

HEALTH WEALTH CAREER

FEI CANADA

MITIGATING RISKS AND MANAGING COSTS OF EMPLOYEE BENEFIT PROGRAMS

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Vancouver

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AGENDA

- What is risk?
- Retirement plan risk
- Benefit plan risk
- Q&A

ARE YOUR PENSION RISKS BEING MANAGED?



PLAN SPONSORS AND FEI MEMBERS:

“HOW DO I PROVIDE A
MEANINGFUL PENSION TO
MY EMPLOYEES WHILE KEEPING
MY COSTS UNDER CONTROL
AND MANAGING FINANCIAL
AND LEGAL RISKS?”

*White paper published by the pension
committee of FEI Canada's policy
forum (April, 2015)*

INTRODUCTION – RETIREMENT SAVINGS PLANS

SET
ASSETS
ASIDE



EARN
INVESTMENT
INCOME ON
ASSETS



USE
ACCUMULATED
ASSETS TO
PROVIDE
RETIREMENT
INCOME



**THE GOAL OF
RETIREMENT
SAVINGS**



TRADITIONAL RETIREMENT PLAN STRUCTURES

DEFINED BENEFIT (DB) PLAN

Provides a guaranteed retirement income determined by a formula based on years of service and actual earnings (salary based plan) or a retirement income based on a flat rate per year of service (a flat benefit plan).

CAPITAL ACCUMULATION PLAN (CAP)

Includes Defined Contribution Pension Plans and Group RRSPs.

Provides contributions to plan member accounts. The amount a retiree will receive will vary based on the amount contributed and the performance of the invested funds over time.

KEY PENSION RISKS

Key pension risks	Who bears the risk?		Comments
	DB Plan	CAP	
Investment & interest rate risk – affects amount of assets and funding	Er	Ee	<ul style="list-style-type: none"> DB – poor returns and lower interest rates can create deficits and increase funding costs for Employer CAP – Employees make investment decisions and bear risk of insufficient savings at retirement
Fiduciary risk – duty of care, loyalty, and prudence (aka Legal risk)	Er	Er	<ul style="list-style-type: none"> CAP arguably greater risk than DB since employee retirement income dependent on member decisions based on info provided by employer and vendors; risk of class action by members of CAP and DB
Longevity risk – financial impact of people living longer than assumed	Er	Ee	<ul style="list-style-type: none"> DB – Employer bears risk of people living longer and funding additional costs CAP – Member bears risk of outliving his or her savings during retirement
Er = Employer		Ee = Employee	

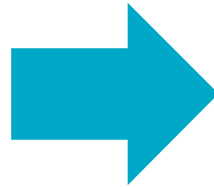
Source: “Are your pension risks being managed”, FEI Canada Policy Forum, April 2015

A DC WORLD

WHAT DOES THE GLOBAL PENSIONS ENVIRONMENT LOOK LIKE?



DRIVE TO
REDUCE
DB RISK



GROWTH
IN DC



FACTS AND FIGURES

- DC has become a dominant method of pension provision.
- Will continue to grow at 7.9% pa* globally as DB and State pensions decline.

*SOURCE: Spence Johnson

CAPITAL ACCUMULATION PLANS

DEFINING THE ISSUES: RETIREMENT READINESS

CAP members who contribute at a level to receive the max employer contribution*

19%

Sun Life estimates that Canadians are missing out on as much as

\$3Billion

in company matched CAPs**

Employers paying out just

40-50%

of available matching funds**

* *Benefits Canada 2014 CAP Member Survey*

** *Postmedia December 3, 2014*

CAP PARTICIPANTS HAVE HIGH INVESTMENT RETURN EXPECTATIONS

17.8%

Average long term expected return of CAP participants*

10 Yr. Annualized Performance to Dec. 31, 2014	
FTSE TMX Canada Universe Bond	5.3%
S&P/TSX Composite	7.6%
S&P 500 CAD	7.3%
MSCI EAFE CAD	4.6%
MSCI World CAD	6.2%

* *Benefits Canada 2014 CAP Member Survey*

INDUSTRY ENVIRONMENT – MERCER'S VIEW



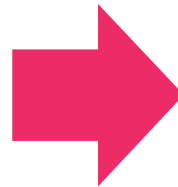
- **CAPs are becoming the retirement vehicle of choice in many countries.**
 - As CAP assets grow, forward-thinking companies are starting to recognize the impact these plans can have on their business.
 - Inadequate CAPs and poor governance leave businesses exposed to significant financial, operational and reputational risks.

CAPITAL ACCUMULATION PLANS ONGOING RISK MANAGEMENT

RISKS SHOULD BE ASSESSED RELATIVE TO OBJECTIVES, BUT OBJECTIVES ARE OFTEN UNCLEAR AND MEMBER AND SPONSOR OBJECTIVES MAY NOT ALIGN.

MEMBER OBJECTIVES

1. Adequate benefits at retirement
2. Market competitive contributions
3. Simplicity
4. Flexibility



TOP THREE REASONS GLOBALLY FOR ESTABLISHING DC PLANS* ARE TO:

1. Remain competitive in terms of **attracting** and **retaining** employees **(76%)**
2. Encourage employee responsibility **(56%)**
3. Provide adequate benefits at retirement **(53%)**

Others: Avoid litigation!

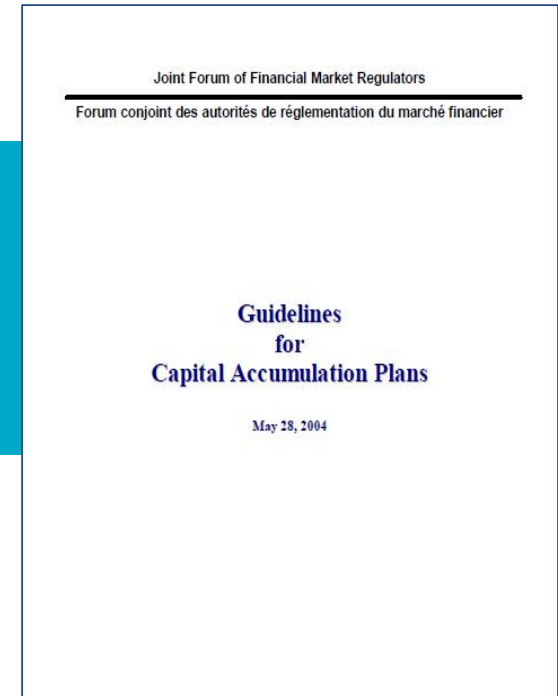
**Mercer Global DC Survey*

CAP GUIDELINES WHAT ARE THEY?

