Benefits Canada at 40: THE EVOLUTION OF DB

While plan assets have grown significantly since Benefits Canada's first top pension funds report in 1980, some organizations are finding new ways to inject life into the defined benefit space.

By *Michael McKiernan*

Jim Keohane couldn't help but laugh when he recently got his hands on a copy of the 1975 annual report for the Ontario Hospital Association's pension plan.

The plan, an ancestor of the Healthcare of Ontario Pension Plan that Keohane now leads, dated back to 1960 and had accumulated total assets of about $300 million by the mid-1970s, according to the document.

"Now, we get some days where our assets fluctuate by more than $300 million," says Keohane, HOOPP's president and chief executive officer, whose current assets total more than $70 billion. "So it's a fairly different world we operate in."

The intervening four decades have seen HOOPP become a key proponent of the so-called Canadian model of defined benefit pension management: massive jointly sponsored plans with multiple participating employers that operate independently and control their investment strategy in-house. HOOPP's 510 employers have more than 300,000 members in the plan.

"We have the scale now that allows us to run everything internally and enables us to access asset classes that are out of reach to smaller funds," says Keohane. "It also means our costs are very low."

'Eventful' period for DB

With *Benefits Canada* marking its 40th anniversary this year, it's also an opportune time to look at the various ways the industry has changed since the publication's beginnings in the 1970s. When it comes to defined benefit pension plans, there's an interesting divergence at play.

"The last 40 years have probably been the most eventful in the history of defined benefit pensions," says Hugh O'Reilly, chief executive officer of OPSEU Pension Trust, another jointly sponsored behemoth with $19 billion in assets. "Plans like ours have transformed from being essentially pay as you go into sophisticated investors with worldwide footprints. What's coming in the next 40 years is going to be just as exciting," he says.

"On the other side, we have seen a diminishment in DB coverage. That's a worry, because it's going to make it difficult for people to maintain an adequate standard of living after they retire," he adds.

When *Benefits Canada* rolled off the press for the first time in 1977, defined benefit pension plans covered almost 50 per cent of employed men and around 35 per cent of women, according to Statistics Canada.

By 2011, the proportion of men with defined benefit plans had halved to 24.3 per cent, while a less spectacular decline among women took them to 32.6 per cent.

Despite the falling coverage rates and the increasing prevalence of defined contribution plans, there are still signs that the defined benefit arena remains strong.

Willis Towers Watson's 2017 global pension assets study recently revealed that the overwhelming majority of assets in Canadian pension plans, 95 per cent, remain in defined benefit arrangements. That compares to just five per cent allocated to defined contribution plans. The split has hardly budged in the decade since 2006, when the same report found 97 per cent of assets were in defined benefit plans.

Ofelia Isabel, a global account director at Willis Towers Watson, says those numbers don't tell the full picture.

"DB plans have been around much longer, so they've had time to accumulate assets, while newer DC ones haven't had enough time to catch up," she says.

In addition, she says defined benefit assets are counted for longer, since they remain in plans long after members retire and begin collecting them. Even long-closed or suspended funds continue accruing value for existing members. By comparison, members typically withdraw their defined contribution funds on retirement, at which point they no longer count towards the total assets.

Public sector dominance

Canada's large public sector workforce, which is generally part of the outsized defined benefit pension funds at the top of the list of the biggest plans, is also responsible for skewing the numbers. But Malcolm Hamilton, a senior fellow at the C.D. Howe Institute who spent most of his 40-year career as an actuary at Mercer, says he expects the defined benefit proportion of pension assets to slowly come down over the next decade or so as the numbers more fully reflect past changes.

"For my entire career, DB plans have been on the decline in the private sector, where they have been replaced primarily by DC plans. We're down to a tiny proportion of workers in the private sector who have a DB plan," he says. "The drivers in each decade were different, but the direction was always the same."

In the 1980s, according to Hamilton, the launch of the first wave of active government regulation of defined benefit pensions made it harder for smaller- and medium-sized employers to justify the cost of running their own plans.

