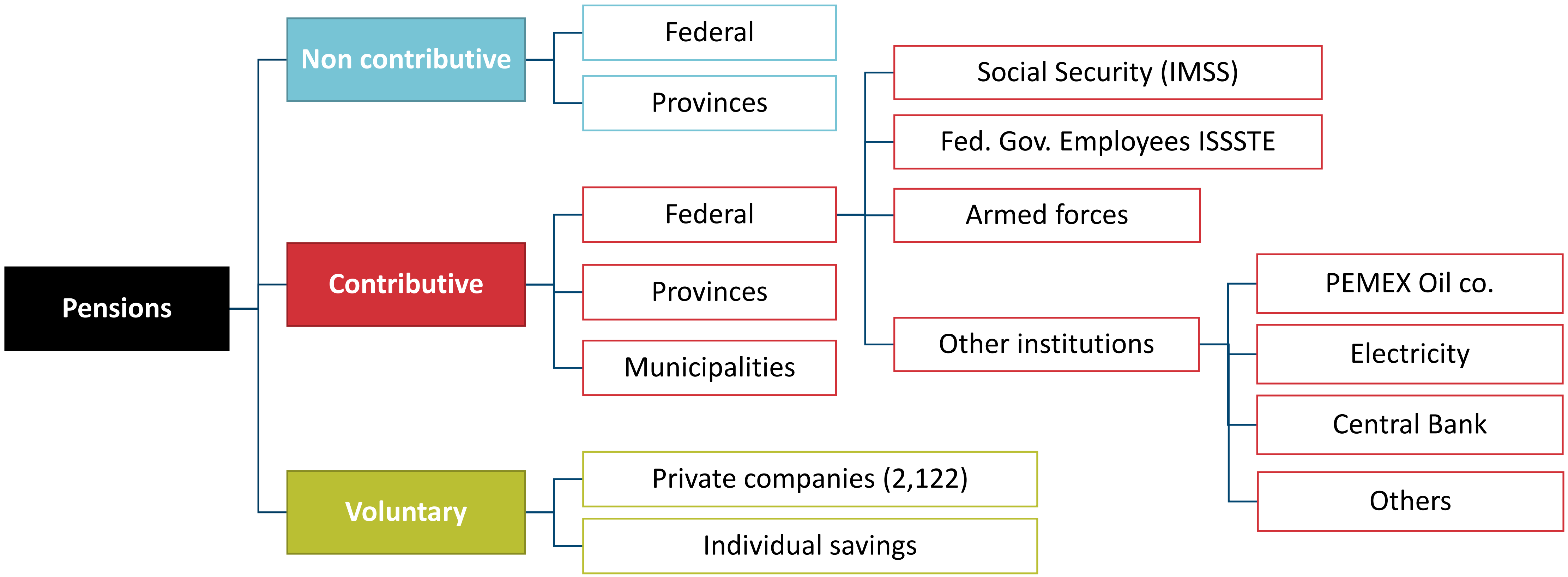
Current situation

- **Fragmented** system:
  - There are about 1,000 pension programs in Mexico.
  - Important inequities are generated.
  - There are overlaps in benefits.
- **Incomplete** coverage
- **Fiscally unsustainable.**
- **Only 2,122 private companies** grant a pension plan to their staff.
- There is **no governing body** for pension schemes.

