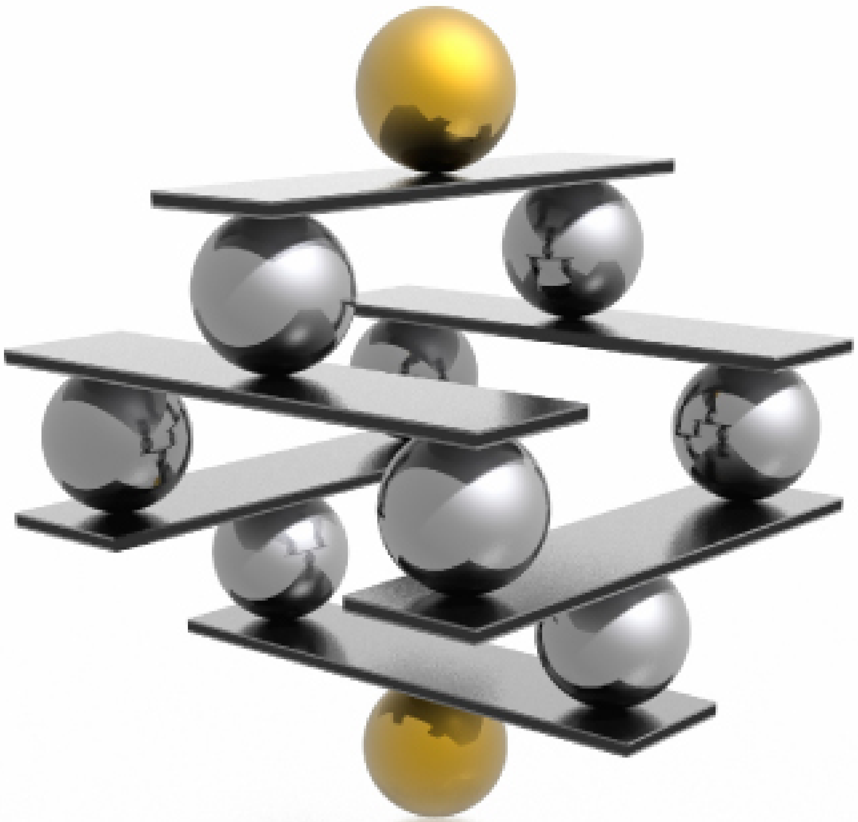
Key Trends in Pension Benefits

Enhancing Sustainability



AMO Annual Conference 2014

Presented by James Koo

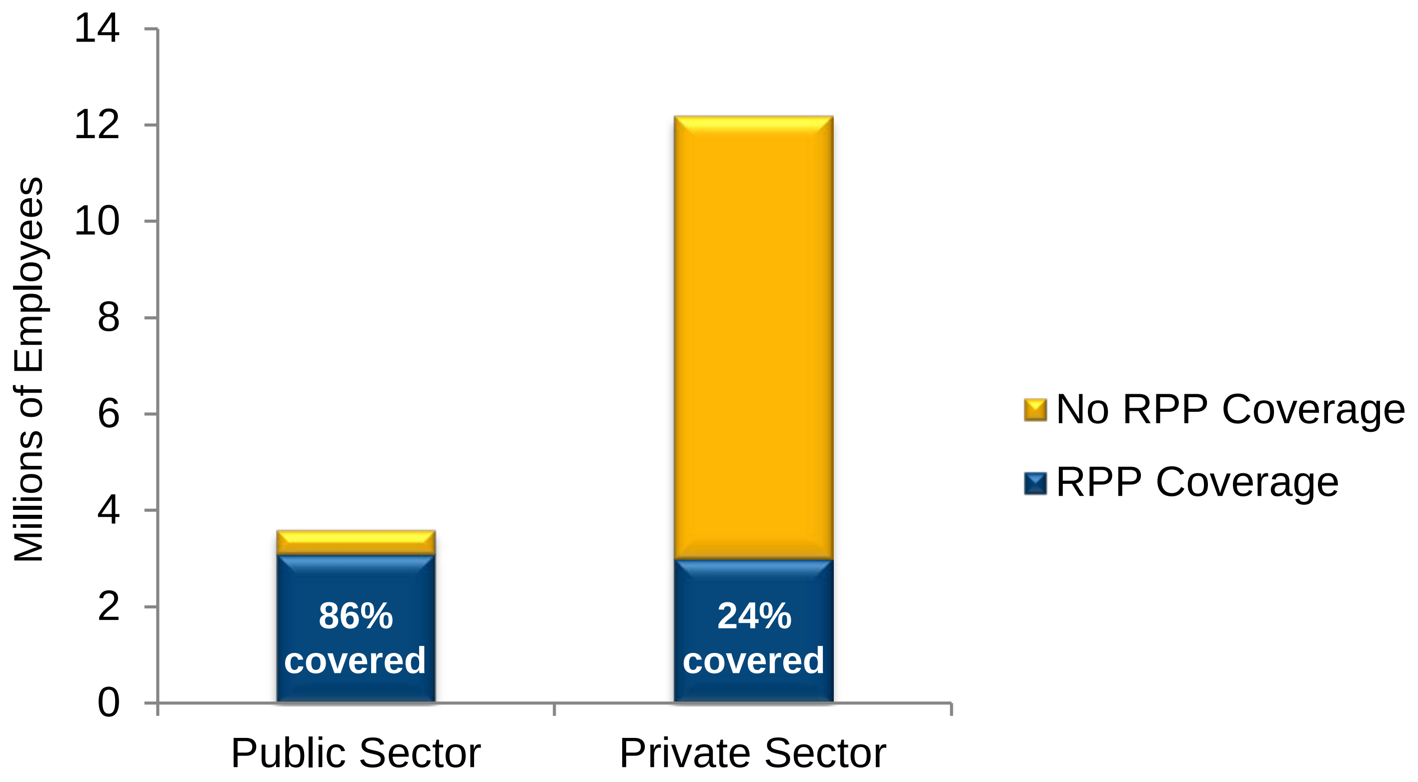
August 18, 2014

Outline

- Context
- Canadian workplace pension coverage
