IT'S TIME TO MAKE A **NEW YEAR'S RESOLUTION** FOR YOUR **DEFINED BENEFIT PENSION PLAN**

Canadians are living longer – which is a good thing. They can spend more time with loved ones and do the things they enjoy. Even better, many Canadians are sticking to their New Year's resolutions to stay in shape! Living longer may also mean receiving pension payments for longer. Are Canadian Defined Benefit (DB) plans ready for the heavy lifting?

The last few years have been a real struggle for DB plans. Falling interest rates, volatile stock markets and increasing life expectancies have made keeping a DB plan in good shape an uphill battle.

According to Statistics Canada, Canadians are already living about 20 years past age 65 and this is increasing. Most Canadian pension plans are relying on life expectancy tables that were developed close to 20 years ago, so they may be underestimating the life expectancies of their plan members and consequently, their liabilities. The exact cost of underestimating life expectancy will depend on the plan's characteristics. A simple rule of thumb is that an additional year of life expectancy for a 65-year-old results in a three per cent to four per cent increase in pension liabilities.

The good news is that there are several solutions available in Canada to help plan sponsors manage longevity risk.

THE FITNESS OPTIONS: **CANADIAN LONGEVITY DE-RISKING SOLUTIONS**

Longevity insurance	Insurance against the possibility that plan members live longer than expected, with the insurer covering the resulting extra cost of additional pension payments.
Annuities	An insurance contract that transfers all the risks, including longevity risk, to an insurer's balance sheet. Annuity buy-outs can be used to transfer all risks and all administration to an insurer. Annuity buy-ins can be used to increase flexibility for plan sponsors. An annuity buy-in is an investment of the plan that requires no additional cash contribution and triggers no accounting settlement.[1] It is also invisible to plan members.
Plan design changes	Changes to future benefits or cost sharing arrangements, for all members or new members only.

[1] Plan sponsors should confirm the need for an accounting settlement with their own auditors.

LEARNING FROM THE EXPERTS

U.K. plan sponsors have had their de-risking programs in place for many years. Since 2006, over £40 billion of U.K. DB pension liabilities have been transferred to insurance companies, including 12 longevity risk deals covering over £14 billon of liabilities.

Plan sponsors in North America are starting to get their plans in shape. In 2011, a record CA$1.4 billion of pension liabilities were transferred to Canadian insurers. In 2012, General Motors and Verizon announced jumbo annuity deals to help manage their pension risk.

Demand for de-risking solutions is increasing and there may be a first-mover advantage for plan sponsors who get on the treadmill quickly.

THE EVIDENCE FOR GETTING IN SHAPE

Hidden longevity costs can be a heavy weight

Longevity risk can have material financial consequences. This hidden longevity cost could be especially large for a pension plan with a high proportion of young members or female members, perhaps as much as five per cent to 10 per cent of liabilities.

Getting in shape is becoming more affordable

Recent research has shown that an annuity can provide a higher rate of return than a matching bond portfolio. This means that the longevity and investment risk protection provided by annuities can be free.

De-risking can improve corporate "muscle"

Research from Kelvin Wilson at Grant Thornton UK LLP ("DB pension plan de-risking," 2011) found empirical evidence that U.K. companies that have de-risked their pension plans enjoyed an average increase of more than 10 per cent in their share price. Why? Because removing pension risk reduces future earnings volatility and allows management to concentrate on their core business.

CREATE A DB FITNESS PLAN

Resolve to take some key steps to get your DB plan in shape:

- Educate key stakeholders and decision makers.
- Understand the characteristics of your plan that will impact the life expectancy of members.
- Contact a pension consultant to help evaluate available solutions.
- Contact an insurer to get a free illustrative quote showing the cost of risk transfer.

The path to fitness begins with a solid plan. Make a New Year's resolution for your DB plan now and get in shape for the future.

ABOUT THE AUTHOR

Heather Wolfe is a Canadian and U.K. actuary who joined Sun Life after working as a pension consultant and a plan sponsor. Heather and her team work with plan sponsors and consultants to provide a wide array of customized de-risking solutions for defined benefit pension plans.

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