UTfA
UNIVERSITY OF TORONTO *faculty* ASSOCIATION

Pensions

Newsletter #2 for UTFA Members

The University Pension Plan (UPP): understanding the risks of moving to a Jointly Sponsored Pension Plan (JSPP)

The creation of the UPP represents a unique, once-in-a-generation opportunity to sustain the defined benefit pension system within the Ontario university sector. This change enables us to maintain a defined benefit pension plan while providing relief for the complex issues that exist under the current model – not only for our current plan members, but for the generations that follow.

Understanding *risk*

Every type of pension plan – whether defined benefit, defined contribution or target benefit – is inherently risky. The risk is both *financial*, and *longevity-related*: you are setting aside money *today* to be used in the future, and to be available for a length of time that depends entirely on how long you will live.

The issue then isn't the risk itself; it's the way the risk is managed and shared.

Jointly sponsored pension plans (JSPPs) carry the same risk as single-employer pension plans, or any other retirement income savings scheme. However, the risk is managed differently.

Managing risk within a retirement income savings program

Both longevity and financial risk are more easily managed when both the plan membership and financial base are large.

A JSPP in the university sector will be significantly larger than any single-employer plan. With respect to longevity risk management, a JSPP inherently includes a larger pool of plan members across whom the risk is spread through a graduated distribution of imminent retirements, in turn contributing to the management of financial risk. Furthermore, a larger asset base enables investment opportunities not otherwise available to smaller plans.

How risk is shared upon conversion to a JSPP

Upon conversion to the JSPP, the university will remain responsible for the current unfunded liabilities of the U of T pension plan, and for risks associated with years of service prior to the inception of the JSPP.

At its inception (sometime in 2020, should the UPP be implemented), the UPP would begin life as a fully funded plan. The U of T will be solely responsible for paying down the historical debt that exists, as permitted under pension law.

The unfunded liability will be paid off by the University over a maximum of 15 years in payments that will continue even if the JSPP is in a surplus position. For the first 10 years of the JSPP, employers still bear all the risk, although the joint governance model will be in place and operational. For the 10 years that follow, the risk sharing begins and will gradually grow to an equal risk-sharing position.

Therefore, after 20 years, the JSPP risks are equally shared between employers and plan members.

More about Joint Governance

Joint governance is being touted as a key reason to embrace the change to a JSPP in the form of the UPP. And with good reason. University administrations, faculty associations, and the unions will have an equal say in plan design, funding, and administration.

Only the JSPP model would give faculty association members a strong voice in pension governance. This model offers greater transparency into plan operations, funding, and decision-making through its joint governance and open information-sharing.

There is also clear and explicit sharing of risk between employers and plan members. It is not a sharing of risk in terms of the individual plan member, but rather risk is shared through the joint nature of the decision-making related to risk management. If there are surplus assets in the JSPP, we will have a say in how they are used. Similarly, if there is a shortfall, we will have to participate in any necessary corrective action to address it.

How sharing risk supports effective risk management

Within a JSPP, the sharing of risk is transparent. Within a single-employer sponsored plan, the risk sharing is determined unilaterally by the employer.

Because of this unilateral ability to manage the risk, employers are shifting their risk responsibilities to plan members, through the conversion of public sector employees' pension plans to defined contribution savings arrangements. Under these new arrangements the risk is borne by the plan member who becomes responsible for ensuring adequate contribution levels, for the investment risk (too conservative versus too aggressive), and for the ongoing investment management in retirement.

Why the trend? Employers, while legally responsible for funding and bearing the pension plan risk, are experiencing legitimate funding challenges. Case in point: plan members may remember the impact to *other* university operations, such as department budgets, when the U of T experienced pension plan funding issues from 2005 through 2010.

Canada's largest banks have similarly participated in the trend, replacing their defined benefit pension arrangements with defined contribution plans for all new hires.

This trend has contributed to the ongoing decline in defined benefit pension plan coverage in the private sector. The contrast between the pension worlds of the public and private sectors has made public sector workers' pensions vulnerable to the political consequences of what has been labelled "pension envy".

In this environment, it is not at all clear that a single-employer sponsored defined benefit plan (like the current U of T pension plan) is really as secure as it is made out to be. The alternative to risk *sharing* through a JSPP may turn out to be complete risk *shifting* from the employer to plan members.

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Leaving the abstract and theoretical to probe the details of proven success stories

We can look at how Ontario's large, jointly sponsored defined benefit pension plans have performed over an extended period covering at least three significant adverse events in financial markets. These large plans — Teachers', OMERS, HOOPP, CAAT and OPTrust — have been successful in managing these risks and are known and respected around the world for having done so.

Yes, there are risks in a transition to a JSPP. However, the risks of *not* transitioning to a JSPP may be greater.