

## Low interest rates challenge for funds

# Pension plans focus on de-risking

BY JIM MIDDLEMISS  
For Law Times

Ask Hugh O'Reilly, CEO of the \$18.4-billion OPTrust pension plan, what keeps him awake at night and the former Cavalluzzo Shilton McIntyre Cornish LLP lawyer doesn't hesitate. "I worry about the retirement income security of 87,000 people and their families.

"What keeps me up at night is making sure we work to maintain the funded status of our plan," he says.

O'Reilly joined OPTrust in January 2015, after a distinguished career as head of Cavalluzzo's pension benefits and insolvency practice.

The OPTrust is responsible for administering the pension plans for the Ontario Public Service Employees Union, one of the country's biggest pension plans.

"It's a great opportunity," he says of running a pension fund.

"People underestimate the ability of lawyers to manage. There is an assumption that CEOs need to be people who come out of the C-suite and corporate environment."

However, he says, lawyers are natural managers. Not only do they manage teams but also "lawyers manage issues."

One of the biggest issues pension lawyers and their clients face these days is de-risking the defined benefit plans that they oversee and advise on.

"Low interest rates are a challenge for pension funds," O'Reilly explains.

He says he was fortunate to inherit a plan that was in surplus; however, keeping it funded in a low-interest-rate environment is challenging.

That's why O'Reilly's attention is focused on de-risking, and he's not alone. De-risking is at the forefront of most pension plan agendas, putting pension lawyers at the focal point of advising their clients on risk reduction strategies.

Take Hugh Kerr, vice-president and associate general counsel of Sun Life Assurance Company of Canada. He's been breaking ground in Canada recently with two high-profile pension risk transfer transactions.

In 2015, he was involved in North America's first longevity insurance agreement, which transferred \$5 billion of pension risk from BCE Inc.'s defined benefit plan to Sun Life.

Under the agreement, the Bell Canada pension plan pays monthly premiums to Sun Life, which then makes monthly pension payments into the plan for the lifetime of existing pensioners.

The second deal involved a \$530-million group annuity plan. Two different infla-



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tion-linked pension plans approached Sun Life separately looking to reduce their risk.

They had almost offset index formulae, which allowed Sun Life to treat the plans as one and structure an annuity deal to take on the risk.

It's believed to be the largest inflation-linked transaction done in Canada.

Kerr, whose role is to advise the retirement services and benefit groups at Sun Life, says it takes time and effort to put together a longevity deal or to find matching plans where risk can be offset.

"I think longevity insurance will find a market," Kerr says. What these deals do, he explains, is "make the existing plans more sustainable" and "make the risk more manageable."

When it comes to de-risking pension plans, lawyers say there is no single approach.

"De-risking means a bunch of different things," says Mary Picard, a pensions lawyer at Dentons LLP in Toronto.

The Sun Life deals, for example, involved using insurance contracts to counteract volatility and risk.

But there are many ways to skin a cat.

For example, Susan Seller, head of the national pension and benefit practice at Bennett Jones LLP in Toronto, says, "Sometimes, at the end of the day, it means winding up the fund or the plan.

"It's the ultimate form of de-risking," which "more clients are looking at and thinking about," Seller adds, particularly for those with plans linked to Consumer Price Index increases.

"It's always a big concern how they are going to deal with that," she says.

Seller says the focus on de-risking means that pension lawyers are busy advising clients on different strategies. She has a five-prong approach. She

says plans need to ensure access to the appropriate financial information and make sure it's current, establish a "prudent" and "well-managed" investment policy that includes asset and liability matching, establish an effective governance structure, seek expert advice where needed and conduct due diligence and follow a prudent process for decision-making.

Picard says she is seeing much more attention being paid to plan governance and investment policies in a low-interest environment.

"When interest rates decrease, horror ensues," she says, noting that plan sponsors fear a return to the days when they were only 60 to 70 per cent funded.

Funding status has improved considerably since the financial crises, according to reports on defined benefit plans from the Financial Services Commission of Ontario.

In its 2015 report, FSCO found that funding ratios both on a going-concern basis and an insolvency basis had im-

proved. Only 31 per cent of DB plans FSCO oversees were less than fully funded on a going-concern basis, versus 36 per cent last year.

That's a significant improvement from 2010, following the financial crisis, when 45% of plans were less than fully funded on a going-concern basis, and funding status was declining.

The task for lawyers then was seeking funding relief for their clients from pension regulators. That has lessened.

While things have improved, the decline of defined benefit plans continues to worry.

The number of DBP dropped to 1,283 in the latest reporting period from 1,506 in 2010, a decline of almost 20 per cent, as risk-averse employers eye alternatives.

Picard says another element to de-risking that is taking on greater prominence as stock markets hit record highs in the U.S. is investment risk.

"Pension plans are shifting from riskier equity classes to more conservative fixed-income

classes that attempt to match the liabilities of the pension plan," she says.

That reflects a shift in thinking among plans, suggests OPTrust's O'Reilly.

"We no longer see ourselves as asset allocators, we see ourselves as risk allocators. We don't see ourselves as investment managers... our job is to deliver pensions," he says.

That's a challenge in a low-interest rate environment, he says, because the "cost of de-risking is expensive."

The annuity market, he says, becomes "much more expensive and much more complicated."

With no signs of interest rates rising, and employees living longer, O'Reilly says he expects that some plans will struggle.

The solution? He suggests there will be more consolidation among plans.

"We're interested in pension plans that want to merge with us. We believe it's very important for pension plans to work together... and not be competitors to one another," he says. **LT**

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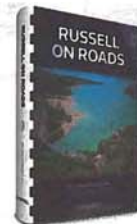
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