The following decade saw disputes over the ownership of surpluses in pension coffers, while ambitious tax reforms further boosted the regulatory burden on private sector employers, says Hamilton.

Since the turn of the 21st century, surpluses have rarely been a concern, with perennially low interest rates putting pressure on employers to maintain the funding ratios of their plans.

Despite some relief measures by governments, most Canadian jurisdictions require plan sponsors to value their assets on a solvency basis, as if the plan were to wind up on the valuation date. Sponsors then need to cover any shortfall with special payments amortized over a five-year period. "The bottom line is low interest rates have made funding a DB plan a very expensive undertaking," says Hamilton.

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An uptick in solvency ratios

After several years verging on crisis, 2016 actually proved a good year for plan solvency thanks to the strong performance of the equity and capital markets, according to William da Silva, retirement practice director at Aon Hewitt in Toronto.

Earlier this year, the median solvency ratio among the firm's Canadian clients hit 96.7 per cent, a huge improvement over the same time last year, when it stood at just over 83 per cent. In addition, almost 40 per cent of plans in Aon Hewitt's database finished the first quarter of 2017 in a fully funded position.

But rather than sparking a rush back to the defined benefit world, da Silva says employers that previously suspended or closed their plans to new members are using the current rosy outlook to head for the exits. A spike in interest rates has reduced the price of de-risking options that allow plan sponsors to wash their hands of a chunk of their pension liabilities by, for example, purchasing annuities. Others are considering winding up their plans altogether.

"Windup is still a heavily regulated administrative process, with a lot of money involved. But with solvency ratios the way they are, it doesn't look nearly as onerous as it did five years ago," says da Silva, noting that another interest rate spike in the near future could accelerate the trend.

Brent Simmons, senior managing director for defined benefit solutions at Sun Life Financial, says the annuity market for Canadian pensions has grown substantially over the last four years, hitting $2.7 billion in 2016. But for 2017, his company has forecast the market could almost double again, to as high as $5 billion as plan sponsors act on what he calls their "regret risk."

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they’ve been underwater for most of that time. Sponsors fear that if they don’t get off the ride now, they may regret it in the future,” says Simmons. “Buying an annuity allows them to transfer the risk to an insurance company. It smooths out the bumps and makes their costs more predictable, so they can focus on the core business.”

In Quebec, the funding ratios of the province’s defined benefit plans received extra reinforcement, thanks to the switch to the less onerous going-concern standard for funding valuations, which smooths short-term volatility by assuming a plan will continue indefinitely. In May, Ontario followed suit, to a large degree, with a plan under which defined benefit pension plans will have to fund themselves on a solvency basis only if their funded status falls below 85 per cent.

Julien Ranger, a partner at Osler Hoskin & Harcourt LLP, says employers and unions have been happy with the stabilizing effect of the Quebec reforms.

“Whether it achieves its other, longer-term objective, which is to maintain the number of DB plans in Quebec to curb the transition to DC, is still unclear,” says Ranger. “We’ll see when interest rates start to go up, whether sponsors decide to remain in DB, or if they annuitize and move out.”

New signs of life

Outside of Quebec, some organizations are taking action to arrest and possibly even reverse the widespread migration to defined contribution plans. The Canada Mortgage and Housing Corp. has approved a new defined benefit plan design to take effect next year for all employees, despite previously closing its old version. Since 2013, new hires were only eligible to join a defined contribution plan. The new defined benefit plan, however, will cover everyone.

Elsewhere, Nova Scotia’s Public Service Superannuation Plan Trustee Inc. launched a membership growth strategy in 2013 that has seen the fund add more than 1,200 new members, mostly from smaller, less efficient defined benefit plans at universities around the province. However, the most recent new additions were 200 Cape Breton University employees who transferred out of their existing defined contribution plans.

The organization “believes that a large, well-managed, robustly funded DB plan, such as the [public service plan], presents an attractive alternative to some public sector employers with existing DC plans,” said plan spokesperson Gisèle Taylor, adding that talks are underway with more potential partners.