- Stresses on the system
- Plan design trends
- Improving Sustainability

Three Pillars of Retirement System

Canadian Workplace Pension Coverage



* Derived from 2011 CANSIM and OSFI data

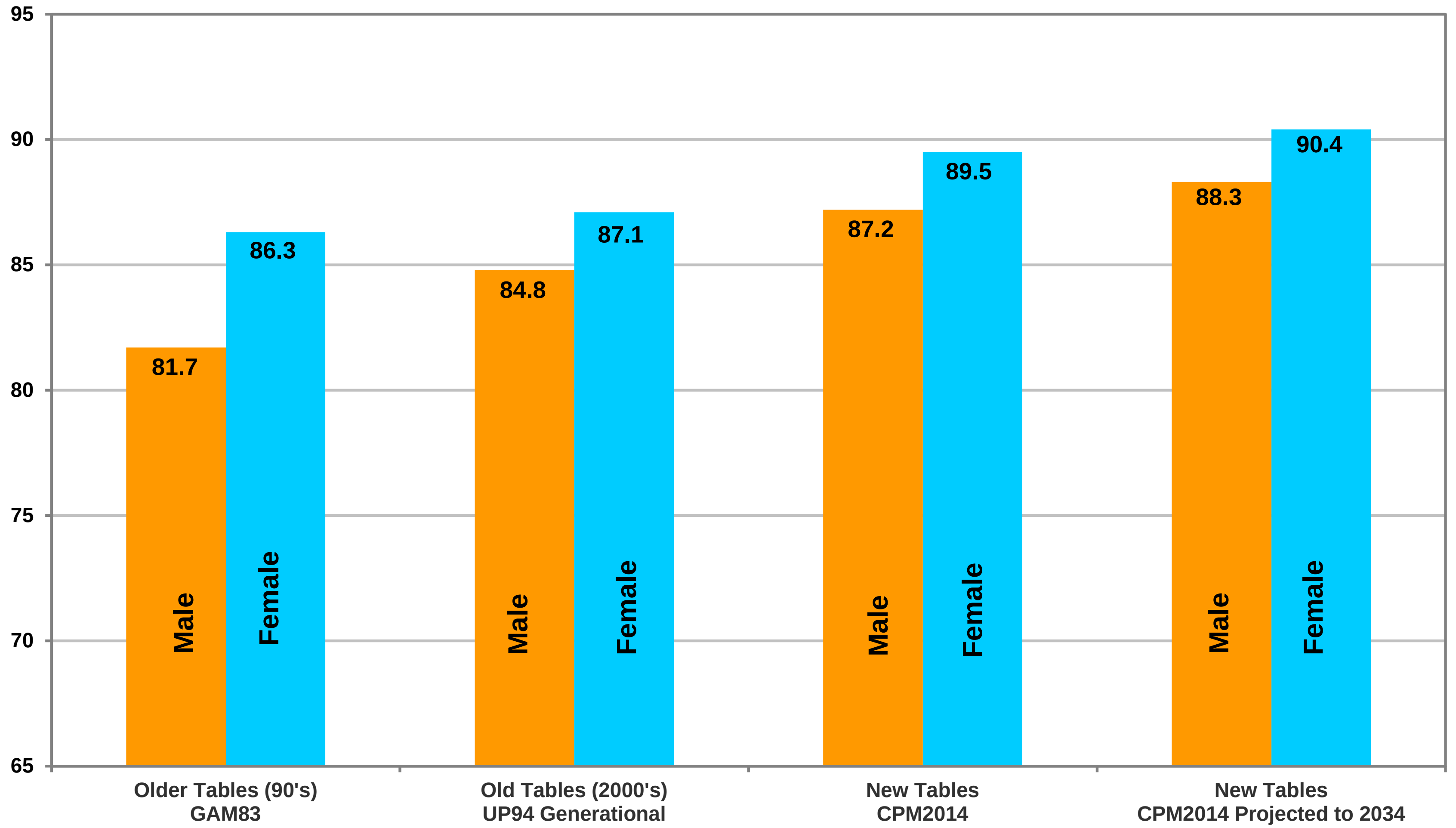
Stresses – Lower Rates and Lower Returns

