

Pensions, benefits and social security colloquium 2011

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Postretirement Benefit Protection Against Insolvency

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Postretirement Benefit Protection Against Insolvency

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Why having Guarantee Funds?

- Pensions are perceived by employees as “Deferred Wages”
 - Need protection against market failure (often equal plan failure)
 - Need diversification (eg. with Book Reserve Systems)
- Challenges faced by Guarantee Funds
 - Moral Hazard (irresponsible behavior)
 - Anti-Selection (leading to subsidy)
 - Systemic Risk (eg. global financial crisis)
 - Governmental involvement (political vs. economic)

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Premium and Claim Structures (Major Guarantee Funds)¹

Guarantee Funds	Premiums	Claims
US – PBGC	flat based / liability based	assets and liabilities taken over
Canada – PBGF (Ontario only)	same as PBGC	cash allocation made to plan administrator
UK - PPF	flat based /risk based	assets and liabilities taken over
Japan	% of liabilities	unclear on the event
Germany	% of liabilities ²	annuity purchases
Sweden	% of liabilities	annuity purchases
Switzerland	based on liabilities	annuity purchases

¹ For Single Employer schemes (may differ for Multi-employer schemes). Certain Countries (eg.the Netherlands) opted for more stringent funding requirements in lieu of guarantee funds

² Based on prior year's experience (Book Reserve method)

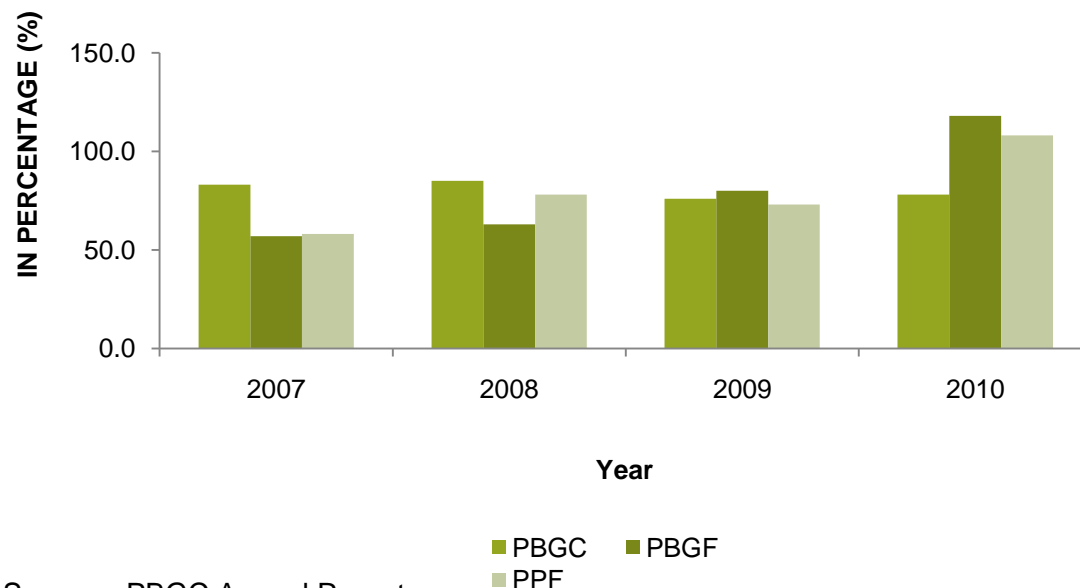
Source:Stewart, F. (2007), "Benefit Security Pension Fund Guarantee Schemes", *OECD Working Papers on Insurance and Private Pensions*, No. 5

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Evolution of the PBGC / PBGF / PPF Financial Position

- A true comparison of the financial position may not be possible
 - different premium and claim structures;
 - different assumptions and methodology (eg. on discount rates- LIBOR vs. Annuity purchase rates);
- Based on a snapshot of assets and liabilities at balance sheet date
 - ignore contingent liabilities (ie. future plan terminations) unless certain conditions are met;
 - the PBGF financial position for FYE 2010 reflects a \$500 M grant from the Ontario province
 - need to consider stochastic projections (eg. PPF levies)
- PBGC publishes results of stochastic projections annually;
- A recent PBGF study with stochastic projections was prepared for Ontario

Evolution of the PBGC /PBGF/ PPF Financial Position (Assets/Liabilities) for FYE 2007-2010



Sources: PBGC Annual Reports
PBGF and PPF Financial Statements

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Case Study – Nortel (1 of 2)

- One of the largest pension fall out in Canada (with Algoma Steel)
- Approximately 20,000 employees were affected
- Main scheme was approximately 65% funded on a solvency basis
- Scheme registered in Ontario
 - Province of registration vs. province of employment
- Complete annuitization (about CAD \$2.5 bn) could not be supported by the Canadian annuity market
 - Paved the path for pension scheme buyouts
 - Alternative to annuity purchase
 - Funds to be held by major financial institutions