Derek Dobson, the chief executive officer of the Colleges of Applied Arts and Technology Pension Plan, wants to go one step further by bringing other public and private sector employers onboard. Last year, a merger with the Royal Ontario Museum's plan added 640 new members, and Dobson hopes to grow even further by attracting employers with existing defined benefit or defined contribution plans or no plan at all.

"We want to stem the conversion to DC for the wrong reasons and we've had interest from employers who had switched to DC but aren't getting what they had hoped out of it," he says.

"We have shown there are other alternatives coming to market and, as awareness grows, I think this type of solution will be very appealing to employers across the country."

Although Joe Nunes, president of Actuarial Solutions Inc., has doubts about Dobson's approach, he says the long-term survival of defined benefit pensions may depend on convincing non-public sponsors to stick with the idea.

"I'm skeptical that making larger and larger plans will continue to reap additional economies of scale. If that were true, then why not just merge all the government DB plans into a single entity?" says Nunes.

"What I have been saying for 20 years is that the government ought to be wary about the fact that they're driving the private sector out of the DB pension business, because I would expect that taxpayers are going to be less and less tolerant of supporting those kinds of benefits when they can't possibly hope to enjoy them in the private sector."

The perils of pension polarization

When *Benefits Canada* ran its inaugural top pension plans feature in 1980, it listed just 20 plans, with Canadian National Railway Co. coming out on top thanks to its $2.5 billion in pension assets. Private sector plans filled more than half of the remaining spots on the list.

And while the top fund this year boasts an inflation-busting $175 billion in assets, the Ontario Teachers' Pension Plan sits atop a list dominated by public sector plans.

Fred Vettese, chief actuary at Morneau Shepell Ltd., believes the shift to defined contribution pensions is irreversible, at least in the private sector. However, he's uncomfortable with the increasing polarization, since he says accounting rules used by public sector plans don't account for the full cost of guaranteeing defined benefit pensions.

"In the civil service, about 20 per cent of the payroll is going into plans, but with interest rates as they stand, the full cost of guaranteeing an indexed pension for life is more like 40 per cent," he says.

If taxpayer dissent becomes vocal enough in the long term, Vettese says some provinces may adopt target-benefit plans for the public sector, following the lead of New Brunswick's shared-risk approach. Hamilton agrees that target-benefit plans are the way to go for the public sector.

"It'll probably take another 40 years for us to get there," he says.

Michael McKiernan is a freelance writer based in St. Catharines, Ont.

TOP 10 | FASTEST GROWING PENSION FUNDS (%)

ASSETS (MILLIONS) AS OF DEC. 31, 2016

	Company	2016 Pension Assets	2015 Pension Assets	Variance
1	Régime de retraite du personnel des CPE et des garderies privées conventionnées du Québec	$2,134.0	$1,863.8	↑14.5%
2	Sobeys Inc.	$2,087.0	$1.846.3	↑13.0%
3	Ontario Municipal Employees Retirement System	$85,200.0	$77,000.0	↑10.65%
4	Alberta Teachers' Retirement Fund Board	$13,361.4	$12,080.7	↑10.60%
5	Labourers' Pension Fund of Central and Eastern Canada	$5,966.7	$5,398.9	↑10.5%
6	Healthcare of Ontario Pension Plan	$70,359.0	$63,924.0	↑10.1%
7	Alberta - Local Authorities Pension Plan	$37,652.5	$34,305.8	↑9.8%
8	Saskatchewan Municipal Employees' Pension Plan	$2,285.4	$2,091.4	↑9.28%
9	Colleges of Applied Arts & Technology Pension Plan	$9,388.2	$8,592.0	↑9.27%
10	Alberta - Public Service Pension Plan	$11,886.6	$10,899.9	↑9.1%

Source: Figures in the report are based on the top 100 plans participating in the 2017 Canadian Institutional Investment Network pension fund survey or annual reports. The table encapsulates organic growth, new mandates and returns, not growth due to mergers and acquisitions.