THE JOINT FORUM OF FINANCIAL MARKET REGULATORS RELEASED THE CAP GUIDELINES – MAY 2004

PURPOSE: To establish clear common standards and expectations of Canadian defined contribution pension and savings plans:

- In the event of litigation related to CAPs, the courts will look to CAP Guidelines to determine expectations of plan sponsors (not legislated).
- CAPSA expects that all CAPs will operate in accordance with the guidelines.



CAP GUIDELINES

WHAT DO THEY SAY?

- Guidelines underscore that **key responsibilities** of a plan sponsor go beyond setting up the CAP and include:
 - Selection of investment options (must be consistent with CAP purpose).
 - Providing initial and ongoing investment education and decision making support to CAP members.
 - **Monitoring of investment options** at least annually from both a quantitative and qualitative perspective.
 - **Monitoring of plan providers**, such as record keeper and investment advice providers.
- Most functions can be delegated, where reasonable and prudent.
 - Responsibility cannot be delegated.

NEW PENSION REGULATIONS IN WESTERN CANADA



WHEN PENSION PLANS FAIL TO DELIVER ON
THEIR PENSION PROMISE, POOR GOVERNANCE
IS OFTEN THE ROOT CAUSE.

(JEPPS Report: Pension Reform in Alberta and British Columbia)

- Both BC and Alberta have introduced the requirement for formal governance policies and regular self-assessment.
- Objective is to promote good governance, risk management and administrative practices.

CAP GOVERNANCE OVERVIEW

WHY DO COMPANIES CARE?

1. Avoid taking on unnecessary risk/liability

- Financial exposure is large
- Potential for error is constant
- Employees bear the investment risk
- Changes in market and demographic conditions
- Increase in pension litigation
- CAPSA, PIAC, ACPM and Joint Forum – Guidelines, Principles and Self-Assessment for governance and Guidelines for CAPs

2. To provide the intended benefit or promise

- Bolster employment relationships
- Enhance shareholder value
- Right thing to do

3. Need to fulfil obligation as fiduciaries

FIDUCIARY RESPONSIBILITY

COMMON LAW FIDUCIARY OBLIGATION

- A fiduciary obligation carries with it a duty of skill and competence and a duty of loyalty.
 - *Supreme Court of Canada*
- Under common law, a sponsor of the plan must:
 - “Exercise the care, diligence and skill in the administration and selection of investment options for the plan assets fund that a person of ordinary prudence would exercise in dealing with the property of another person”.
- Use any special skills you possess internally and seek outside expertise where it does not exist internally.
- The performance of a fiduciary duty requires due diligence (i.e. not perfection).

WHAT IS DUE DILIGENCE?


- Due Diligence is important:
 - A Fiduciary should be in a position to demonstrate that all decisions are made prudently (i.e. based on appropriate and adequate research and/or advice).
 - Reasonable steps have been taken before a decision is made.
 - Rationale for all decisions should be documented.
- Due Diligence includes:
 - Obtaining advice where needed.
 - Generally following industry standards.
 - Delegating, appointing and monitoring.




MITIGATING RISKS IN CAPS



EXAMPLES OF POSSIBLE CHALLENGES FROM PLAN MEMBERS:

 Inappropriate/inadequate investment options offered to plan members

 Uncompetitive/inappropriate fees

 Insufficient/inaccurate information provided to plan members

 Improper delegation to service providers

 Improper investment advice or decision making tools

 Conflicts of interest

MITIGATING RISKS IN CAPS

ROUTINELY MONITOR:



INVESTMENT PERFORMANCE

Are the investments performing?



INVESTMENT FEES

Benchmark to similar-sized plans



MEMBER INVESTMENT OBJECTIVES

Are members on track?



INVESTMENT PLAN TRENDS

Are there any red flags?

MITIGATING RISKS IN CAPS PLAN FEES



- As little as 20 basis points (0.2%) in excess fees can reduce the payout of retirement benefits by as much as \$300,000 over an employee's lifetime.*
- Participants want to ensure that the growth of their account balances is not subject to "hidden" or uncompetitive fees.
- In the US, DC plan fees are the target of intense scrutiny from legislators, regulators and litigators, and lawsuits continue to grab the headlines.

**DC Fee Management – Mitigating Fiduciary Risk and Maximizing Performance, Mercer 2013.*

POP QUIZ – TRUE OR FALSE

IN FEBRUARY 2015 LOCKHEED MARTIN CORP SETTLED A LAWSUIT FOR THE MISMANAGEMENT OF THEIR US 401K RETIREMENT PLAN. HOW MUCH DID LOCKHEED MARTIN PAY AS A RESULT OF THE SETTLEMENT?

- a) \$2,000,000
- b) \$12,000,000
- c) \$32,000,000
- d) \$62,000,000

ANSWER:

\$62,000,000. EMPLOYEES ARGUED THAT EXCESSIVE FEES WERE IMPOSED ON PLAN PARTICIPANTS WHICH ULTIMATELY REDUCED RETURNS.