Pension programs in Mexico



Pension liabilities

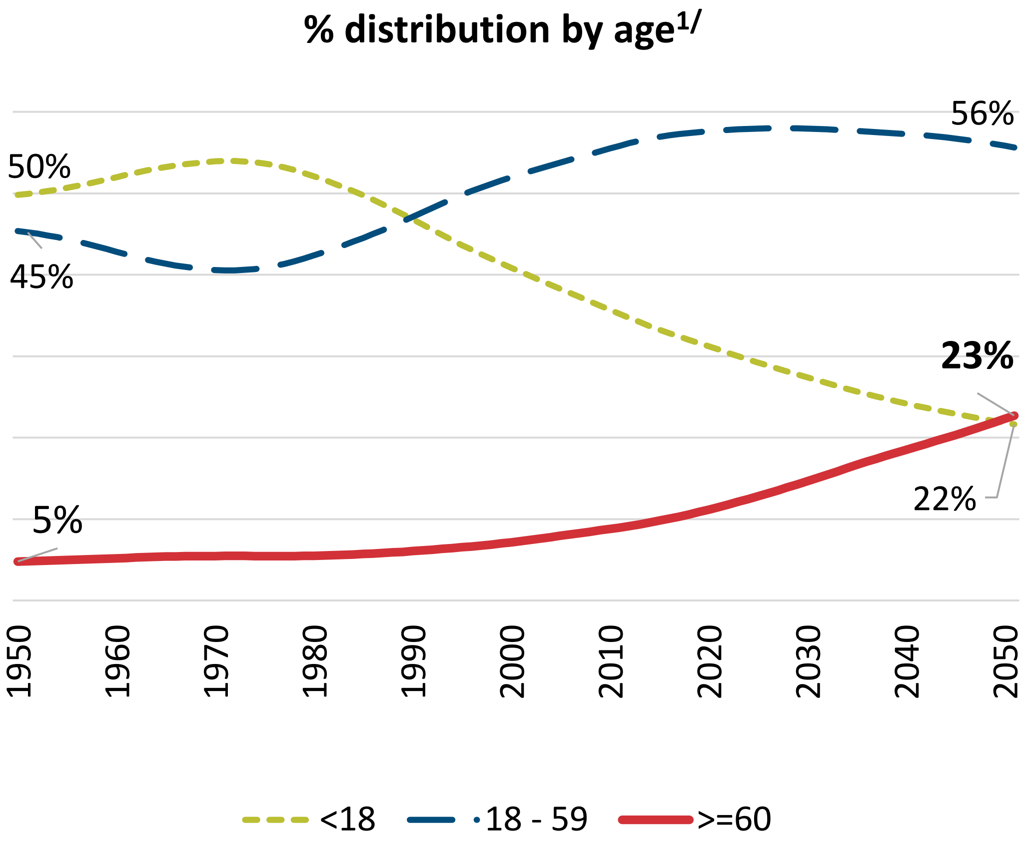
Present Value of Total Obligations

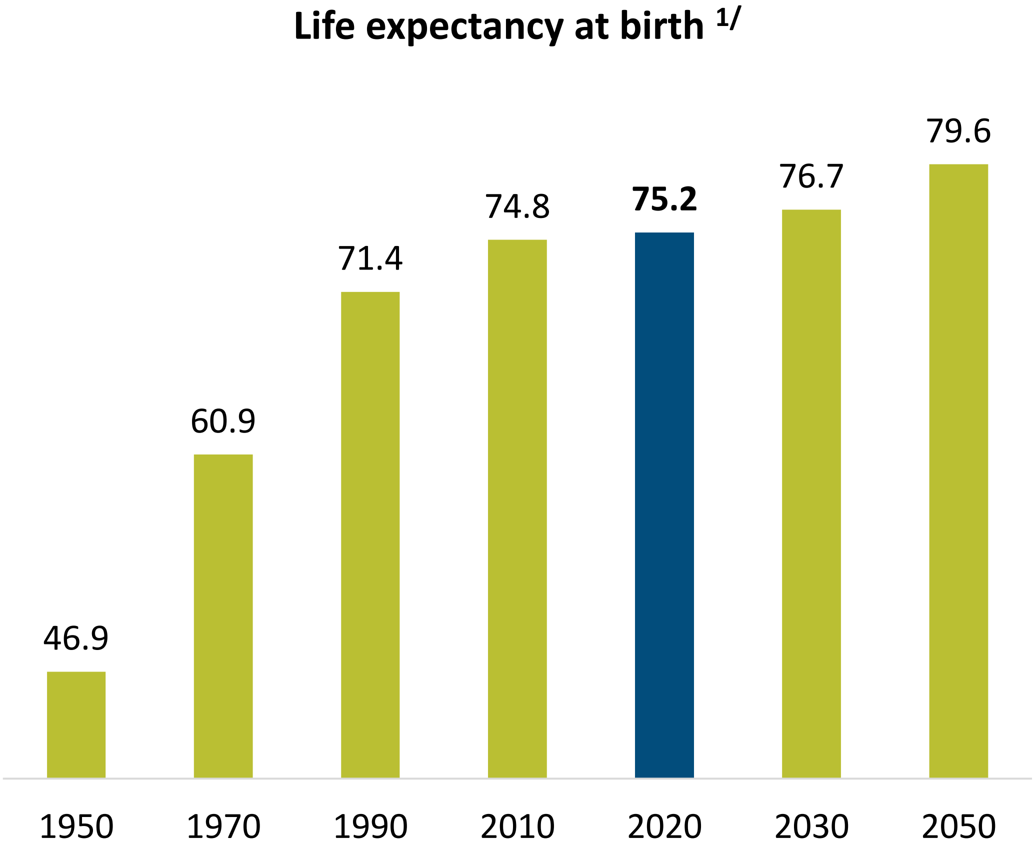
	% GDP	current population workers and pensioners *
TOTAL	126.30%	
IMSS – Private companies’ employees	70.40%	26 million
ISSSTE – federal government employees	27.00%	4 million
Armed forces	4.80%	352,361
PEMEX	5.80%	233,364
Electricity Co.	0.80%	99,230
Other federal government agencies	17.50%	599,810

