Pension Reform
Background Document
May 2012

The challenges of private and public pension plans in recent years have been well documented. Many pension plans are facing significant funding deficits. This challenge is not unique to New Brunswick, but is a world-wide problem.

The New Brunswick pension system was designed in a time when people worked longer and lived less. They were designed in a time of economic growth, and the future predicted was one of continued robust growth, reflected in continuing strong returns on investments in equities.

When investment returns were good, they were expected to continue to be good, and benefits were increased and contributions decreased. However, the combination of the burst of the dot.com bubble and the recession of 2008 have now shown us that those original predictions were too optimistic. As a result of all these factors, many plans as they presently exist are not sustainable in the long term. In order for New Brunswick's pension system to remain sustainable, change is required. The status quo is not an option.

In response to these challenges, the government commissioned a Task Force to examine New Brunswick's pension system with a goal of ensuring a system which is secure, sustainable, and affordable. The three-member *Task Force on Protecting Pensions* was appointed by Justice and Consumer Affairs Minister Marie-Claude Blais in December 2010.

The mandate of the task force was to lead consultations and examine the long-term stability and security of pensions in New Brunswick. In September of 2011, the mandate was extended to include all public sector pension plans. The purpose and end goal of the public sector review is to ensure plans are sustainable and that the plan benefits are protected.

The Task Force examined many issues, including:

- rules protecting employees and pensioners;
- ensuring that the long-term sustainability of pension promises made to workers is honoured and protected; and
- reviewing the structure meant to protect pension plans to insure they are as effective as possible.

The Task Force has been working collaboratively with union representatives in New Brunswick to thoroughly examine the subject. In fact, some progressive ideas and plan improvements were submitted by unions for consideration.

Challenges facing New Brunswick's current pension system

There are a number of significant challenges to New Brunswick's current pension system. These challenges apply to both private and public sector plans. Given the severity of these, it is clear that the status quo is not an option.

Economic and Financial

Any pension plan is only as strong as its ability to pay the benefits. Defined benefit plans in particular are subject to large swings in value, and often are underfunded. This places the long-term security of the plan and member benefits at risk. So called "guarantees" under such plan are often little more than "guaranteed wishful thinking".

Since the year 2000 two serious recessions have meant ongoing market instability and sustained downturns in the global economy. The combination of the burst of the dot.com bubble and the recession of 2008 brought large drops in value for most pension plans throughout North America. These recessions revealed problems with traditional plans that were inherent for a long time, but were masked by the exceptional investment returns of the 1980's and 1990's.

To illustrate, just prior to the beginning of the most recent recession in 2008, a typical Canadian pension plan would have expected to earn approximately 6% during 2008. However, due to the recession the typical plan actually suffered investment losses of approximately 18%, resulting in a loss over prediction of approximately 24%. The market returns of 2009 – 2011 have been equally unstable and have not produced many funding gains. This contributes greatly to pension plan insecurity.

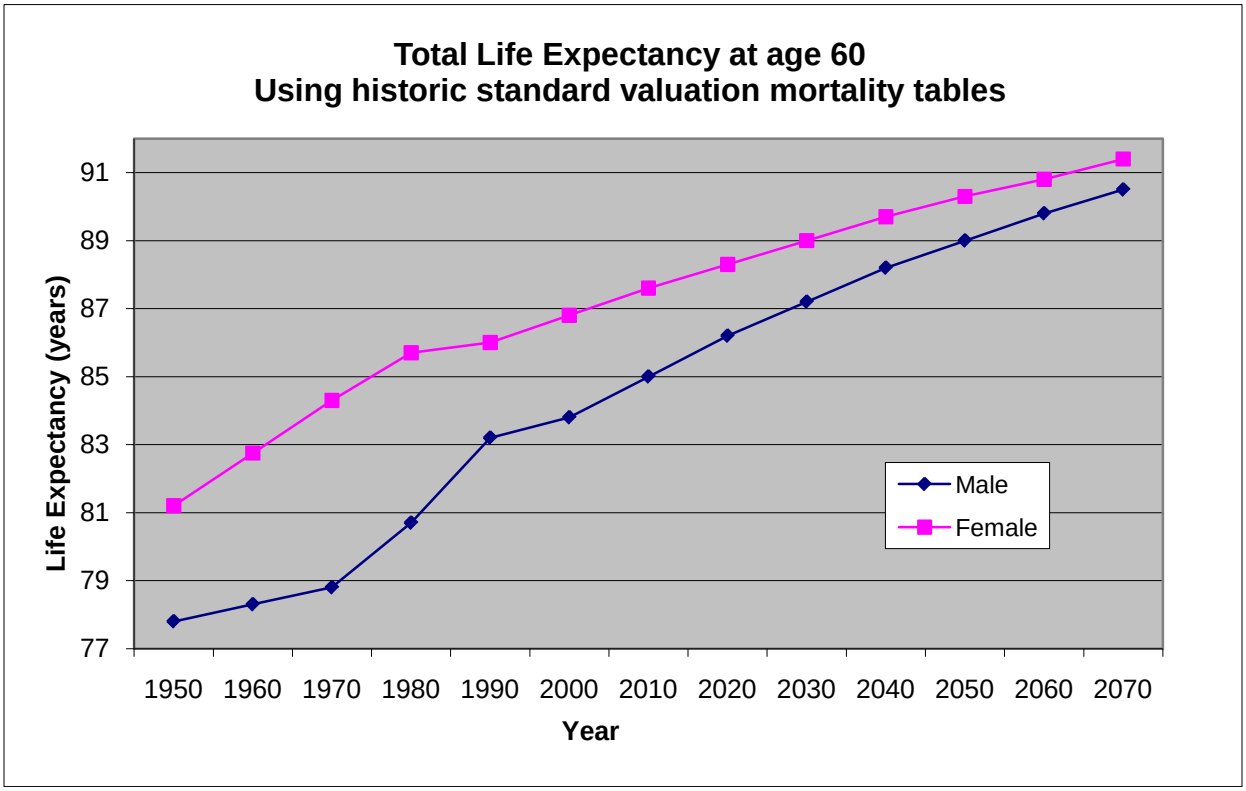
Governments also felt the impact of pension expense volatility. Between 2008 and 2009, New Brunswick's financial statements showed an increase in pension expenses of $169 million.