TOP 100 PENSION FUNDS

TOTAL PENSION ASSETS (MILLIONS) ARE REPORTED AS OF DEC. 31, 2016, UNLESS OTHERWISE INDICATED
PA = Pension Assets ↑↓ Indicates an increase or decrease in total pension assets from 2015

Rank	Pension fund	Rank 2015	Change	2016 PA	2015 PA
1	Ontario Teachers' Pension Plan	1	↑2.3%	$172,082.0	$168,246.0
2	Ontario Municipal Employees Retirement System	3	↑10.6%	$85,200.0	$77,000.0
3	Public Service Pension Plan (Federal)	2	↑4.1%	$84,723.0	$81,348.0
4	Healthcare of Ontario Pension Plan	4	↑10.1%	$70,359.0	$63,924.0
5	Government and Public Employees Retirement Plan	5	↑6.2%	$63,604.3	$59,877.7
6	B.C. Municipal Pension Fund	6	↑6.0%	$46,319.6	$43,678.8
7	Alberta - Local Authorities Pension Plan	7	↑9.8%	$37,652.5	$34,305.8
8	B.C. Public Service Pension Plan	8	↑4.5%	$28,309.5	$27,086.2
9	B.C. Teachers Pension Fund	9	↑4.4%	$25,519.4	$24,444.6
10	Ontario Pension Board	10	↑5.7%	$24,349.1	$23,045.9
11	Canada Post Corp.*	13	↑5.4%	$23,117.0	$21,937.0
12	Hydro-Québec	11	↑3.1%	$22,935.0	$22,243.0
13	Canadian Forces Pension Plan	12	↑0.0%	$21,999.0	$21,991.0
14	BCE Master Trust Fund	14	↑1.6%	$20,843.0	$20,510.0
15	Quebec Construction Industry*	15	↑6.6%	$20,688.5	$19,401.4
16	OPSEU Pension Trust	16	↑3.5%	$19,045.0	$18,399.0
17	Air Canada Pension Investments	18	↑6.1%	$18,037.0	$17,000.0
18	Canadian National Railway Co.	17	↓-0.6%	$17,591.0	$17,704.0
19	Ontario Power Generation Inc.	19	↑2.6%	$13,410.0	$13,072.0
20	Alberta Teachers' Retirement Fund Board	21	↑10.6%	$13,361.4	$12,080.7
21	General Motors of Canada Ltd.^	22	↑5.4%	$12,437.2	$11,800.0
22	Royal Bank of Canada*	23	↑5.1%	$12,178.1	$11,589.8
23	Canadian Pacific Railway	20	↓-0.8%	$12,083.0	$12,181.0
24	Alberta - Public Service Pension Plan	24	↑9.1%	$11,886.6	$10,899.9
25	Régime de rentes du Mouvement Desjardins	25	↑7.6%	$11,431.4	$10,622.4
26	Régime de retraite du personnel d'encadrement	26	↑5.6%	$11,011.7	$10,426.8
27	Colleges of Applied Arts & Technology Pension Plan	28	↑9.3%	$9,388.2	$8,592.0
28	The Public Employees Pension Plan (Saskatchewan)	29	↑6.1%	$8,967.4	$8,451.0
29	Telus Corp. Pension Plan	27	↑2.7%	$8,873.0	$8,641.0
30	Royal Canadian Mounted Police Pension Plan	30	↑5.0%	$8,483.0	$8,076.0
31	City of Montreal[1]	45	↑37.4%	$7,900.6	$5,748.0
32	New Brunswick Public Service Shared Risk Plan Trust	31	↑4.4%	$7,215.4	$6,910.9