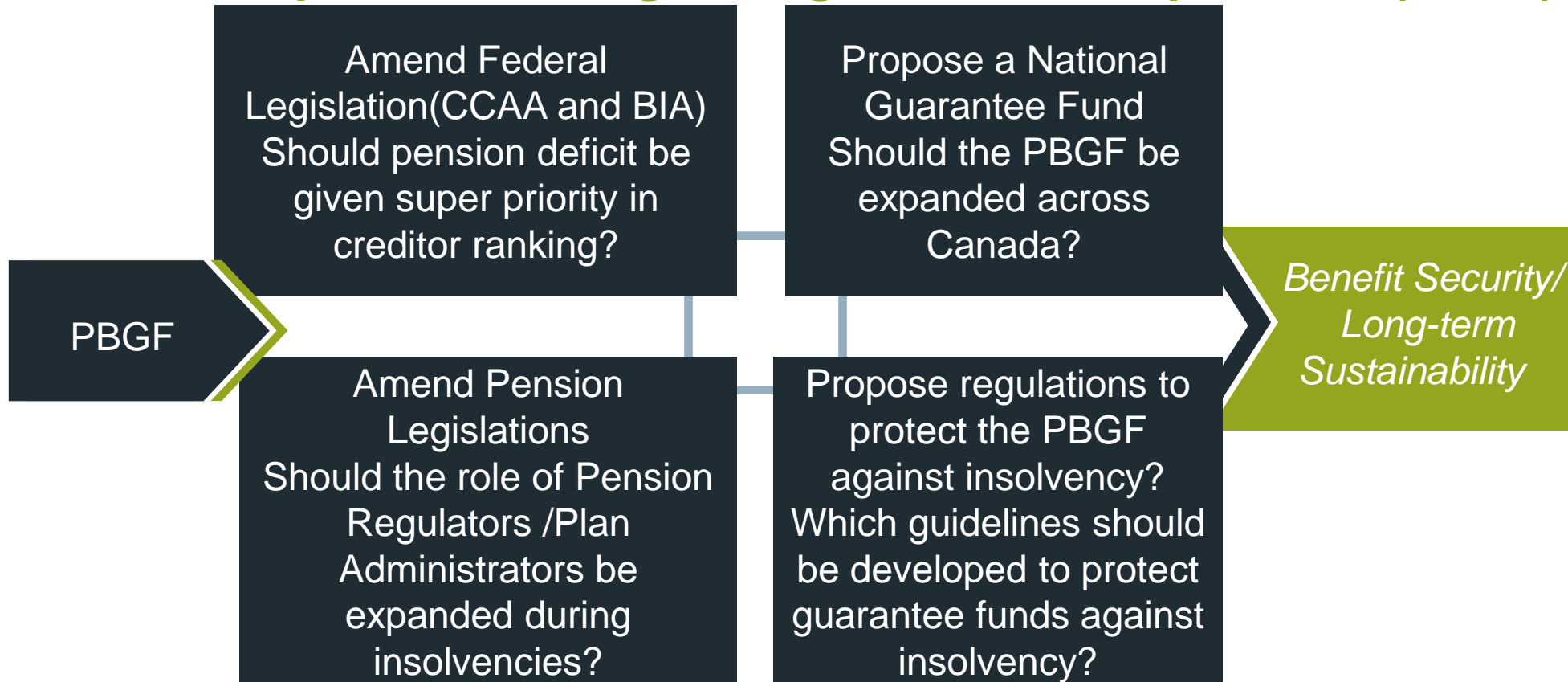
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Case Study – Nortel (2 of 2)

- Ontario Response
 - CAD \$500 M grant from Ontario Government to PBGF
 - Option for members to go with non insurer funds (buyout)
- Quebec Response
 - ``Orphenage`` provision by Québec Regulator
- Global ramifications
 - PBGC took over the US pension scheme
 - UK and EMEA claims - Order from UK Pension Regulator submitted in Ontario
- Next steps
 - Proposed changes to Federal Legislations
 - *Companies' Creditors Arrangement Act* (``**CCAA**``)
 - *Bankruptcy and Insolvency Act* (``**BIA**``)

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Canadian Proposals—Getting the right balance of policies?(1 of 3)



Getting the right balance of Federal, Provincial and other regulatory policies to improve benefit security while assuring the long-term sustainability of the retirement system

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Canadian proposals—Getting the right balance of policies?(2 of 3)

- Should pension deficit be given super priority in creditor ranking?
 - Results could be higher cost for credit, pressure on plan funding
- Should the role of the Pension Regulators / Plan Administrator be expanded?
 - Set up benchmarks to identify schemes « at risk of failure »
 - Risk management (eg.stress testing, cancel benefit improvements, etc.)
- Should the existing Guarantee Fund (PBGF) be expanded across Canada?
 - Learn from challenges in other countries (eg.premium structures)
 - Based on total estimated pension wind-up deficits
 - “National PBGF” exposure would be “multi billion” dollars

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Canadian proposals—Getting the right balance of policies?(3 of 3)

- Which guidelines should be developed to protect guarantee funds against insolvency?
 - Proper risk management (asset/liability mismatch, sponsor's financial health, etc.)
 - Who should own the governance of guarantee funds?
 - How a guarantee fund should deal with its own insolvency?
 - Should all pending claims be paid on a *pro rata* basis?
 - Should they be paid by the first in the queue ?
 - Should an emergency fund (with special levies) be imposed?
 - Should the Government provide ``Back up Insurance``?

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Are ``non pension`` postretirement benefits protected?

- The short and simple answer is NO
 - Typical plan provisions include the right by employers to amend or terminate health and welfare schemes
 - Retiree medical contracts can be rejected in courts
- In the Nortel case, employees lost not only their jobs but postemployment health and welfare coverage
 - Some remaining trust assets for LTD benefits are being disputed in courts
- Not much regulations to date to protect ``non pension`` postretirement benefits
 - BIA and CCA proposals for Health/LTD (similar to pension)

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Concluding remarks

- If postretirement benefits are communicated as “deferred wages” to employees, their protection against insolvency should be a priority
- We have explored different ways of addressing benefit protection
- A common challenge among regulatory regimes is getting the right balance of policies to achieve security and sustainability
- I believe that pension and benefit reforms should provide:
 - Risk management tools to prevent scheme failures
 - Schemes considered “at risk” should be monitored against potential failures
 - Greater role should be given to regulators and plan administrators before and during insolvencies
- **PLEASE SHARE YOUR VIEWS!**

Questions or comments?

The views expressed in this presentation are those of the presenter with appropriate sources as quoted in the document.

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