

Job Tenure and Wage Risk

	EE	ER
Backloaded DB	Riskier	Insure against EE quitting before retiring
Final average salary DB	Low final years salary due to ill health / economy	Can reduce risk by using highest 5 years
Career Average DB	Wage diversification (Limited pre-retirement inflation protection)	Offer ad-hoc adjustment
DB Plans (ER bear pension risk)	Better protected (Risks not diversifiable to individuals)	ER can diversify the risks

R-C102-07 Pension Risks and Insurance

Financial Market Risk – Pension Plans

Employees	Affect MEPs' contribution rate or benefit levels Riskiest if plans have no inflation protection
Firms	DB plans less risky (risk-sharing between retirement cohorts) DC plans depends on average market investor
Insurers	Shift risk to insurers by annuity purchase
Government	Share risk from tax deductible ER contribution Lower tax revenues from lower DC retirement benefits

R-C102-07 Pension Risks and Insurance

Calculation of Target Replacement Ratio

$$RR = \frac{P_rRPG - P_rRT - P_rRS \pm NCCR + P_oRT}{P_rRPG}$$

1. RR = Target replacement ratio
2. P_rRPG = Pre-retirement gross pay
3. P_rRT = Pre-retirement taxes
4. P_rRS = Pre-retirement savings
5. $NCCR$ = net changes in consumption requirements from pre to post retirement (can divide into work-related expenses & net change in age-related expenditures)
6. P_oRT = Post-retirement taxes

Fundamentals of Private Pensions (9th Edition)
Chapter 16: Total Retirement Income: Setting Goals and Meeting Them

Managing Rising Extended Health Care Costs

1. Increasing deductibles and coinsurance
2. Modification to drug program
 - a. Generic Substitution
 - b. Lowest Cost Alternatives
 - c. Drug Utilization Review
 - d. Therapeutic Substitutions
 - e. Lifestyle Drugs
 - f. Managed Care Formularies
 - g. Three-Tier Co-Payments
3. Health care spending accounts
 - a. More EE choice w/o major plan overhaul
 - b. Utilizes DC concept vs. DB approach
 - c. Easier to administer than flexible benefit plan
 - d. Easier to communicate value of benefits
4. Coordination of benefits (COB)
 - a. Eliminate ER overpayments and maximize EE reimbursements
 - b. Dictates sequence of expense adjudication if more than 1 private health plans

Handbook of Canadian Pension and Benefit Plans (14th edition)
Chapter 17: Extended Health and Dental Care Plans

Reasons For and Against Funding Policy

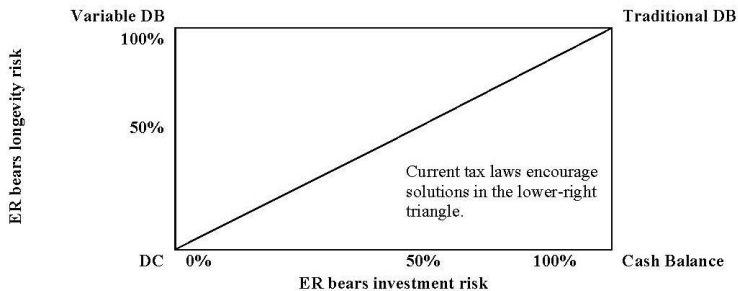
Funding policy (How will pension promise be secured)

For Funding	Against Funding
Legislated requirements (and Tax advantages)	Higher after-tax ROR from by retaining assets within business
Less intergenerational transfers to EEs, shareholders, taxpayers	Gov'ts do not go bankrupt (Public sector argument)
Cost recognition required by accrual accounting (Funding to offset liability buildup)	Gov't investment in capital markets undesirable (Public sector argument)
Protect against economic downturn (potential solvency issue for ER)	Potential for politically motivated actions (Public sector argument)
Contribution stability	

Handbook of Canadian Pension and Benefits Plans (14th Edition) Chapter 5:
Financial Management of Pension Plans

21st Century Plan Design Mindset

Decoupling investment risks, and longevity risks



Retirement Plan Designs for the 21st Century & Comments ...

Supplemental Pension Plans

RCA

	RCA Trust Fund	RCA Refundable Tax Account (the CRA Account)
SPP contributions	Get 50% of ER SPP contributions	Get 50% of ER SPP contributions
Investment of assets in the account	Allowed	Not Allowed (i.e. assets in the CRA account earns no interest)
Distributions of investment return from the RCA Trust Fund (the CRA account is not allowed to earn any income)	50% of the investment income from the RCA Trust Fund remained in the Fund	50% of the investment income from the RCA Trust Fund transferred to the CRA account annually.

Principal advantage:

Funding does not result in immediate tax consequence to employee

R-C603-07 Retirement Compensation Arrangements: a curmudgeonly excursion

Supplemental Pension Plans

Accounting Implications

Impact on	Vehicles with pre-funding	Vehicles without pre-funding
Income Statement (Pension expense)	Lower (due of offsetting effect from asset return)	Higher
Balance Sheet (Pension assets / pension liability)	Little or no pension accrual	Higher balance sheet liability

R-C602-07 Funding Supplementary Pension Plans

**FSCO Asset Transfer Policy
(Regulatory Relief from This Policy
Available Upon Certain Conditions)**

1. Asset transfer ratio = A / B , where:
 - a. $A = MV$ of investments held + any cash balances
+ accrued or receivable income items
 - b. $B =$ Transfer liabilities + Residual liabilities
2. Transfer liabilities = Max (GC, solvency) of the total of:
 - a. (Pension + deferred pension + ancillary benefits) or
 - b. (Pension for which successor ER has responsibility)
3. Residual liabilities = Max (GC, solvency) of:
 - a. (Pension + deferred pension + ancillary benefits) or
 - b. (Pension for which ER has retained responsibility)
4. Asset transfer value = Transfer liabilities * Min (Asset transfer ratio, 1.00)
5. Residual asset value = Residual liabilities * Min (Asset transfer ratio, 1.00)

**Hypothetical Wind-Up
Purpose
Standard**

Purpose

1. Alternative funding basis to a going concern valuation
2. Illustrate financial position if plan were wound up

Standards (Same as full wind-up except following)

1. Detailed membership data reporting N/A
2. Calculate entitlements assuming no surplus or deficit
3. Reflect contingent wind-up benefits
4. Set Wind-up date = Calculation date = Settlement date
5. Explicit wind-up expense assumptions payable from fund
6. Disclose if use approximation of market value

CSOP Pension Plans 3000 – 3700