MITIGATING RISKS IN CAPS FEE BENCHMARKING



SAMPLE GROUP	Plan Demographics			Total Plan Summary		
	Total Assets	Unique Members	Total Assets per Unique Member	Total Fees per Unique Member	Estimated Total Recordkeeping Fee per Unique Member	Estimated Fees charged by Investment Manager per unique member
Lower Quartile Plan	\$16,021,947	681	\$23,527	\$121.06	\$30.79	\$90.27
Average Plans	\$13,359,270	625	\$20,826	\$131.95	\$48.62	\$83.33
Median Plan	\$9,193,274	564	\$16,300	\$124.32	\$59.05	\$65.27
Upper Quartile Plan	\$10,377,173	470	\$22,079	\$165.20	\$77.78	\$87.43

	Fee per Member	# of Members	Total Assets (proj.)	Assets (proj.) per member	Fees per member (bps)
ABC Plan	\$189	730	\$12,559,220	\$17,204	110
Average	\$132	625	\$13,359,270	\$20,826	63

MITIGATING RISKS IN CAPS MONITORING INVESTMENTS



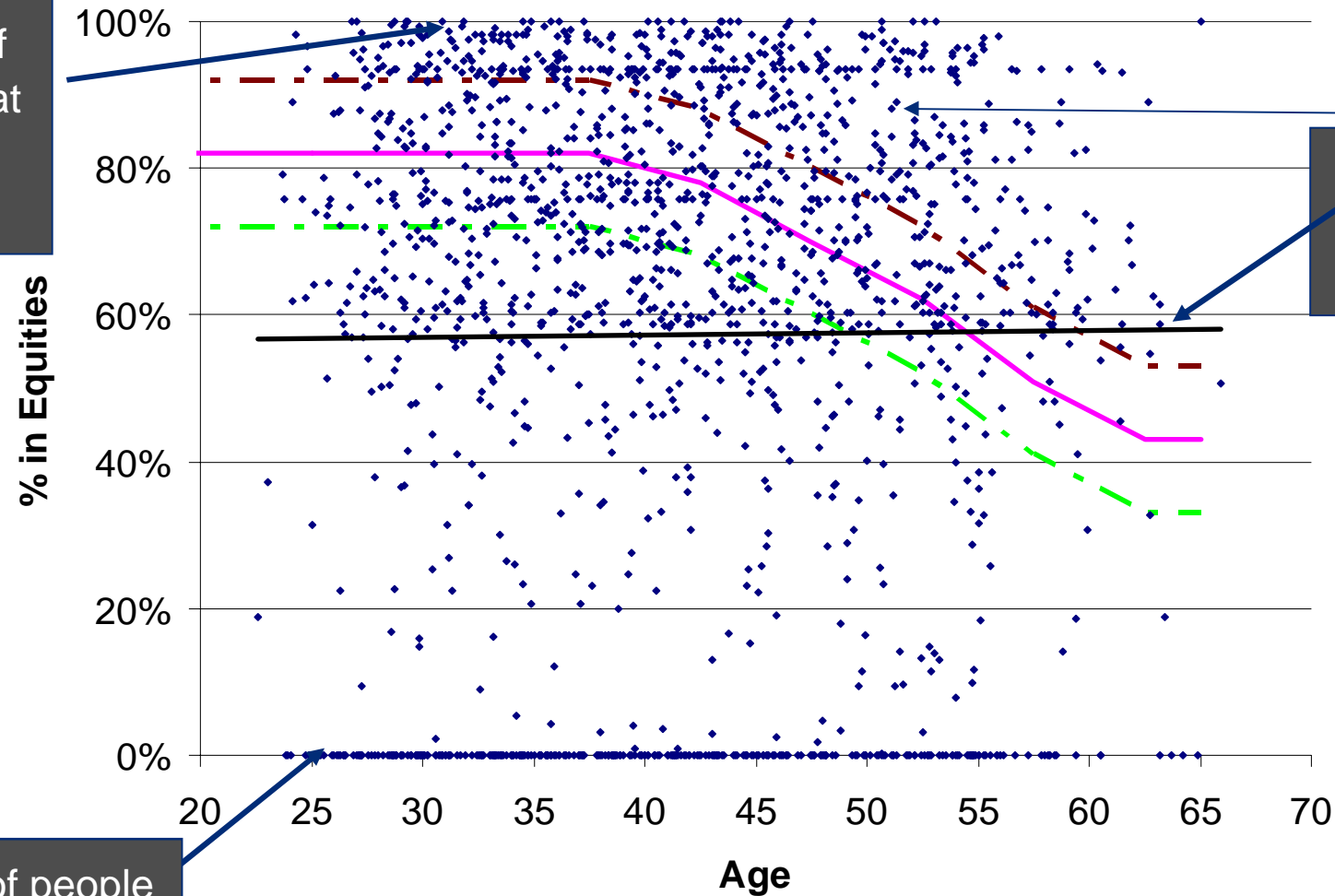
**Return in \$C (before fees) over 1 yr and 4 yrs ending June-15
Comparison with the Pooled - Canadian Balanced (PFS) universe
(Percentile Ranking)**

	1 yr (%)	4 yrs (%pa)
Percentiles from the Mercer Universe		
5th Percentile	11.45	10.98
Upper Quartile	9.91	10.20
Median	8.51	9.48
Lower Quartile	7.23	9.03
95th Percentile	4.54	8.31
Number of Funds	42	41

ARE MEMBERS INVESTING WELL? DO THESE MEMBERS' ASSET ALLOCATIONS LOOK RIGHT?



2.0% of people at 100% equity



Gradient is now marginally upward sloping

19.8% of people at 0% equity

- ◆ Member Asset Allocation
- Maximum (Benchmark + 10%)
- Linear regression of Individual Asset Allocation
- Benchmark Asset Allocation
- Minimum (Benchmark - 10%)

MITIGATING RISKS IN CAPS PLAN ADMINISTRATION ERRORS

CASE STUDY #1 – INCORRECT CONTRIBUTIONS

The Error:

- A significant deviation in annual contributions for a particular class of employees was discovered
- Contributions were being allocated to the incorrect class