Period	Starting Long Canada Bond Yield	Canadian Equity Returns	Long Bond Returns	Inflation
1980's	12.5%	12.2%	13.0%	6.2%
1990's	10.9%	10.6%	11.1%	2.1%
2000's	5.6%	5.6%	7.4%	2.1%
2010-2013	3.7%	6.8%	6.8%	1.7%
Next 20 Years	3.1%	?	?	?

Source: Canadian Institute of Actuaries, Report on Canadian Economic Statistics

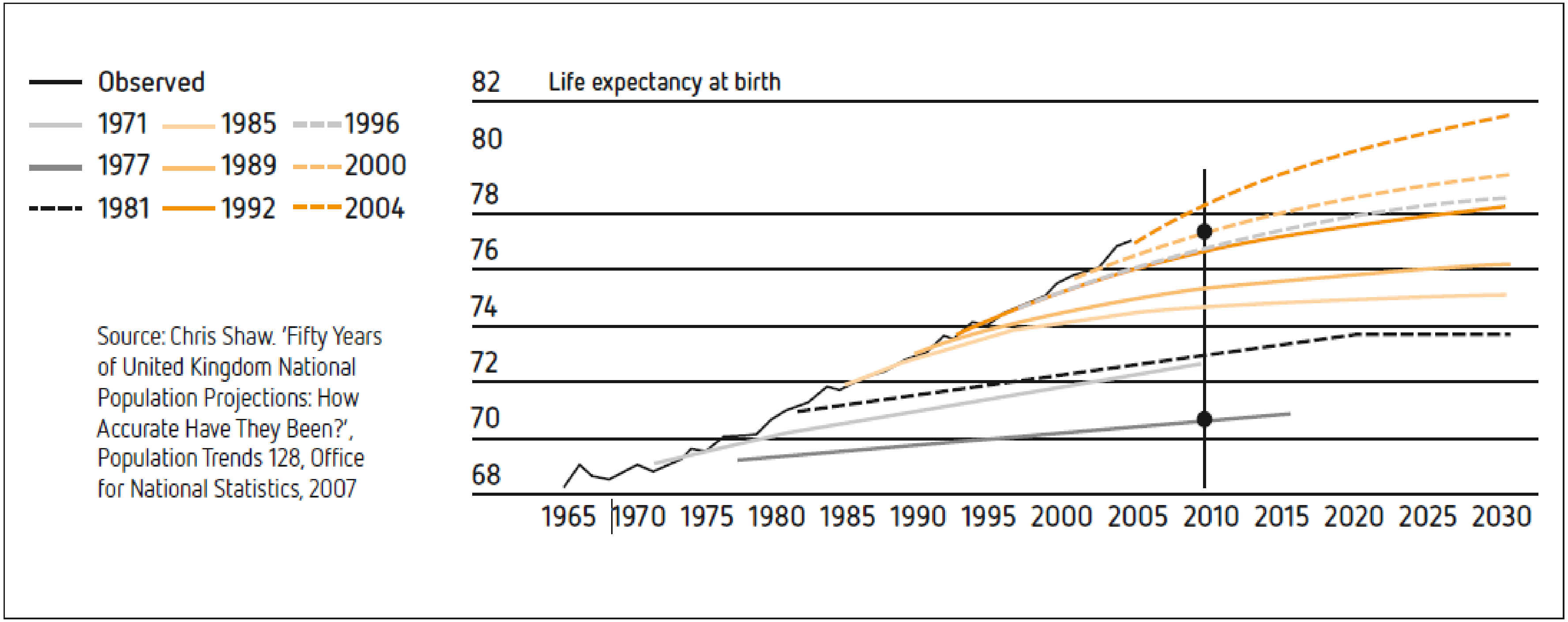