** Population may not be added since there are overlaps.*

Ageing

By 2050 **23%** of population will be over **60 years old**.



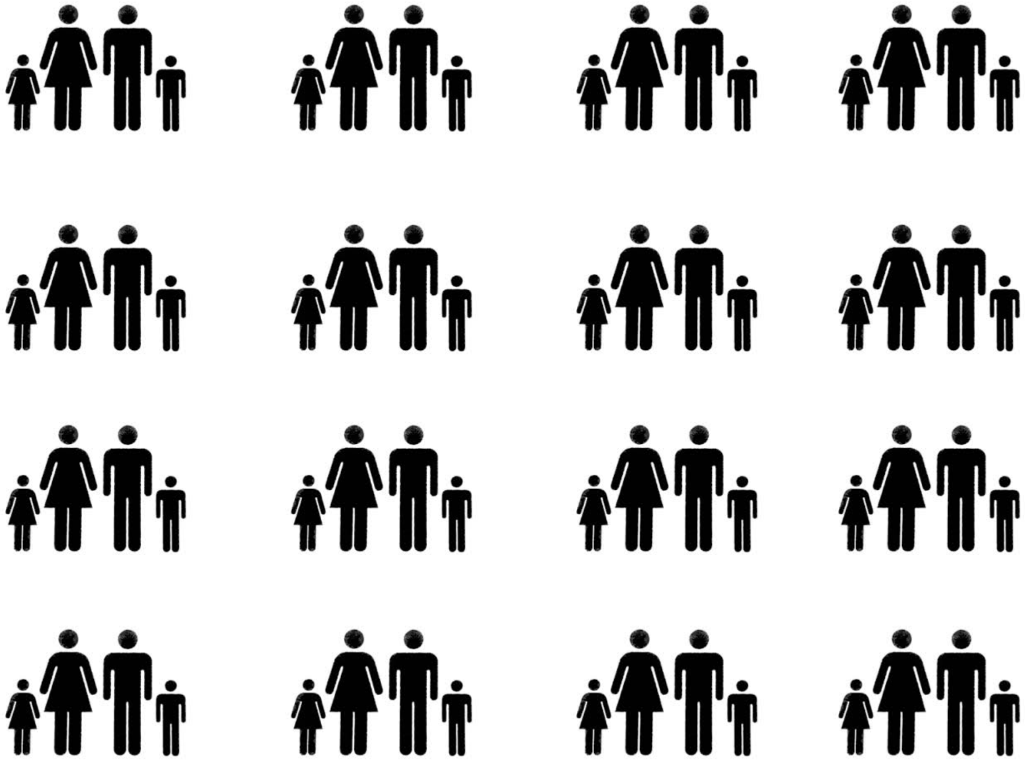


Life expectancy at 65 years=16.5 years.