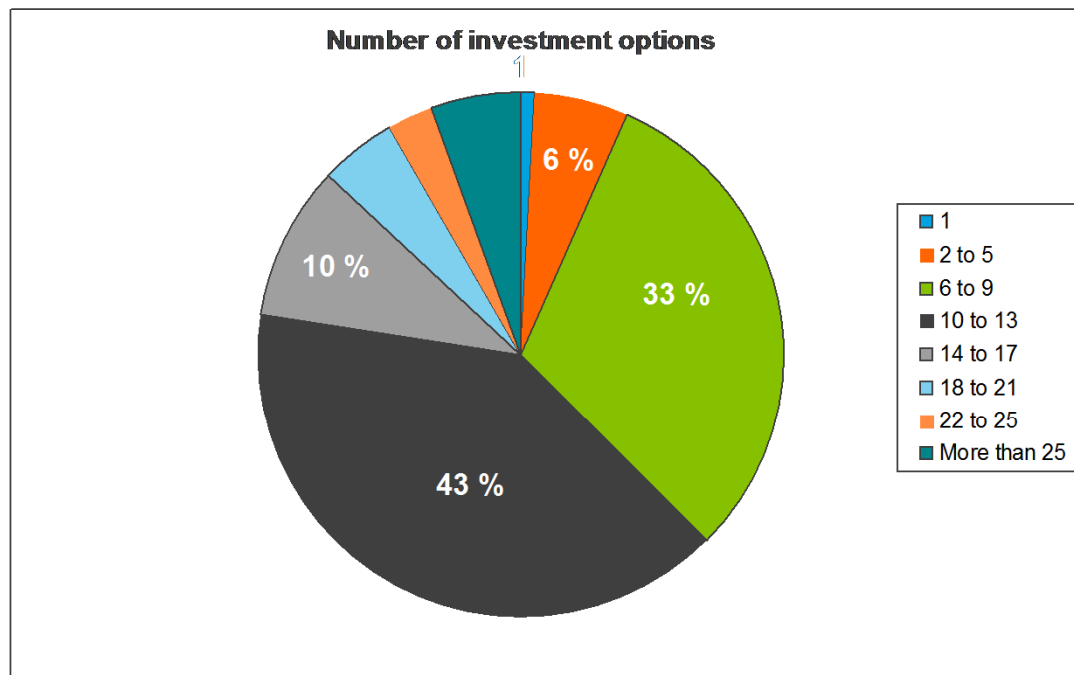
The Solution:

- The error was caught during a routine annual review and before the tax year had changed

MITIGATING RISKS IN CAPS PLAN ADMINISTRATION ERRORS

CASE STUDY #2 – INCORRECT INVESTMENTS

DC plans in place for less than 5 years¹



¹ Mercer's
Global Defined
Contribution Survey

- About 3/4 offer between 6 and 13 investment options and 40% offer less than 10.
- About 20% offer more than 13 options (only 7% offering 17 options or more).

MITIGATING RISKS IN CAPS PLAN ADMINISTRATION ERRORS

CASE STUDY #2 – INCORRECT INVESTMENTS

	Ideal Target Date Fund	Income	2020	2025	2030	2035	2040	2045	2050	Total	Possible Mismatched Target Date Funds
Under 35	2050						32		1	33	32
35 - 44	2040					13	43		1	57	1
45 - 54	2030	1		13	37	18	1		1	71	3
55+	2020	3	17	20						40	3
Total		4	17	33	37	31	76		3	201	39

MITIGATING RISKS IN CAPS

THE VALUE OF ANALYTICS

- Important to understand how members are using the investment options available to them.
 - There is always the very real possibility that some members may be confused about the options available to them and how they work.
- Ongoing monitoring and communication are critical to managing all aspects of Capital Accumulation Plan risk.

MITIGATING RISKS IN CAPS

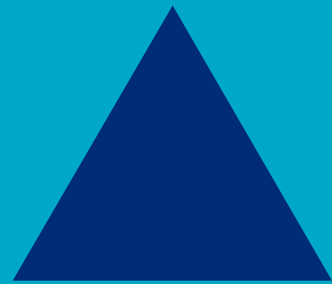
COMMON MISTAKES AND RED FLAGS

- Reliance on record keeper for compliance
 - Who is reviewing the record keeper?
- Fees that have not been looked at for years
- Investment line-ups that have not been reviewed
- Investment policies not in place
- Investment policies not annually reviewed
- Do not meet own governance requirements
- “Small plan” oversight applied to what is now a “large plan”

**SIPPs are a
best practice**

MANAGING RISK

WHAT ABOUT EMPLOYEE BENEFITS



RISK PERSPECTIVES

BENEFIT PLANS

- Risks are larger; consequences more material
- Insurers are accepting less risk
- Low level of due diligence and oversight
- Risk of litigation and arbitration: adjudication decisions
- Social media significant implications for employment brands
- Increased cost of getting it wrong

