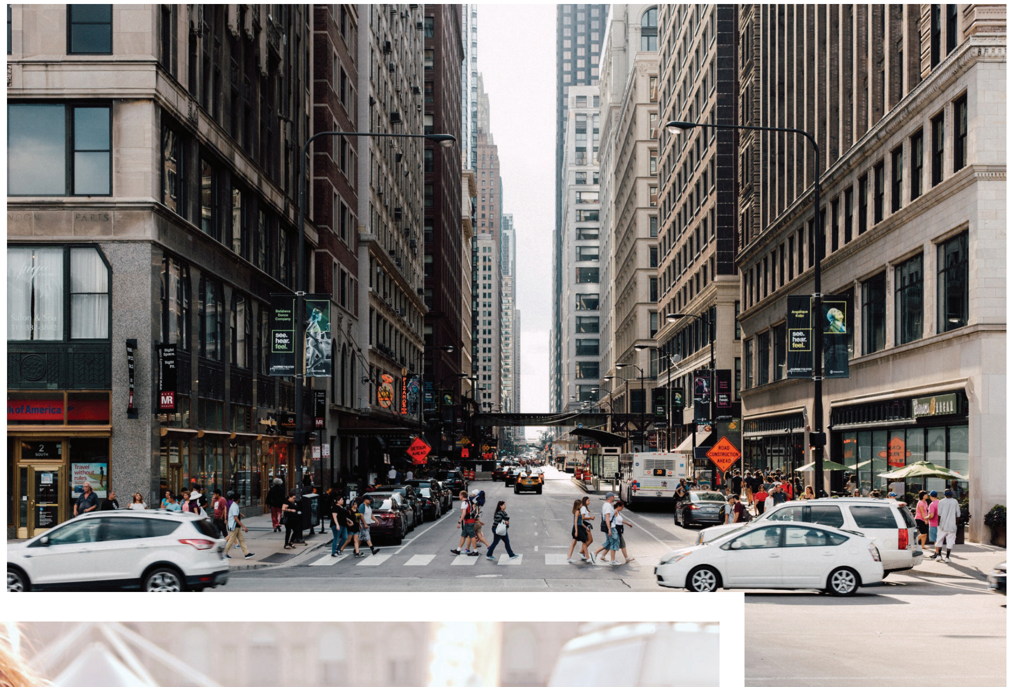
Marris Miller

2018 Client Letter



Pensions That Move You *Forward.*

Marris Miller

January 2019

Dear Clients and Partners,

Our Premises: Although many companies and organizations are undertaking a liability hedging process for their pension programs in this expected low-rate environment, most methodologies are heavily math-based, and as the research of Dr. Richard MacMinn, the Edmondson-Miller Chair in Insurance and Financial Services at the College of Business at Illinois State University has suggested, the value of such methodologies lack proof. Let's take a look back at one of 2018's biggest lessons for the pension industry and discuss how we can do things differently in the new year to secure the future financial health of your members and your organization.

In August last year, Sears Canada pension payments were cut by 30%, further shrinking a previous 20% cut, due to short assets compared to liabilities and a delay in setting up pension payments. The claims process was advised by court-appointed counsel Koskie Minsky LLP, actuarial advisor Segal Company, and administrator Morneau Shepell. The retirees are now in court and fighting for more money.

It is evident that the discontinuity involved in the company's bankruptcy led to the onset of the Sears pension cut. But what would the other side of the story be if Sears had survived? The pensioners would likely have continued to receive a full pension. However, it may still be a game of musical chairs: the last person to get out will be left with nothing.

At the same time as the Sears issue unfolded, some of Canada's most claimed pension funds were diligently building up their pension reserves for greater resiliency, in hope to withstand future uncertainties better.

What's the difference? What did the once-iconic store, one which sold more diamonds than any other department store, do wrong? Did the numbers lie?

What have we learned and what's next

The pension institution has been a story of successes, failures, enthusiasms, controversies, remarkable growth and epic falls. We are running on a century of precedents since the railways offered the first after-work pay, Andrew Carnegie revolutionized the investment of the pension funds. Today, retirement funds and peoples' lives are more intertwined than we're willing to admit, which has made labour and capital more vulnerable.

In fact, just weeks ago, the Government of Canada announced their own next steps in national consultations on enhancing retirement security for Canadians.

Marris + Miller Launches Open Pension^{SM}

Our clients have defined benefit plans with assets between tens of millions to billions of dollars. Some started with difficulties but have worked with us to transform their funds with impressive results. The decisions were simple, and our clients had the intellectual curiosity to be well-informed and patient enough to make good decisions.

This is the foundation of Marris + Miller's Open Pension^{SM} Initiative – we continue to build tools for our clients that radically improve efficiency and results. Your feedback is pertinent, and it directly influences the tools we use, which are evaluated by employee interest and value dispersion. We continue to share these resources as open source among all clients at no added cost, with the creative significance of which we can be proud.