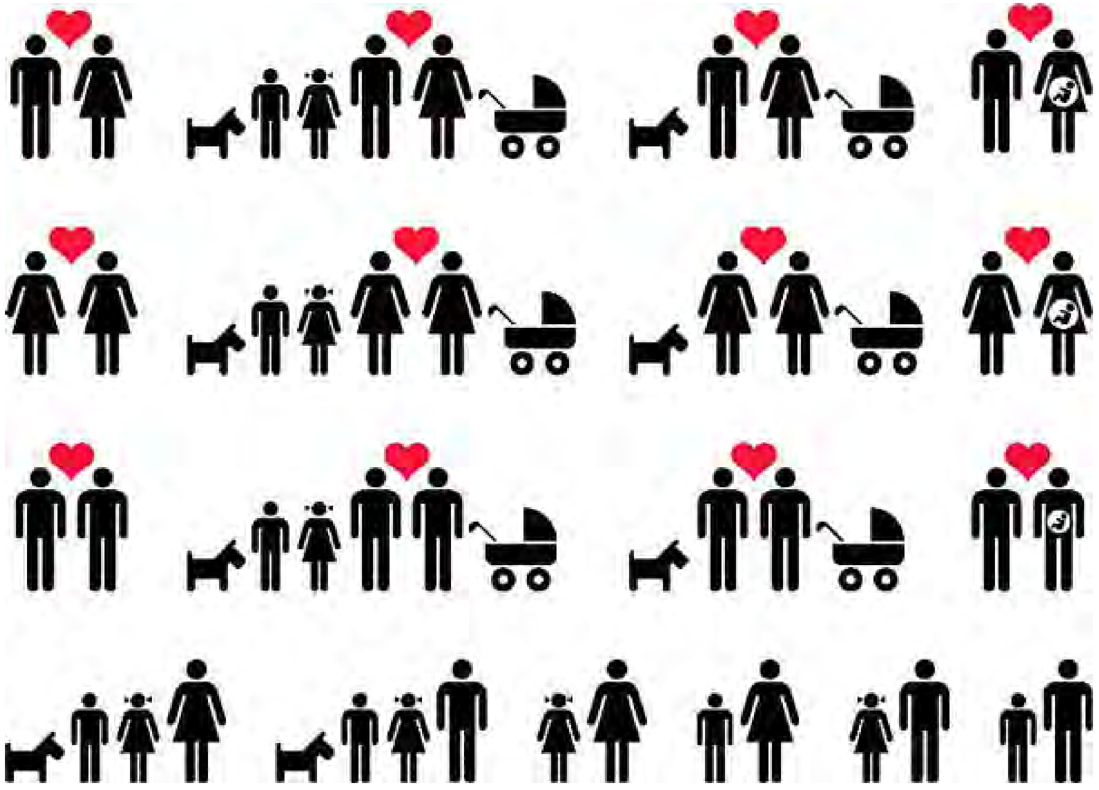
[1/] Consejo Nacional de Población

Family and society

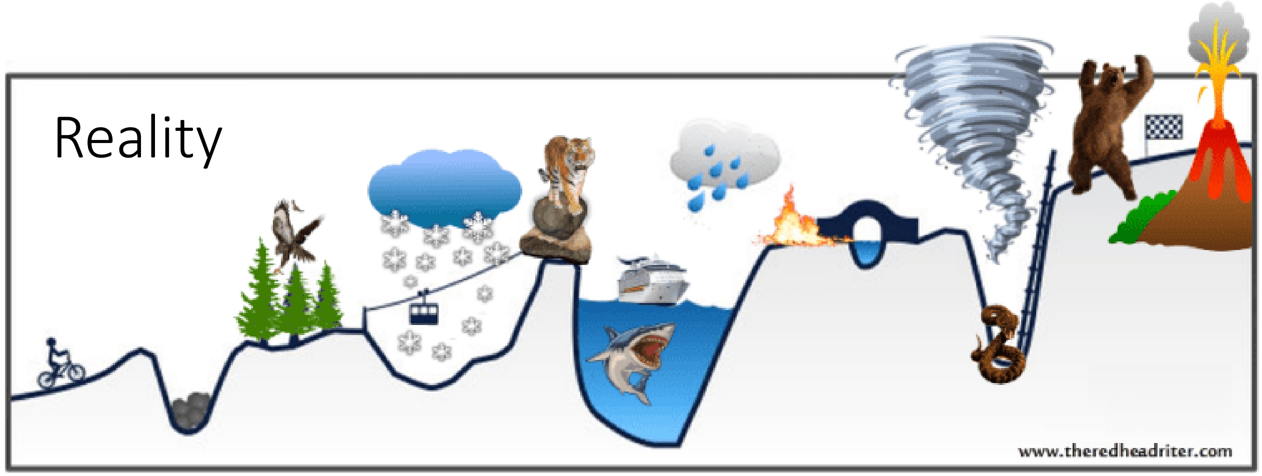
THEN



NOW



Communication and discussion



¡Gracias!

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PENSION REFORM AND INNOVATION IN CANADA

Robert L. Brown

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Global Pension Reform Update

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The Existing Pension Landscape

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Only 37.5% of workers have workplace pensions

DB
25.2%

DC
6.7%

"Other" (e.g. Hybrid Plans)
5.6%

In 1977, coverage was 52%

Public Vs. Private Sector Coverage

Public sector coverage is 88% of workers

- 80% have DB

Private sector coverage is 23.0%

- 9.5% DB
- 7.5% DC
- 6.0% “Other”

Leads to Pension Envy

Why the Decline in DB Coverage?

- Increased Longevity
- Low rates of investment return
- Accounting Standards
- Mark to Market

All Create Volatile & Higher Costs

Private Sector Response

DC Plans including Group RRSPs

Assistance in setting up Individual CAPs

Nothing

Problems with Self-Directed Individual Account Plans

- Increased Expected Longevity
- Low rates of Interest
- Volatility of Investment Returns
- Two Market Crises
- More Expensive Life Annuities

Actual Innovations

Pooled Registered Pension Plans, 2012

- Federal initiative
- Effort to make large DC Plans available to e'ee's of small companies and to self-employed individuals
- Easy for SME to join
- Bulk of admin handled by professional third-party financial institution
- Low cost investing and wider asset opportunities
- British Columbia, Nova Scotia, Quebec and Saskatchewan have joined
- Not many PRPPs formed to date

The New Brunswick Shared Risk Plan (2012)

What is a Shared Risk Plan?

- The Base Benefits (e.g., career average) are TB