Financial, legal, and reputation risks



RISK PERSPECTIVES

AREAS OF RISK



EXAMPLES OF SOME AREAS OF RISK IN YOUR BENEFITS PLAN



Underwriting / financial arrangements



Promises you cannot keep



Uncompetitive/inappropriate fees and plan costs



Inaccurate information provided to plan members

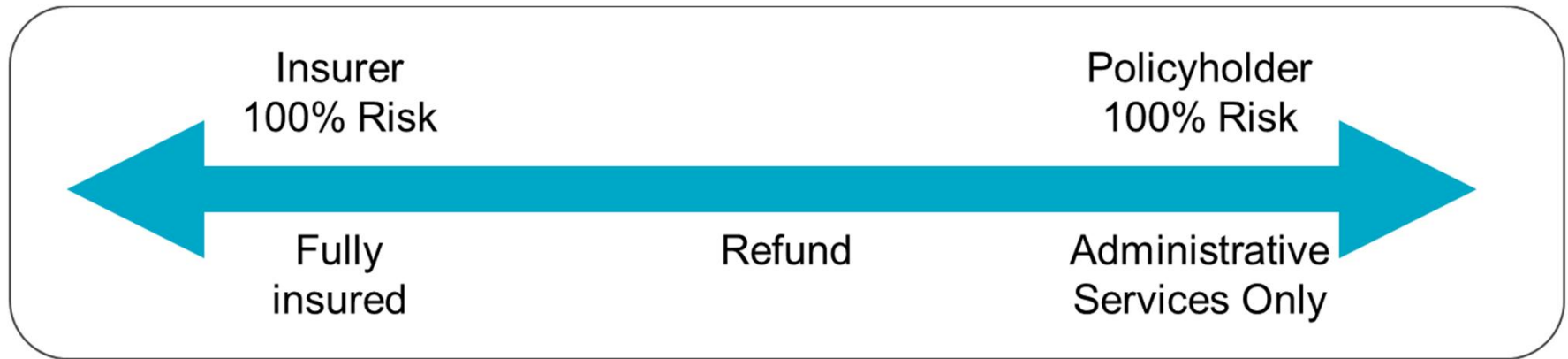


High and unanticipated costs



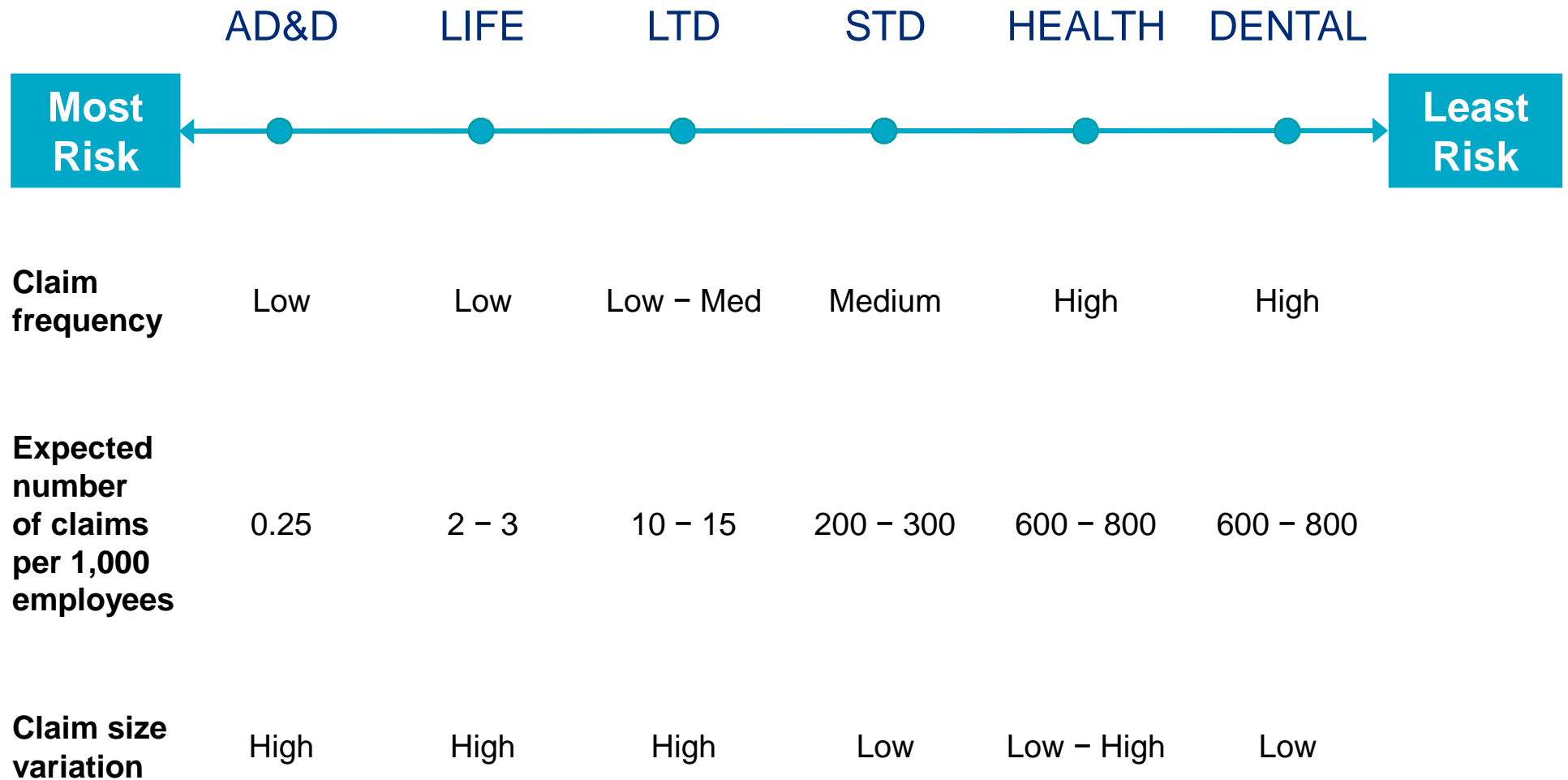
Administrative errors

RISK PERSPECTIVE REVIEW OF FUNDING ARRANGEMENTS

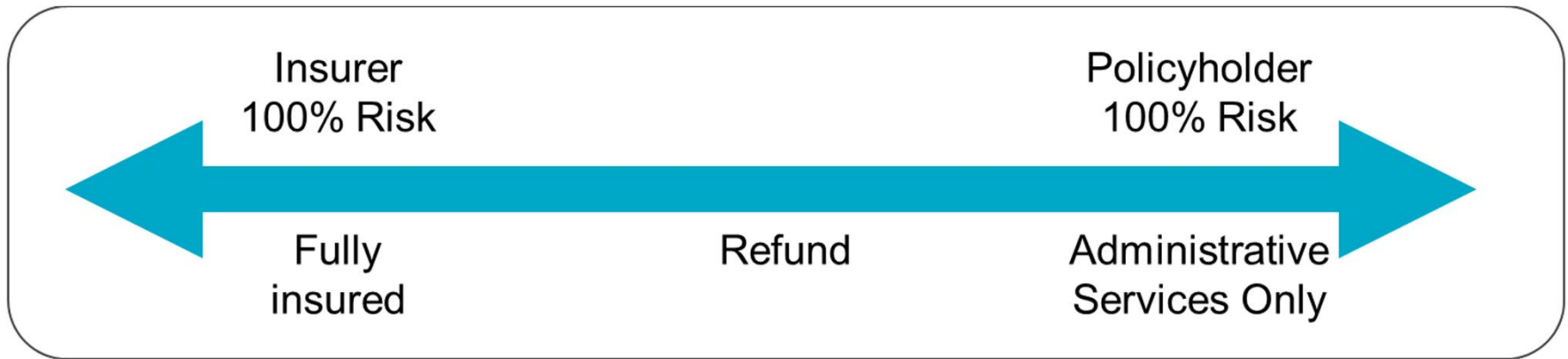


TYPES OF UNDERWRITING ARRANGEMENTS

A REVIEW OF RISK FACTORS



RISK PERSPECTIVE REVIEW OF FUNDING ARRANGEMENTS



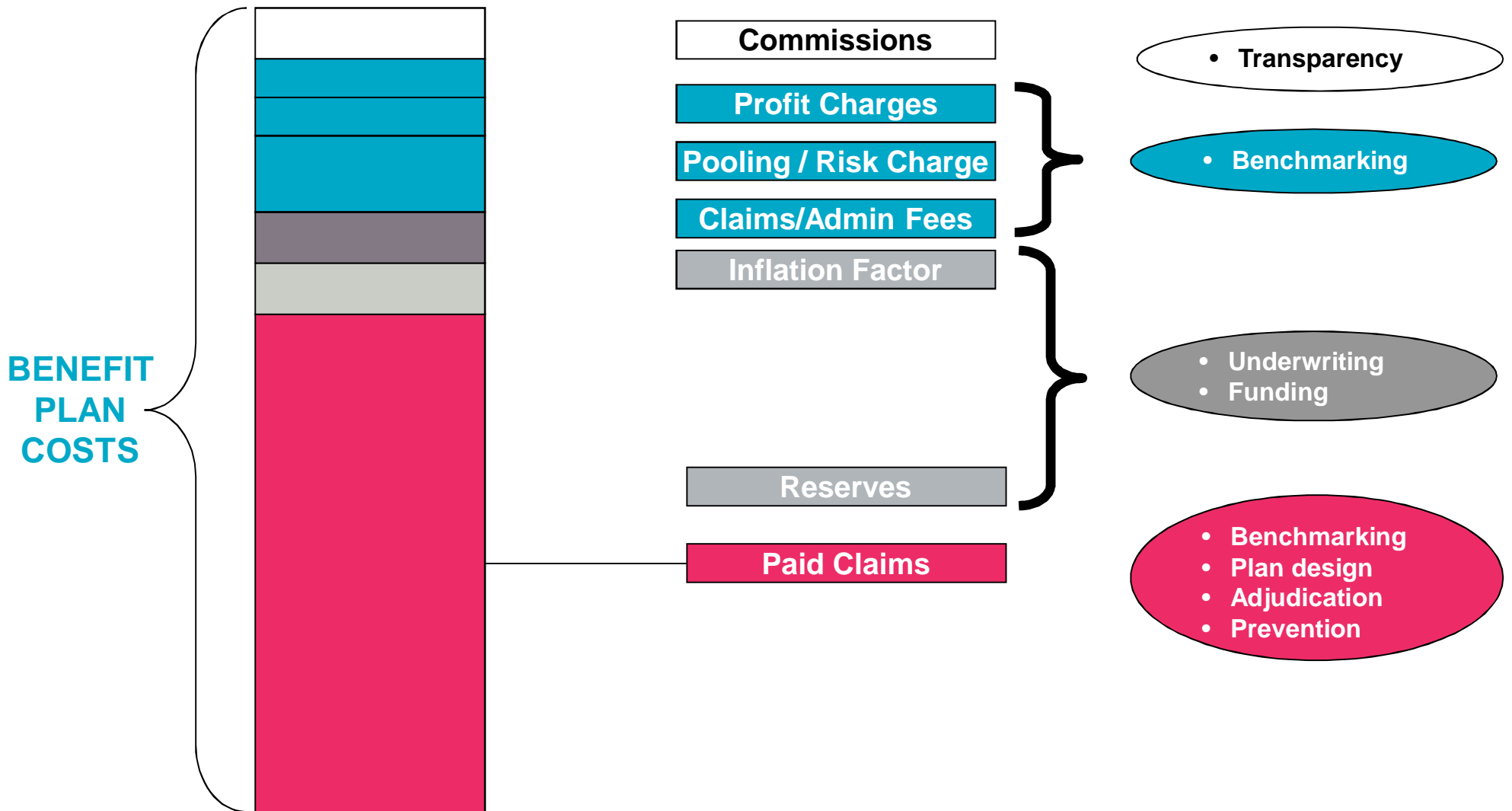
POP QUIZ – TRUE OR FALSE

I HAVE A FULLY INSURED HEALTH AND DENTAL PLAN.

FULL RISK LIES WITH THE INSURER,
I DON'T NEED TO WORRY.



UNDERSTANDING WHAT'S IN THE PREMIUM



RISK IN BENEFIT PLANS



Risk of Uncompetitive/inappropriate fees and plan costs

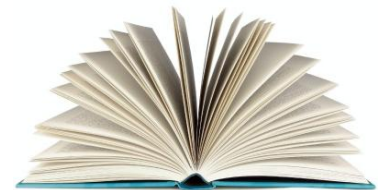
- Transparency – has your advisor clearly disclosed their commissions?
- Benchmarking – has your advisor benchmarked insurer expenses?