33	Nova Scotia Health Employees' Pension Plan	35	↑8.2%	$7,146.0	$6,603.5
34	The Civil Service Superannuation Board	32	↑2.8%	$7,090.0	$6,898.4
35	Healthcare Employees' Pension Plan (Manitoba)	37	↑7.7%	$6,956.0	$6,458.0
36	Hydro One	33	↑2.1%	$6,874.0	$6,731.0
37	Imperial Oil Ltd.	34	↑0.7%	$6,670.0	$6,625.0
38	Canadian Broadcasting Corp. Pension Plan	36	↑1.8%	$6,578.5	$6,464.9
39	The Winnipeg Civic Employees' Benefits Program	39	↑6.3%	$6,410.9	$6,033.5
40	Saskatchewan Healthcare Employees' Pension Plan	41	↑7.5%	$6,365.8	$5,922.2
41	Canadian Imperial Bank of Commerce	42	↑6.2%	$6,282.6	$5,918.1
42	Rio Tinto Alcan Inc.*	38	↑2.2%	$6,277.0	$6,143.0
43	Scotiabank Group Master Trust Fund	46	↑8.5%	$6,233.5	$5,742.8
44	Teachers' Retirement Allowances Fund Board (Manitoba)	40	↑4.1%	$6,196.0	$5,951.2
45	Toronto Transit Commission	43	↑5.6%	$6,135.8	$5,809.9
46	Newfoundland and Labrador Public Service Pension Plan Fund	47	↑8.2%	$6,128.9	$5,663.4
47	Bank of Montreal	44	↑4.0%	$6,014.0	$5,781.0
48	Labourers' Pension Fund of Central and Eastern Canada	50	↑10.5%	$5,966.7	$5,398.9
49	Nova Scotia Public Service Superannuation Fund	48	↑5.5%	$5,861.9	$5,557.7
50	Bombardier Trust (Canada)	49	↑6.0%	$5,744.5	$5,419.0
51	New Brunswick Teachers' Pension Plan	51	↑3.1%	$5,484.3	$5,320.1
52	ABRPPVM - Montreal Police Pension Fund	52	↑6.3%	$5,426.0	$5,105.0
53	Shell Canada Ltd.^	54	↑5.4%	$5,329.0	$5,056.0
54	Nav Canada	53	↑3.5%	$5,281.2	$5,103.4
55	Nova Scotia Teachers' Pension Fund	56	↑3.6%	$4,889.5	$4,717.5
56	Resolute FP Canada Inc	55	↓-1.4%	$4,824.0	$4,893.7
57	TD Bank Group - Pension Fund Society	57	↑3.4%	$4,789.0	$4,631.0
58	Saskatchewan Teachers' Retirement Plan	59	↑8.4%	$4,757.6	$4,390.2
59	Alberta - Management Employees Pension Plan	60	↑6.8%	$4,606.3	$4,314.3
60	Montreal Transit Corp.	58	↑3.6%	$4,595.0	$4,436.5
61	B.C. College Pension Fund	62	↑5.6%	$4,436.1	$4,202.3
62	University of Toronto	63	↑8.1%	$4,414.0	$4,081.5
63	Telecommunication Workers Pension Plan	61	↑0.8%	$4,317.7	$4,283.7
64	Enbridge Inc.*	89	↑6.5%	$4,280.0	$4,020.1
65	Suncor Energy Inc.	64	↑5.1%	$4,271.5	$4,064.6
66	Co-operative Superannuation Society Pension Plan*	65	↑0.1%	$4,254.9	$4,252.7
67	IBM Canada Ltd.	66	↑1.3%	$4,014.0	$3,964.0
68	University of Québec	68	↑7.4%	$3,900.5	$3,630.1
69	Pulp & Paper Industry Pension Plan	67	↑2.0%	$3,847.9	$3,771.8
70	National Bank of Canada	72	↑7.2%	$3,776.0	$3,521.0