Continuous improvement emerges from collaboration, knowledge, experience and learning. We learn from each other which we believe is the best way to move business, individuals and society forward.

Our Open Pension^{SM} initiative is focused on social impact while establishing a new service standard for pension work.

Raise your expectations

Ask what you would do when assessing a billion dollar business acquisition: what would you want to know, and what checkpoints would you put in to ensure delivery of performance and business results? The same goes for pensions. Why would you accept a below-expectation level of performance for your pension funds?

We need to hold industry experts and ourselves accountable.

Informed leaders defend their pension policies and practices. These critical decisions are made by CFOs, CEOs, and the Boards. HR leaders are instrumental in implementing, executing and communicating their pension policies. The experts' roles are to supplement your successful management. The actuarial lexicons are arcane, but that's no excuse for anything less than an actuarially-sound pension fund. Sometimes a vigorous process using actuarial tables is also subject to conventional thinking that's outdated. The current solutions in the market (de-risking, LDI, ALM, longevity and interest hedging) are math-heavy ones, and, in this way, they often become a smokescreen to cloud common sense.

That's why it's necessary to step back and look at these tools with a business lens, and get clarification on what will work best for your business. We need to see beyond the deficits, governance checklists, funding pressures and other mechanical processes. Although these are necessary, they do not fundamentally change the way pension work is done.

Your role is to lead the dynamics of pension management: the purpose, the why, the people, the stakeholders. You need to take on pension decisions feeling confident and comfortable in making informed decisions.

The Three Cornerstones of Pension Management

A small shift in leadership can change pension dynamics. If there is a persistently low expected return, we need to know how to do more with less with not only defined benefit plans, but also with more vulnerable defined contribution plans. In the 1970s, companies realized that they were losing the overt benefit of "hands-off" defined contributory plans. It would be a mistake to assume the same would not apply to today's labour and after-work pay scenarios.

Amid the numbers, common sense has taught us to seek for what's true and what needs to be done. Those who manage pensions know that feeling in the pit of their stomach that there has to be a better way. We have a responsibility to ensure that the heavy math is not concealing disastrous outcomes, such as those manifested in Sears and GE pensions. Among these unexpected events, the guarantees that mitigate our choices are members' old age, their inability to work and their overarching dependency on the capital market. We need a new perspective on labour and capital. And we need to raise our expectations.

- The first cornerstone of our thinking is *perception*, our ability to understand the inner relationships of human psychology, wages, market and the pension institution to explain how a pension system works. Deficits will happen through economic downcycles: a company or organization needs reserves and liquidity levers to prepare for such events. For example, a mutual insurance company in a prairie province has had a surplus in its pension since the 1990s and, despite the 2008 crisis, has continued to have the flexibility and agility for its pensioners while many other plans have converted to contributory plans or cut benefits. A resilient plan is durable and is capable of weathering through uncertainty, both for your member and your organization.
- *Fairness* is another cornerstone of our thinking, determined by considerations of shifts in labour, large-scale industry changes and economic capital reserved for future uncertainty, all to serve the greater good. Pensions should be designed for people, not experts: actuarially-sound plans should not be compromised because other set-ups seem more convenient at the time.
- Finally, our sense of *ownership*, what do we want and why we do what we do, how do our decisions impact our lives and the lives of others. We need to think of pension decisions as

business decisions, asking ourselves which strategy adds value and which ones are merely noise. Dr. Richard MacMinn led findings that explained why a longevity hedging de-risk strategy is less effective at improving overall firm performance compared to annuity buy-in and buy-out[1]. We strategically helped a client take an annuity purchase as the first step and secured its surplus position three years ago; the plan continues to hold surplus today.

Goals for 2019

A more resilient future is achieved with small steps. We're grateful to have worked with leaders who take steps to make educated decisions.

Here is where we want to accomplish in 2019:

1. Easy access for management and members to increase flexibility in plan experience without comprising security features of core pension elements
2. Make defined benefit pensions simple-to-manage with our network of experts
3. Help businesses that are reluctant to move away from their actuarial consultants to compete with bespoke independent advisory services, so that you can create a sound and sustainable corporate pension strategy
4. Strategic pension consulting, helping forward-looking businesses transform from the *mechanics* of pension management to the *dynamics* of pension management through Marris + Miller's *Perspectives* publications. We want to build business leaders, not merely technical experts
5. Help businesses and unions share the same vision to search for true positive impact

A huge thank you to each and every client for your business and confidence, to our collaborative partners for your support, and to Marris + Miller firm members for your ingenuity, your passion and your hard work. Here is to another successful year to move you forward.

Best,

M. C. Miller

M. Catherine Miller, FSA, ACIA
Managing Partner, Marris + Miller
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[1] Dr. Richard MacMinn has conducted research shows that when pensions are managed as business-related risks, firm value increases by 17%.

Thank You For Reading