- Underwriting – the type of arrangement will impact fees and costs. What are they?
- Reserves – is removing reserves really a cost saving or simply impacting cash flow timing?
- Managing Claims – Do you understand provider adjudication practices and other claims management strategies to manage claims?
- Are you leaving money on the table with a fully insured arrangement?

POP QUIZ – TRUE OR FALSE

I HAVE SELF INSURED HEALTH AND DENTAL PLANS.

THIS IS THE BEST ARRANGEMENT FOR MY GROUP – CLAIMS HAVE BEEN STABLE AND I HAVE HIGH AMOUNT POOLING PROTECTION. MY RISK IS NEGLIGIBLE.

*THIS MAY HAVE BEEN TRUE IN THE PAST.
BUT HIGH AMOUNT POOLING PROTECTION
IS NOT WHAT IT USED TO BE.*



THE CALM BEFORE THE STORM

HIGH AMOUNT POOLING

What is high amount pooling protection?

- High amount pooling is insurance protection against individual high claims

Example:

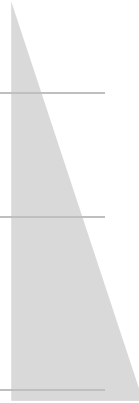
Pooling threshold:	\$20,000/person
Cost of claim:	\$100,000/claimant
Amount charged to the plan:	\$20,000
Amount charged to insurer pool:	\$80,000

- In the past, plan sponsors have been insulated from high cost claims as a result of pooling.
- Now most often triggered by in Canada drug claims.