- COLA, Bridge Benefits and Early Retirement subsidies only provided when there are sufficient funds
- ALL Benefits can be reduced if there are insufficient funds

The New Brunswick Shared Risk Plan (SRP)

- Must have a Funding Policy
- Plan Administrator then adjusts variables to hit target
- Plan must go through annual stress test (asset liability modelling)
- At inception, the stress test must show a 97.5% probability that base benefits will not be reduced over a 20-year period and a 75% probability that certain ancillary benefits will be paid over 20 years
- Stress test is required for any permanent benefit change

The New Brunswick Shared Risk Plan (SRP)

- No solvency funding requirements
- Instead do an annual valuation
- The funded level is measured on a 15-year open group basis
- The administrator of the Plan must be a Trustee, or a Board of Trustees of a not-for-profit
- All plans to date have some form of joint governance
- There must be a dispute mechanism built into the plan
- To date, no accrued benefits have been reduced

The New Brunswick Shared Risk Plans (SRP)

- For the E'er, the Plan is TB with fixed contributions (can be some narrow adjustments)
- For a worker, the SRP may be less favoured than full DB, but more desirable than a DC (pooled investment and longevity risk)
- Stress test enhances benefit security
- Was designed for public sector plans but several private sector plans have converted or are in the process of converting

Quebec Amendments—Effective Jan. 1, 2016

- Funding of a solvency deficit will no longer occur
- Funding will be based on an “enhanced” going-concern valuation including a PfAD
- The PfAD will take into account:
  - The % of assets in variable-yield securities
  - The level of matching between assets and liabilities measured by the ratio of the asset duration to the liability duration

