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June 2016 Newsletter

Target Benefit Pension Plans in Alberta

Alberta passed legislation in 2014 to permit registration and operation of target benefit pension plans (TBPP) for single employer pension plans and non-negotiated multi-employer pension plans.

A TBPP is neither a defined benefit pension plan (DB) plan nor a defined contribution (DC) plan but can include the best features and can eliminate the negative features of both DB and DC plans. A TBPP operates with a fixed contribution designed to produce a desired, or target, defined lifetime pension at retirement. If economic and/or demographic experience is not as favourable as predicted, benefits can be temporarily reduced to maintain the full funded status of the plan. Benefit reductions are restored when plan experience improves. Aggressive risk management approaches are applied to reduce the probability that benefits earned in the past will ever have to be reduced.

Contributions to a TBPP are fixed and never increase:
- Employer contribution volatility eliminated;
- Employer investment risk is eliminated, and
- Employer demographic risk, and in particular, mortality risk, is eliminated.

DB cost accounting and disclosure rules should not apply to a TBPP if all risks are transferred to employees:
- Complicated accounting valuations and calculations would be eliminated
- The financial impact of volatile DB accounting costs on employer financial statement would be eliminated

A TBPP can be designed to minimize administration costs:
- Administration and investment expenses can be paid from assets of the TBPP
- A multi-employer target benefit pension plan enables administration costs to be spread over a larger number of plan members
- Investment MER declines as asset value grows
- Plan members bear a share of the administration expenses

All risks remain in the TBPP and are shared collectively by the plan members:
- Individual investment risks are eliminated both before or after retirement
- Individual longevity risk is eliminated
- Collective risk sharing permits a more aggressive investment strategy than for a DC plan

The collective risks imposed on plan members are managed effectively to minimize probability that benefits earned in the past will ever have to be reduced:
- Contributions are set at target level, but a more conservative benefit is granted each year
- Benefit increases are granted only when sufficient surplus exists
- Significant contingency reserve is held to absorb losses

Regulatory environment is permissive:
- Alberta/BC permit a non-negotiated multiemployer pension plan or a single employer target benefit plan
- Income Tax Act explicitly permits tax-deductible funding for contingent (target) benefits

A target benefit plan can:
- **Adopt the best features** of a DB pension plan and a DC pension plan, and
- **Eliminate the negative features** of both the DVB and DC pension plans.
- **Eliminate the employer risk** in a DB plan
- **Eliminate individual employee risk** in a DC plan.

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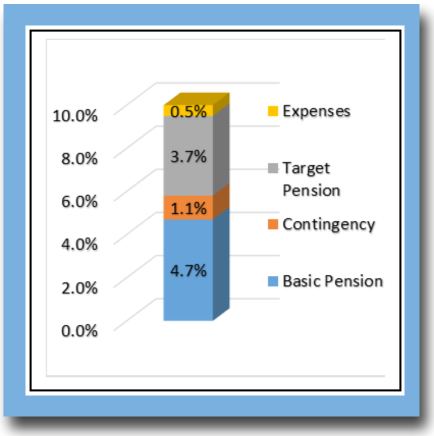
A TBPP would be best operated as a career average update plan:

- The Target Pension would be based on highest average salary with cost of living benefits
- The Basic Pension would be based on current salary with no cost of living benefits
- A 10%[1] total contribution would be adequate to provide a meaningful pension[2], allocated as:
  - 4.7% to provide the Basic Pension
  - 1.1% to build contingency reserve
  - 3.7% to upgrade to the Target Pension
  - 0.5% for administration expenses
- Surplus, in excess of the liability for the Basic Pension plus the contingency reserve, would be used to increase the Basic Pension



Risk Management Measures

- In the event of adverse demographic or economic experience:
  - New cost of living awards would be suspended
  - Then, contingency reserve used to absorb losses
  - Then, future Basic Pension accruals would be reduced
  - As last resort, Basic Pensions would be reduced
- When surplus emerges:
  - Rebuild contingency reserve
  - Then, restore any past reductions in Basic Pension
  - Then, restore any foregone Basic Pension accruals
  - Then grant cost of living increases on Basic Pensions for active and retired members
- Statistical analysis would illustrate low probability of necessity to reduce Basic Pension with a 15% to 25% contingency reserve

TBPP Design Features Can Minimize Administration Costs and Risks

- Normal retirement at age 65
- No plan subsidy on early retirement
- No subsidy to married plan members
- No subsidy to commuted value of Basic Pension payable on termination from the plan
- Limited recordkeeping requirement for career average plan
- Contributions can be shared equally with employees

Successful TBPPs are not new:

- Dutch plans
- New Brunswick plans
- Quebec Forestry Cos.
- BC Public Service
- Collectively bargained multi-employer plans in Canada

Summary

Growing shortages of skilled workers will further exacerbate the human resource management challenges of Canada's employers. Retirement savings plans will continue to be an essential component of the total compensation package necessary to attract and retain skilled workers. Target benefit pension plans are a pension solution that eliminate the shortfalls in DC plans without imposing financial risk on the sponsoring employer.

For more information or to arrange a meeting please contact Lesniewski Moore Consulting Group Inc.

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1Based on assumption that assets earn 5% per annum in future, salaries increase by 3% per annum, inflation will be 2% per annum and based on the Canadian Pensioners Mortality Table (2014) with mortality improvements based on Scale B applied on a two-dimensional generational basis.

2 Pension units of 0.625% up to YMPE plus 1.25% of salary in excess of the YMPE, in conjunction with the CPP and OAS, for a 35-year employee at age 65 would provide total pensions in retirement, after income tax, of about 66% of pre-retirement net disposable income at a salary level of about twice the Canadian average wage.