UPWARD PRESSURE ON SPECIALTY DRUGS TREND

- ✓ Increase in Utilization
- ✓ New Drug Approvals
- ✓ Shift to In-Home/
Outpatient Administration



Average
cost per
script:

SPECIALTY
\$1,240

TRADITIONAL
\$46



Inflammatory Conditions

Multiple Sclerosis

Anticancer

Blood Disorder

HIV/AIDS

Source: Express Scripts Canada 2012 Drug Trend Report

THE STORM IS HERE INTRODUCTION OF NEW DRUGS

Hepatitis C – 250,000 patients in Canada

- Harvoni – \$71,000 per 12 week treatment (potential to reach \$142,000)

High Cholesterol – affects 40% of Canadians

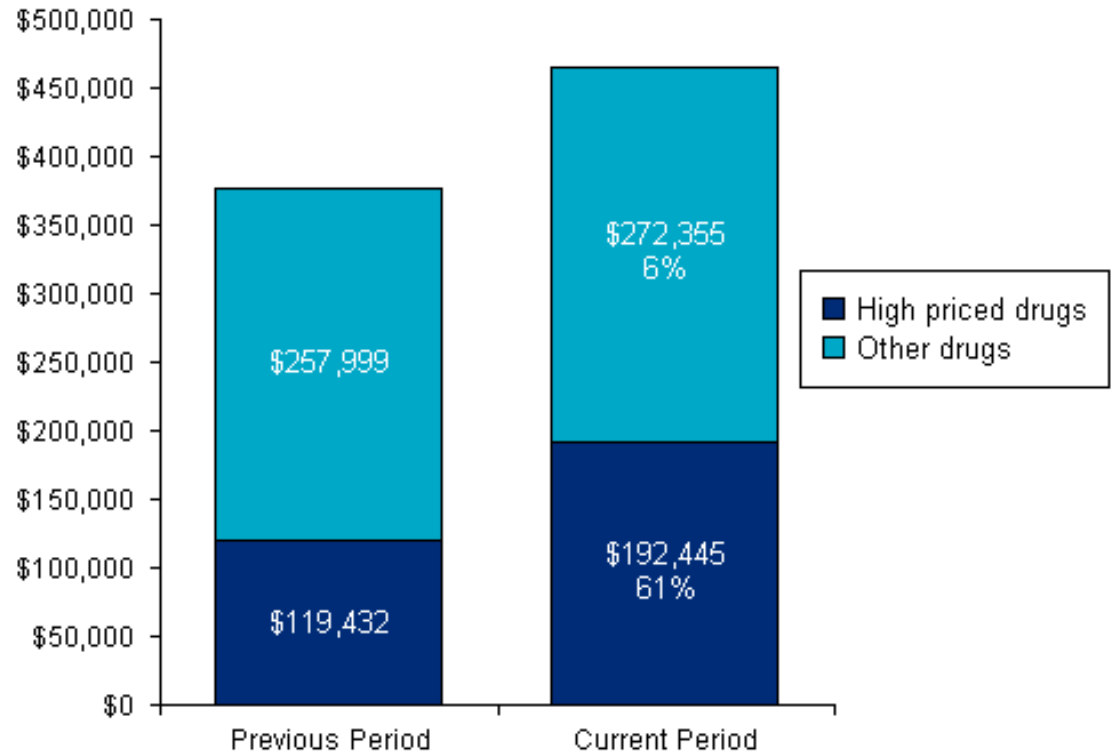
PCSK9 inhibitors introduced 2015/2016

- Increased annual cost of treatment (approximately \$300  \$4,000-\$12,000)

THE STORM IS HERE DRUG COSTS

HIGH PRICED DRUGS HAVE INCREASED BY **61%** COMPARED TO AN INCREASE OF **6%** FOR ALL OTHER DRUGS COMBINED

Cost for high priced drugs vs other drugs



	Claim 1	Claim 2	Claim 3	Claim 4	Claim 5	Claim 6	Claim 7	Claim 8	Claim 9
Individual claims	\$26,953	\$23,543	\$21,252	\$21,036	\$17,284	\$15,490	\$12,409	\$10,232	\$8,560
Amount over pooling level	\$11,953	\$8,543	\$6,252	\$6,036	\$2,284	\$490	n/a	n/a	n/a

Source: Mercer DUR sample

HIGH AMOUNT POOLING

THE STORM IS HERE - DRUG COSTS

We are now seeing **Erosion of Pooling Coverage** in the Marketplace

Insurers are:

- Excluding recurrent claims from pooling protection
- Experience rating pooling charges
- Increasing pooling charges exponentially

Total claims	Current Pooling charge	Proposed new charge	% increase
\$1,200,000	\$100,000	\$125,000	25%
\$570,000	\$35,000	\$90,000	157%
\$160,000	\$10,000	\$53,000	430%

- Increasing thresholds
- Excluding certain drugs from coverage
- Creating hostage plans

HEALTH POOLING

WHAT CAN YOU DO

- Is the insurer doing their part in minimizing large recurring claims?
- Revisit pooling arrangements and thresholds
- Ask the right questions in a marketing
- Review your plan design

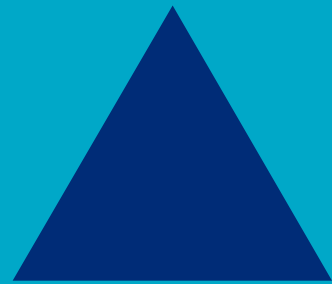
RISK PERSPECTIVE UNDERWRITING AND FUNDING



Underwriting and funding / Risk of high costs

- Understand your risk exposure and underwriting arrangements
- Understand your claims experience
- Identify risks in your plan design
- Continue to monitor
- Be prepared to take on more risk

MANAGING RISK OTHER AREAS OF RISK IN BENEFIT PLANS



RISK PERSPECTIVES BASICS



EXAMPLES OF SOME AREAS OF RISK IN YOUR BENEFITS PLAN



Underwriting / financial arrangements



Promises you cannot keep



Uncompetitive/inappropriate fees



Inaccurate information provided to plan members



High and unanticipated costs



Administrative errors

RISK PERSPECTIVES BASICS

The greatest risk to an organization is not knowing:

- What benefit promises have you committed to
- Where you are not compliant
- When your policies and procedures are likely to cause lawsuits
- The cost of employee dissatisfaction

RISK PERSPECTIVES UNINTENDED CONSEQUENCES

CASE STUDY

The Error:

- A company laid off a significant number of employees as a result of its merger. In the severance package, the letter to employees referred to “continuation of group life insurance” for the duration of the salary continuation period.
- Company only intended to continue the employee basic life insurance, the communication led the employees to believe all life insurance coverage was being continued, including optional life insurance for employees and dependents.
- An employee’s spouse passed away during the continuation of coverage period.