TOP 100 PENSION FUNDS

Rank	Pension fund	Rank 2015	Change	2016 PA	2015 PA
71	UNIVERSITY OF MONTREAL*	69	2.9%	$3,737.9	$3,633.7
72	IWA-FOREST INDUSTRY PENSION PLAN	70	3.2%	$3,673.0	$3,557.6
73	B.C. HYDRO & POWER AUTHORITY PENSION FUND	74	4.2%	$3,379.5	$3,243.9
74	U. S. STEEL CANADA INC.^	78	5.4%	$3,234.3	$3,068.6
75	TRANSCANADA CORP.[2]	88	23.8%	$3,208.0	$2,591.0
76	PROVINCE OF NEWFOUNDLAND AND LABRADOR POOLED PENSION FUND	76	-1.7%	$3,146.9	$3,201.2
77	GLENCORE CANADA	75	-2.2%	$3,141.4	$3,211.0
78	MANULIFE FINANCIAL	86	15.9%	$3,037.0	$2,621.0
79	GREAT-WEST LIFE ASSURANCE CO.	79	0.5%	$3,034.0	$3,018.7
80	TECK RESOURCES LTD.*[3]	80	2.8%	$3,028.6	$2,945.9
81	CANADIAN UTILITIES LTD. PENSION PLAN	81	2.3%	$2,974.3	$2,907.8
82	LAVAL UNIVERSITY	82	3.6%	$2,958.6	$2,854.5
83	WORKPLACE SAFETY & INSURANCE BOARD EMPLOYEES PENSION PLAN*	83	6.5%	$2,937.0	$2,757.0
84	SYNCRUDE CANADA LTD.	87	8.5%	$2,833.0	$2,612.0
85	GEORGE WESTON LTD.	77	-9.0%	$2,804.6	$3,083.2
86	PROVINCE OF PRINCE EDWARD ISLAND	84	3.4%	$2,767.0	$2,675.1
87	PRATT & WHITNEY CANADA	85	3.5%	$2,717.4	$2,626.5
88	ALBERTA - SPECIAL FORCES PENSION PLAN	90	7.4%	$2,597.3	$2,417.6
89	MTS INC.*	106	-2.8%	$2,575.5	$2,649.7
90	ARCELORMITTAL DOFASCO	92	7.4%	$2,354.0	$2,192.8
91	YORK UNIVERSITY	93	7.0%	$2,316.8	$2,165.0
92	SASKATCHEWAN MUNICIPAL EMPLOYEES' PENSION PLAN	95	9.3%	$2,285.4	$2,091.4
93	CANADIAN COMMERCIAL WORKERS INDUSTRY PENSION PLAN	94	5.7%	$2,276.8	$2,153.8
94	VIA RAIL CANADA INC.	91	1.9%	$2,245.3	$2,204.3
95	SUN LIFE ASSURANCE CO. OF CANADA	96	8.1%	$2,244.4	$2,075.9
96	RÉGIMES DE RETRAITE DE LA VILLE DE QUÉBEC[4]	98	5.3%	$2,151.6	$2,043.3
97	UNIVERSITY OF BRITISH COLUMBIA FACULTY PENSION PLAN	100	6.5%	$2,139.0	$2,009.2
98	RÉGIME DE RETRAITE DU PERSONNEL DES CPE ET DES GARDERIES PRIVÉES CONVENTIONNÉES DU QUÉBEC	103	14.5%	$2,134.0	$1,863.8
99	UNITED FOOD AND COMMERCIAL WORKERS UNION PENSION PLAN	97	3.0%	$2,122.4	$2,061.0
100	SOBEYS INC.	104	13.0%	$2,087.0	$1,846.3

2016 TOP 100 TOTAL:	$1,239,569.5
2015 TOP 100 TOTAL:	$1,176,497.7
VARIANCE:	5.4%

Notes: *2015 figure has been restated. ^ General Motors, Shell Canada and U.S. Steel Canada declined to participate this year. Their totals were calculated using the average growth across the top 97 pension funds in 2016. **1.** The increase is due to a number of district pension plans transferring to the City of Montreal. **2.** The increase is due to TransCanada's acquisition of Columbia Pipeline Group in 2016. **3.** Cominco Pension Fund Co-ordinating Society, ranked at No. 80 last year, was incorporated into Teck Resources Ltd. **4.** Fiducie globale des régimes de retraite de la Ville de Québec has been renamed as it no longer has a global trust.

Source: Figures in the report are based on the top 100 plans participating in the 2017 Canadian Institutional Investment Network pension fund survey or annual reports. *Benefits Canada* assumes no responsibility for the accuracy of the data provided. All totals are subject to +/- variance due to rounding. If you would like to participate in future surveys, contact CIIN at soo.kim@tc.tc or 416-847-5119.

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