Stresses on the System – Living Longer

- Estimated Total Life Expectancy at Age 65



Stresses on the System – Living Longer

- Projections have consistently underestimated longevity



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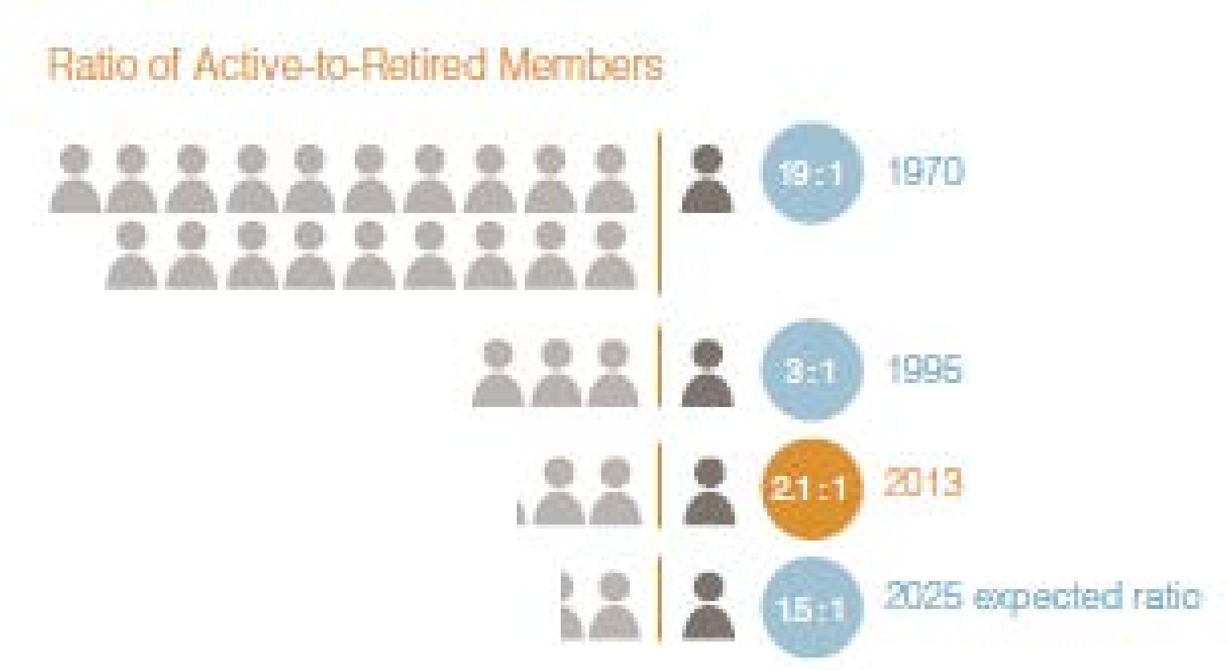
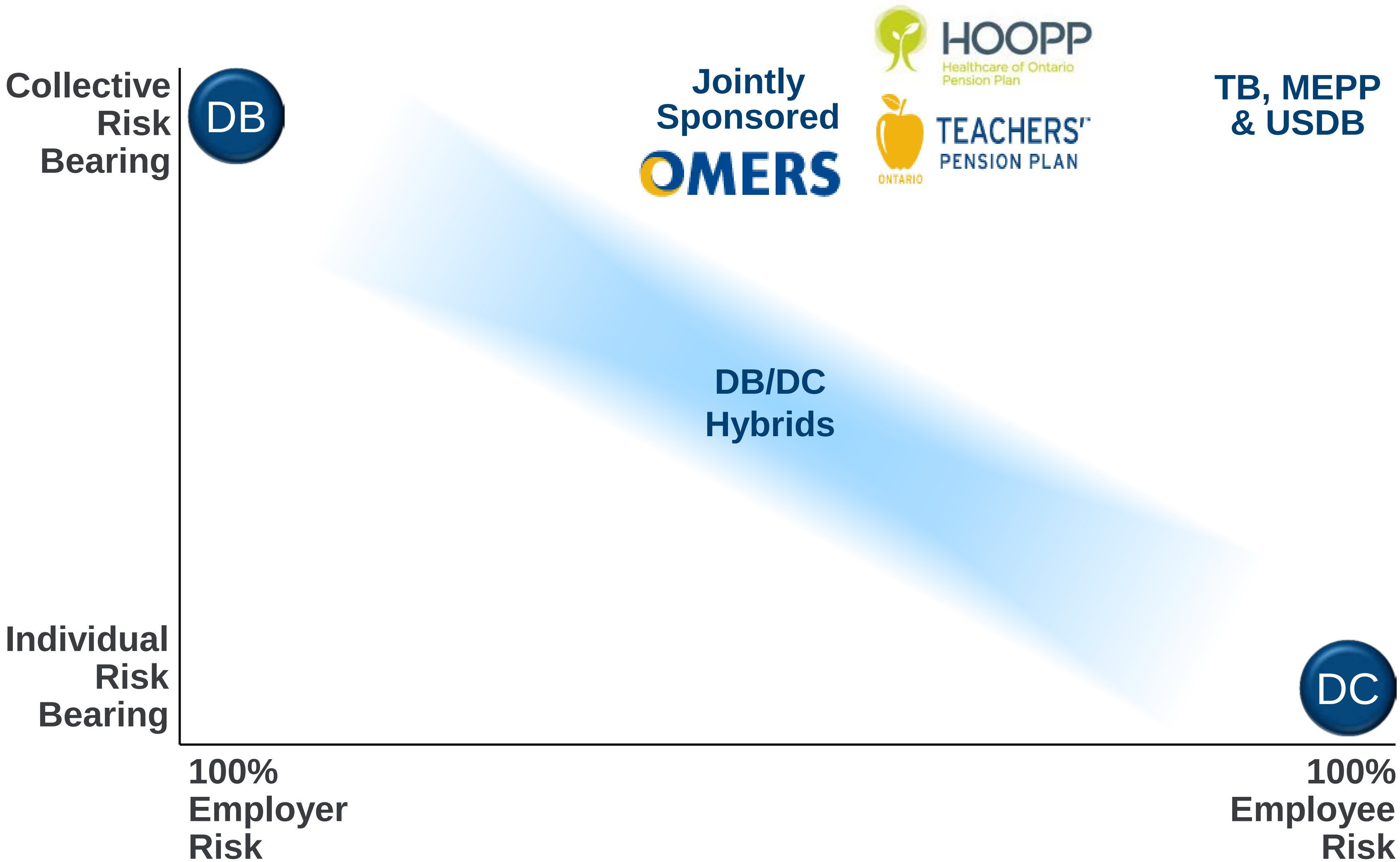
Stresses – Aging Population/Maturing Plans