Impact:

- The insurer for the acquired company refused to accept the claim. The cost of the \$100,000 life insurance coverage translated into a potential payout of up to \$200,000 to account for tax treatment.

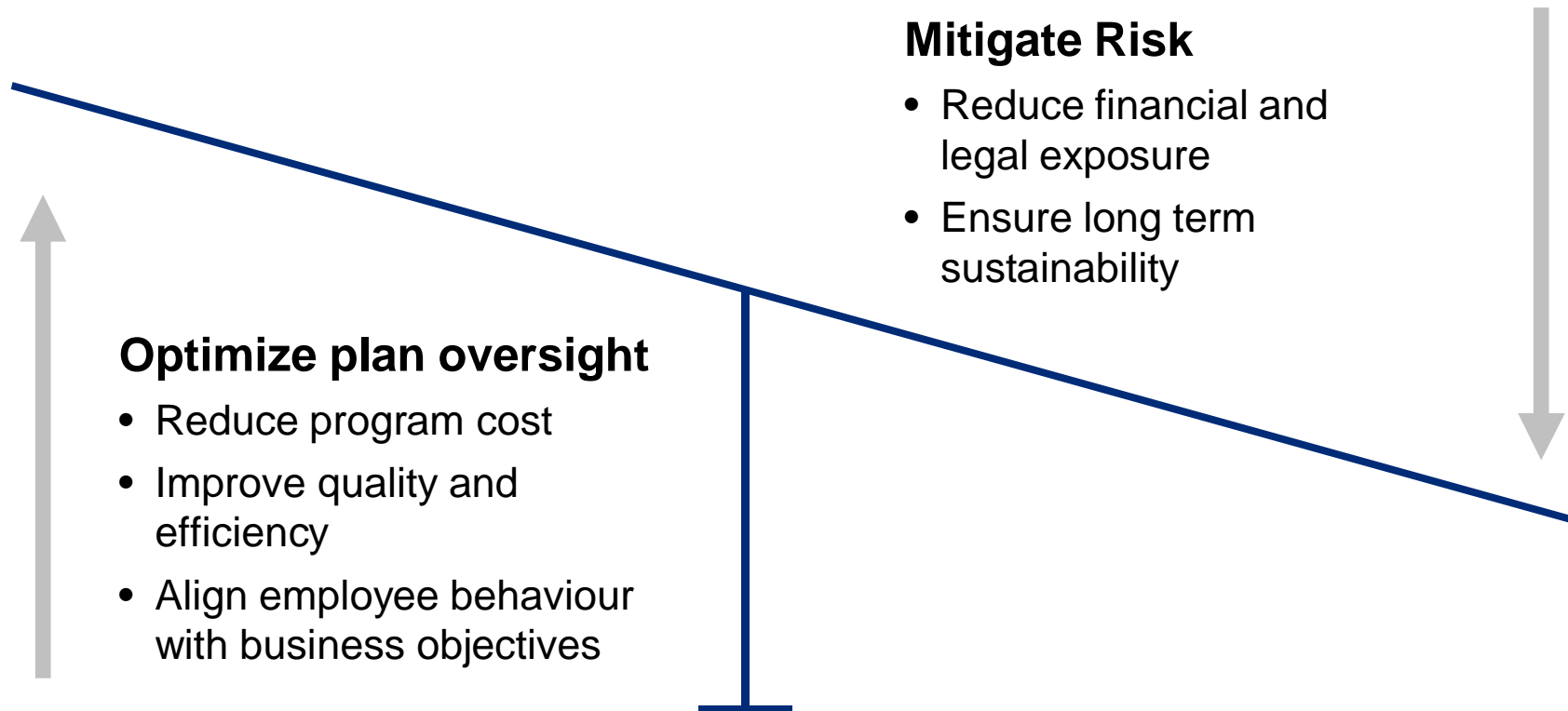
RISK PERSPECTIVE

OTHER EXAMPLES

1. Offing continuation of disability and health coverage beyond statutory notice
 - Group insurer not insuring disability beyond statutory notice
 - Continuation of health coverage
 - Don't assume, ask!
2. Not fully understanding the rules
 - Travelling overseas and not getting coverage: read the fine print, make sure employees understand.
3. Offering retiree benefits at the table
 - At negotiations, offered retiree benefits “we only have a couple of retirees, we can afford the premium”.
4. Understanding your fiduciary duty
 - As Plan Sponsor, you have a fiduciary liability with respect to the operation of the plan, including any decisions made with respect to the plan.

MANAGING RISK GOVERNANCE IS SO IMPORTANT NOW

Effective governance is a business imperative for financially successful organizations



CLOSING THOUGHTS

A CHECKLIST

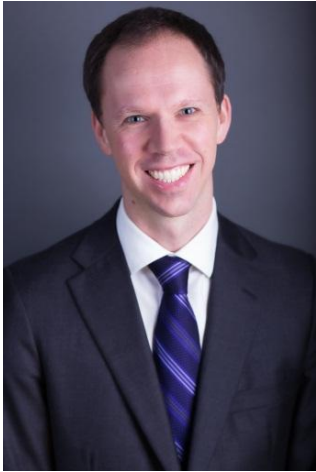
- Are your **funding and underwriting** arrangements in line with your risk philosophy / tolerance
- Do you understand your **health pooling arrangements** and plan risks?
- Do you know what **fees and costs** you are paying? Are they competitive?
Are you managing your providers
- Is your **plan design** aligned with objectives? Is it sustainable?
- Is **plan documentation** consistent, compliant and up to date?
- Are your **administration processes** consistent with contract?
- Do your decision makers have **accurate information** to make informed decisions and avoid unintended promises?
- Do you have **appropriate governance** guidelines in place?

IN CONCLUSION....

***One of the primary –
if not the most important – reasons
to provide employee benefits
is to manage risk!***



QUESTIONS AND THANK YOU!



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MAKE



**TOMORROW,
TODAY**