Quebec Amendments

- Contribution holidays and the use of surplus assets to fund plan improvements will depend on the funded level of the plan
- The obligation for the Plan Sponsor to fund any deficit at Plan termination still applies

Ontario Funding Reform—Effective May 1, 2018

- Similar to Quebec
- But with important differences

Ontario: Solvency Funding Changes

- Special payments towards solvency deficit only required for plans that are less than 85% funded on a solvency basis
- Special payments based on five-year amortization with up to 12-month deferral from valuation date
  - Only on portion of deficiency below 85% threshold
- Can use letters of credit towards special payments for reduced solvency deficiency
  - Maximum: 15% of solvency liabilities up to 85% threshold

Ontario: Changes to Going Concern Funding

Going Concern Funding

- Unfunded liabilities amortized over 10-year period (was previously 15-year period) with 12-month deferral from valuation date
- Special payments in first year following valuation based on previous actuarial report
- New and existing amortization schedules consolidated at each valuation
- Required to fund a Provision for Adverse Deviations (PfAD) on liabilities and normal cost

Ontario: Provision for Adverse Deviation (PfAD)

New reserve in a plan's going concern valuation – consists of sum of:

1. Fixed amount based on whether plan is open (4%) or closed (5%) to new members
   - If at least one portion of plan does not permit new members to join, plan is "closed"
2. Variable amount based on plan's exposure to "non-fixed income assets" and whether plan is open (0%-12%) or closed (0%-23%)
3. Variable amount based on going concern discount rate in relation to benchmark discount rate defined in regulations
   - Currently 0% for many plans

Provision for Adverse Deviation (PfAD)

- Variable amount (Components #1 and #2 combined)

Non-fixed income assets – %	PfAD – closed plans	PfAD – open plans
0%	5%	4%
20%	7%	5%
40%	9%	6%
50%	10%	7%
60%	12%	8%
70%	16%	10%
80%	20%	12%
100%	28%	16%

Company XYZ plans is considered ‘closed’/’open’, and has non-fixed income assets of xx%.

Target PfAD is x.x% based on current policy

Indexation

Must fund both pre and post-retirement indexing provisions

- However, PfAD not applied to either liabilities or normal cost in respect of future indexation
- Ad hoc pension increases fall under benefit improvement rules

Benefit Improvements

To improve benefits, plan must have, after improvement:

- Solvency ratio of at least 80%; and
- Going concern funded ratio (without PfAD) of at least 80%

Further Legislation

- Nova Scotia, Manitoba and British Columbia looking at similar amendments

Other Examples of Innovation—UBC Faculty

- Retiree can buy a Joint and Last Survivor Variable Annuity
- Annuity varies both as to “i” realized and mortality
- Can “buy” a 4% base annuity or a 7% base annuity
- Your payments then go up or down based on realized “i” versus 4% or 7% (and realized mortality)
- This offering was unique in Canada: prohibited by tax laws
- This changed on March 16, 2019

Other Examples of Innovation—CAAT DB Plus

- CAAT—Colleges of Applied Arts and Technology
- The CAAT Plan Covers 50,000 members from 51 employers
- Plan is 120% funded with assets of $10.8B

Other Examples of Innovation—CAAT DB Plus

- Organizations who want to join the CAAT plan choose a fixed contribution rate between 5% and 9% from the e’ee matched by e’er
- CAAT does the rest—invests and pays out cheques
- CAAT claims it can pay out twice what a private CAP Plan could—and for life—J & LS
- This is a “not-for-profit” plan
- Also offers inflation “protection”, survivor benefits and early retirement options
- Any employer can join and three have to date
- For more, join us at Session 178 tomorrow at 10:15

OPTrust Select

- OPTrust is the plan for Ontario civil servants
- DB plan is fully funded with $20B of assets
- 95,000 participants
- Admin costs are 36 BP

