

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

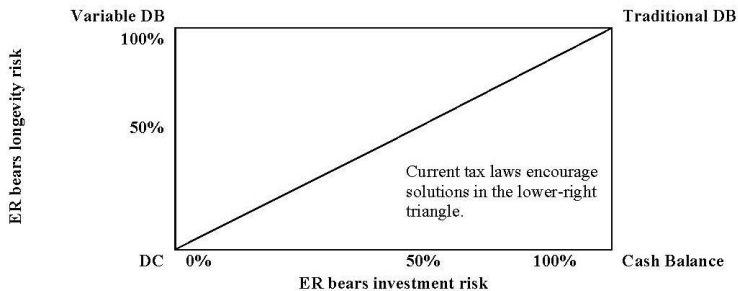
Funding policy (How will pension promise be secured)

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 ...

Phased Retirement

Non-Discrimination Protection

Non-Discrimination Protection

Plan May Fail If	Possible Solutions
Lowers NRA for in-service distributions	Permit a facts and circumstances test
FAE based on annualized salary and most affected members highly paid	Develop safe harbors and/or special rules
Only phased retirees can receive certain payout options (e.g. partial benefit payout)	

1. Phased retirement may replace early retirement window, often used to discriminate against older EEs

Protecting Participants and Beneficiaries in a Phased Retirement World

Pension Protection Act (2006)
Single ER DB Pension Plans

Funding Targets

Funding Targets (from 2008)

Interest Rate	3 segments rates from yield curve based on corporate bonds in top 3 quality levels 24-month average No corridor Optional phase-in period
Asset Valuation	24-month smoothing 90-110% corridor
Mortality Tables	Treasury to prescribe table Proposed regulations used RP-2000 with projection Sponsor may request plan specific tables

R-C807-09 The Long and Short of the PPA (2006)

Pension Protection Act (2006)
Single ER DB Pension Plans

Disclosure

Disclosure Rules (Applicable to all DB plans)

1. DB benefit statements minimum every 3 years
2. New annual funding notice to all members (Replace the summary report and Section 4011 notices)
3. Section 4010 PBGC filings if prior year funding < 80%
4. Annual report includes plan mergers info. (E.g. Pre / Post merger funding status)
5. Multiemployer plan in endangered or critical status: Disclose status and summary of improvements or rehabilitation plan

R-C807-09 The Long and Short of the PPA (2006)

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Termination Benefits

Termination Benefits (benefits provided regarding to EE termination)

1. Special termination benefits (offered only for a short time)
 - Recognize liability and a loss when EE accepts offer and amount is reasonably estimable
2. Contractual termination benefits (Pre-specified by plan terms for a specified trigger event)
 - Recognize liability and a loss when probable that EEs will become entitled to and amount is reasonably estimable
3. Cost recognized = Lump sum payments + PV of any expected future payments
4. May involve curtailment

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