A solvency deficiency is a serious credit rating consideration. New Brunswick was downgraded by Moody's in 2009 and placed on a negative outlook in 2010 by Standard and Poor's. Ontario has also been placed on a negative outlook, in part due to its substantial and volatile pension expenses. Many Canadian provinces face similar challenges in this regard when it comes to pension plan expense volatility.

In any pension plan, potential swings of hundreds of millions of dollars in liability create future uncertainty. These swings make it difficult for governments to budget for the future. In the same way that large debt and deficits are not sustainable, neither are large pension deficits. They represent fiscal pressure for future tax increases and increased pressure on other worthy programs. In order to build a New Brunswick with fair and stable tax rates and sustainable social programs, government must address this economic and financial challenge.

Increased Life Expectancy

The current pension system was designed in a time when people worked longer and lived less. Today, however, people are actually living longer and retiring earlier. New Brunswickers are no exception to this rule.



Since the 1950s, life expectancy has been increasing at roughly 1 year per decade. Recent studies clearly show that life expectancies will only continue to increase. The only thing that is uncertain at this time is at what pace it will increase. It has been documented that 50% of babies born today in the USA will live to be 100. The number of centenarians in the USA in 40 years will be about 10 times what it is today. Canada has slightly better life expectancy than the USA. Therefore this challenge must be addressed in order for the current pension system to remain sustainable.

Early retirement

Increased life expectancy coupled with early retirement creates a significant challenge for current pension systems. Most public sector pension plans in Canada have early retirement provisions. Many retirees in recent decades have taken advantage of these provisions. The result has been a decrease of 7 years for the average retirement age.

When early retirement is combined with the average increase in life expectancy of 4 years, this means that, on average, pensions to someone retiring today will be paid approximately 11 more years than was expected in the 1970's.

To put this into perspective, life expectancy at retirement was 17 years in the 1970's. With the addition of approximately 11 years to the expected pension payment period, average pension payment periods have increased by more than 60% over the last 40 years.

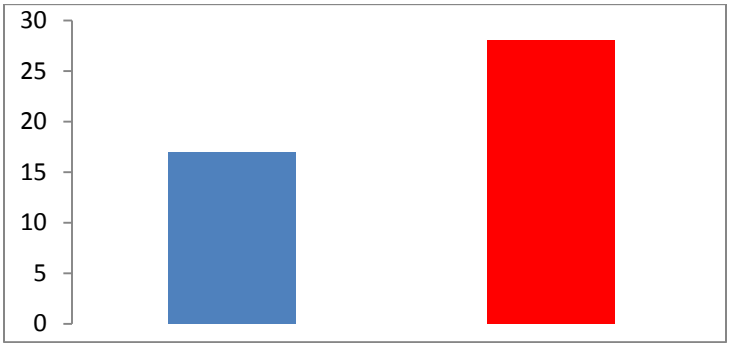


Fig. Predicted life expectancy at retirement in the 1970s (blue) and today (red).

Given this new demographic reality, the current public pension system must be updated in order to remain sustainable, in order to meet the needs of current and future retirees.

Inter-generational Inequality

It is a demographic fact that in Canada 'baby boomers', those born between 1947 and 1962' have had fewer children than their parents. For national pension plans this creates what can be referred to as a 'population deficiency'. This deficiency can only be made up by higher rates of immigration. New Brunswick does not historically have a high rate of immigration. Further, this lack of working age population growth has been shown to reduce economic growth potential. What this means for many pension plans, is that the next generation will contribute more to a pension plan than their baby boomer predecessors. Further, they will receive less in benefits because they will contribute both towards their own pensions and to fund the deficits that have emerged during the last 12 years. This issue cannot be left unchecked. A more balanced approach needs to be adopted that respects fairness for all groups.

Risk and Volatility

The challenges Canadian pension plans face today are due largely to the fact that risk management procedures were not required to be in place when they were created. This is why a number of private pension plans have failed in recent economic conditions.

They did not take in to account future risk and volatility when they were created. Pension plans designed in the 1970's were designed in a time of market growth and prosperity and provisions for security and stability were not considered. This is true throughout North America and New Brunswick is no exception.

Arrangements going forward should clearly identify the risks of a particular pension plan and how they will be shared. Pension plan funding problems cannot be remedied merely through the establishment of different investment policies, or through granting extended amortization periods for deficits.

The design of a pension plan should allow it to make modest course corrections and maintain long term stability. Changes and 'tune ups' to the plan which do not address the underlying issue do little more than buy time.

If the need for pension plan changes is not addressed before the problems become severe, drastic action becomes necessary. By moving to a new, more secure system now, New Brunswick can avoid the need for drastic measures in the future.