Source: OMERS 2013 Annual Report

- OMERS Plan Liabilities = 440% of Contributory Payroll at end of 2013

Plan Design Trends



Reasons for Trend: Sustainability

- Definition - Pension **Sustainability:**

  "Ability to meet the needs of the present, without compromising the ability of future generations to meet their needs."

- Traditionally only two levers for jointly sponsored plans (such as OMERS), were:
  - Contribution Rates (already very high) and
  - Future benefits for active members.

- **Intergenerational fairness** is a key requirement for sustainability.
  - Gains in 1980's and 1990's spent on improvements and contribution holidays
  - Heavy burden on current and future actives to cover losses, when active/retiree ratio is declining.

Improving Sustainability

- How much should be set aside at retirement?
- Retirement at age 62, spouse age 59 (joint & survivor benefit)
- $32,000 annual pension (indexed) plus $10,000 bridge benefit to age 65.

	Inflation-Linked Bonds	**Diversified Portfolio with Assumed 3% real return**	**Diversified Portfolio with Assumed 4% real return**
Assumed Real Return	0.8%	3.0%	4.0%
Lump Sum Present Value at Age 62	$ 886,000	$ 656,000	$ 582,000

- $886,000 with no investment risk, or fund less and accept risk?

Improving Sustainability

- Most will agree to take reasonable degree of investment risk (otherwise adequate benefits unaffordable). But who bears risk?
- True cost of pension won't be known until many years after retirement.
- Many public plans have moved to Conditional Indexing.
  - Still fund to an agreed upon Target Indexing
  - Accept reasonable amount of investment risk so that adequate pensions can be provided at a reasonable cost.
  - But flexibility to adjust indexing on year-by-year basis.
  - Intergenerational fairness.
  - Gives plans three levers, instead of two levers: contributions, future benefits for actives, **and** conditional benefits that can be adjusted (including adjustment for retirees).

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Improving Sustainability

- Target Benefit Plans: flexibility to adjust benefits (not just indexing) in extreme circumstances.
  - Have worked well in Union Sponsored Multi-Employer Plans
  - Trend for Public Sector plans to move towards this model.
  - Legislative changes to enable model for Private Sector (may be too late)