OPTrust Select

- Enhanced risk sharing with active members and pensioners
- Low cost
- Targeted to Ontario workplaces in the broader public sector, charities and not-for-profits that do not have a DB Plan
- Contributions of 3% e'ee and 3% e'er
- Benefit is 0.6% * Years of Service * Career Average Earnings
- Indexation both before and after retirement depends on funding level
- Both the contribution rate and accrued benefits can be adjusted
- Retirement income is for life—J & LS

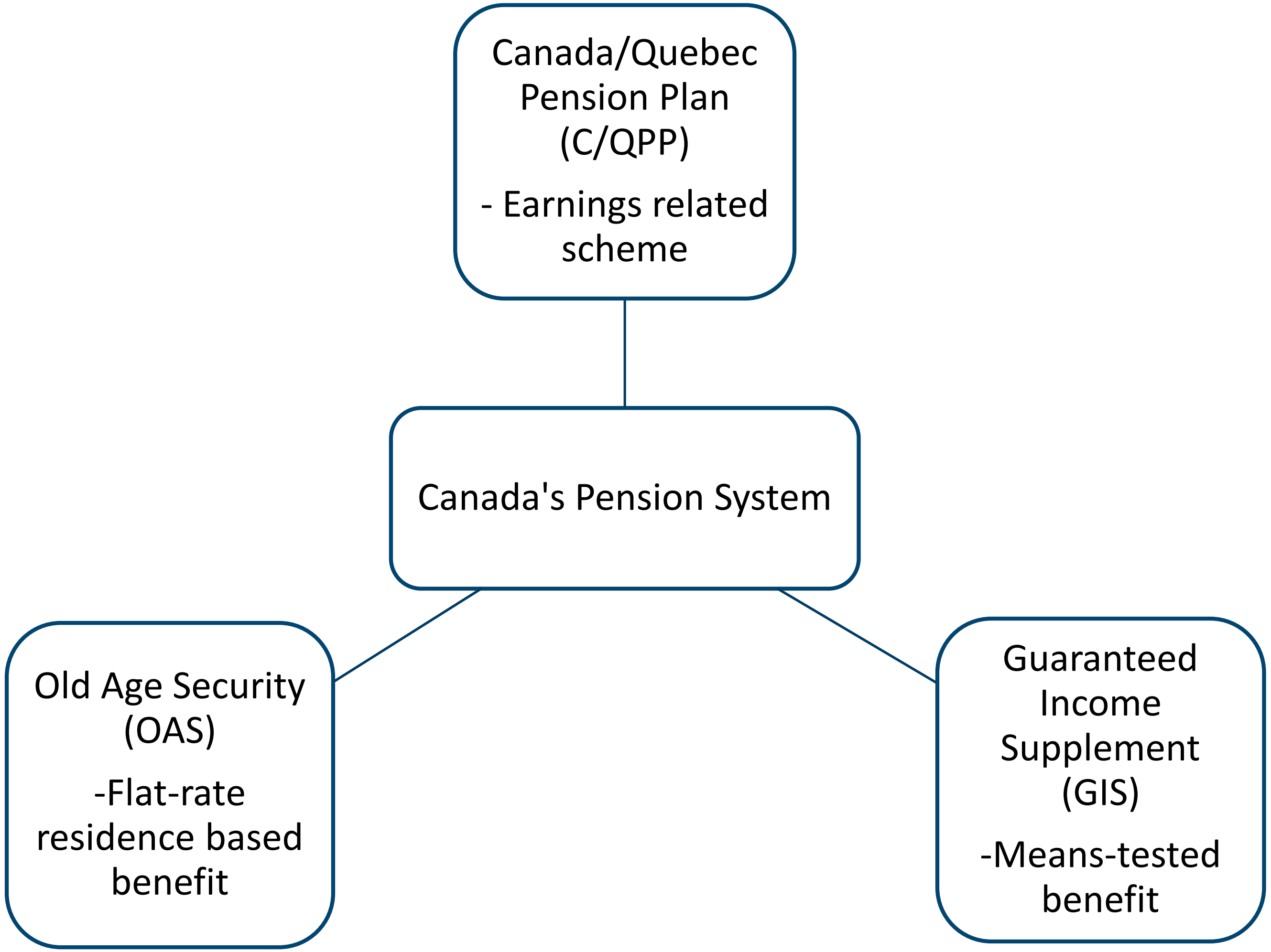
Federal Budget, March 16, 2019

- Now legal to use “Registered” Savings to buy a Advanced Life Deferred Annuity (ALDA) where payments start at age 85
- Great for workers in DC plans
- Prior to this you had to start withdrawals at the end of the year you turned 71 and pay income tax on these withdrawals
- Now tax will not start until age 85
- Limited to 25% of registered holdings or $250,000 (lessor)

Federal Budget, March 16, 2019

- Now permit Pooled Registered Pension Plans and DC plans to offer variable payment life annuities directly from the plan
- Payout varies with investment income earned and mortality
- Like UBC plan
- Virtually guarantees stability of underlying fund

Government Sources of Retirement Income



C/QPP

- CPP sustainable at 9.9%
- QPP sustainable at 10.8%
- CPP early/late adjustment factors widened to reflect life expectancy
- CPP Removed the Work Cessation Test

CPP Actuarial Adjustment Factors

- 0.6% per month for retirement prior to 65 (but not before age 60)
  - If you Retire at age 60, get 64% of a full benefit

- 0.7% per month for retirement after age 65 (up to age 70)
  - If you retire at age 70, you get 142% of a full benefit

The New Expanded CPP/QPP

- Base benefit moves from 25% to 33.33%
- This will cost 2% of earnings (1% + 1%)
- Max limit on contributable earnings (old YMPE) to rise 14% in 2024
- This will cost 8% (4% + 4%) on earnings above the YMPE ($57,400)
- After 40 years, max benefits will be up 50% from $13,110 to nearly $20,000 in 2064

Did this happen because of a failure of private sector workplace pensions?

CPP 2

It is Fully Funded

- This minimizes intergenerational transfers
- Everyone pays for their own benefits
- Implies enhanced benefit security

BUT

- Full benefits do not accrue until 2064
- Investment income will create more volatility

CPP 2

It will be very big (over $1 T in assets)

- Can attach to alternative investments like infrastructure, private equity
- It can carry the longevity risk and pay out lifetime benefits

BUT

- Where can you invest $1 T prudently?

It is a Target Benefit/Target Contribution Plan

- This will enhance stability and sustainability
- It is consistent with the base CPP

BUT

- What happens when benefits have to be decreased or contributions increased?
- Will Canadians understand? Will politicians have the courage to act? If not, ABM.

In Conclusion

- Canadians realize that the only way to deliver health care effectively and efficiently is collectively
- Starting to understand that the only way to deliver retirement income security effectively and efficiently is collectively
- Individual CAP Accounts are not the answer

Merci!

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Additional Canadian Observations

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Private Sector Coverage

Previously –

Private sector coverage is ~ 50%

- Almost all DB

Currently –

Private sector coverage is 23%

- 9.5% DB
- 7.5% DC
- 6.0% "Other"

Canada never had good private sector coverage

Private Sector Coverage Problem

Employment Income vs. Earned Income

- Self Employed Excluded

Single Employer Pension Plan Focus

- Small Employers Excluded

Self Directed Individual Plans (RRSPs) are not Pension Plans

- False Expectations

Private Sector Coverage Solution

Employment Income vs. Earned Income

- PRPPs or regulatory change

Single Employer Pension Plan Focus

- Multi-employer Plans Sponsored by an Expert Board

Self Directed Individual Plans (RRSPs) are not Pension Plans

- Collective Defined Contribution Pension Plans

Ideal Design

- Shared Resources for Members
  - Larger Plans and More Resources

- CPP Experience for Employers
  - Make contributions

- Pooling for the Benefit of Members
  - Hurdle Annuity

- Choice in Managed Targets (Collective or Individual)
  - Basic Needs, Lifestyle Maintenance, Wants

In Conclusion

- We must deliver retirement income security collectively
- Individual CAP Accounts are not the answer
- Target Benefit Plans are not the complete answer

- We must save DB while improving DC as much as possible

Thank You!

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Q&A

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