Saskatchewan Federation of Labour Pension Conference

Legal Issues and Challenges Pension Trends in 2014

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Topics we will cover

- Saskatchewan regulatory environment
- Saskatchewan pension legislative reform in 2013 and 2014, public sector and private sector
- Trends in pension bargaining in 2014 in Saskatchewan and across Canada

Regulatory Environment

- Saskatchewan *Pension Benefits Act, 1992* (S.S.1992 C. P-6.001) (“PBA”)
- *Pension Benefits Regulation, 1993* (C. P-6.001 Regulation 1) (“Regulation 1”)
- Statutory plans or plans contained in by-laws
  - Eg. Regina Civic, City of Saskatoon
- Collective Agreements

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Regulatory Environment

- Saskatchewan *PBA,1992*
  - administered and enforced by Superintendent, Pensions Division, Financial and Consumer Affairs Authority
  - Under Attorney General's (AG) portfolio (Gordon Wyant – Saskatoon NW, former City Council member)
- In practice, two primary regulatory staff, Dave Wild and Leah Fichter

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Regulatory Environment

Experience with policy submissions and lobbying for solvency relief shows that the AG's office relies heavily on recommendations from the Superintendent's office

- Atypical as **policy-making** functions usually fall to the Ministry whereas **policy-administering** functions are delegated to the regulator

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Regulatory Environment

- Superintendent has been taking very aggressive positions with plans that he regulates in this province
  - Refusing to enforce contributions required by an actuarial valuation
  - Requiring that actuarial valuations include a “reserve” of 10% of liabilities, <u>effectively adding 10% to the cost of every plan</u>

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Regulatory Environment

- Failing to administer the PBA when advised of contraventions – ensuring required contributions are made is a core function of the regulator
  - Open to judicial review
- No authority in the PBA or Regulation 1 to require “margins” or reserves, or any plan terms in excess of the minimum standards
  - Open to judicial review

Regulatory Environment

- Mandate and powers of the regulator are to administer the PBA as set out in the statute
  - No mandate to influence private and bargained arrangements between employers and employees
- Superintendent has also expressed a view as to his preferences in plan design – target benefit plans or fixed cost plans – and this is influencing collective bargaining
- Does this adverse regulatory environment require a coordinated strategy to resist?

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Pension Reform – Public Sector

- 2012-2013 broader public sector pension plan funding consultation
  - Consultation guided by Superintendent's office
- Submissions by several union groups
  - CUPE, SUN, others
- Two models considered:
  - extended solvency funding periods; and
  - no solvency funding requirement but reduced going concern periods
- Reasons why solvency measure does not apply to public sector plans

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Pension Reform – Public Sector

- Result of consultation - Amendment to Regulation 1
  - **solvency exemption** - listed plans not required to fund to solvency measure
  - all broader pubic sector plans in the province are listed (Table 1), except Regina Civic
  - amortization period for funding **going concern** deficiencies reduced from 15 to 10 years

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Pension Reform – Public Sector

- Solvency relief
  - solvency funding exemption is consistent with similar relief extended in jurisdictions across Canada
  - No clear rationale for making GC measure more conservative
    - Increases plan costs, reduces effect of solvency relief
    - In addition – “activist” regulator adding costs to plans (as described earlier)

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Pension Reform – Private Sector

- AG to examine the possibility of permanent solvency relief for MEPPs (multi-employer pension plans) in Saskatchewan – consultation expected in Spring 2014
- Temporary relief has expired
- Across Canada MEPPs are exempt from solvency funding, subject to certain conditions

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Pension Reform – Private Sector

- However 6 Saskatchewan MEPPs no longer eligible for temporary solvency relief (started 2009, expired 2012).
- One plan's lobby effort secured an exemption from solvency funding for now with consent of regulator
  - Extending filing date, or extend interval for filing (from 3 to 4 years, etc.), with retroactive effect to zero out existing payment schedules
- <u>Other MEPPs may need to seek similar relief if valuations are required to be filed</u>

Trends in Bargaining

1. Pension "crisis" has faded – plans moving to surplus

2. Target benefit plans in broader public sector

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Pension Crisis?

- Industry conditions
  - Saskatchewan overall GDP growth 3.9% (higher than projected)
  - Strongest growth of employment in Canada, lowest unemployment rate in Canada (4.1%)
- Market conditions
  - Historically low interest rates rise slightly in 2013
  - Market returns generally high in 2013 (10%+)

Pension Crisis?

- As a result, indices measuring pension plan health show plans moving into surplus in 2014
  - Mercers, Towers Watson, Aon Hewitt
  - Stories about Air Canada plan
- Current health primarily driven by returns on assets
  - If interest rates rise slowly over medium term, will be significant surpluses

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Pension Crisis?

- Despite healthy economic conditions, a significant attack on public sector wages and pensions in 2013-2014
- “Sustainability” proponent’s main claims:
  - Markets no longer providing returns
  - DB plans no longer affordable
  - Longevity improvements increasing cost
  - Taxpayers bearing cost of public pensions
  - Inter-generational inequities
- These arguments must be “debunked”

Pension Crisis?

The "driver" of the sustainability debate is the perception of a "crisis" in pension funding, BUT…

- The 2008 financial crisis was worst in 75 years, and has now passed – should be viewed as a rare event requiring temporary adjustments, not a trend requiring structural change to plans
- Majority of plans in Canada, and in Saskatchewan specifically, are relatively "healthy" (> 85% funded and increasing)
- Market returns are consistent with long-term trends

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Pension Crisis?

"DB is no longer 'affordable' and not 'sustainable'"

- A euphemism for employers seeking to drive down their costs in bargaining – may seem reasonable and justifiable, but is disguising future or present cuts in total compensation
- Employees should not be subsidizing employer fiscal decisions (paying deficits, other spending priorities)
- Many employers in Saskatchewan seeking to cap their costs to their plans at 8% or 9%
  - May be sufficient in the long term but right now, still climbing out of deficit because of the funding cycle
  - Most employees willing to pay a little more over time to ensure stability of DB plans and certainty of benefits
  - How many took contribution holidays in 1990s or 2000s?
  - How many will do so again when surplus arises?

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Pension Crisis?

Do ‘taxpayers’ pay public pensions?

- No. Large public sector pension plans have examined the contributions to average pensions, and found that perhaps 20% of any public sector pension is funded through contributions of the employer
- Balance - 80% - is funded through employee contributions and investment income on all contributions

Pension Crisis?

Are public sector pensions ‘gold plated’?

- A good DB plan pays about $18,000 per year
  - Encana CEO Gwynn Morgan’s DB plan pays $1.7 million per year, yet he calls BPS pensions gold plated
- There is “pension envy” because in private sector, only 15% or 20% of employers provide a pension plan
- The real “crisis” is that in the private sector, the laudable and important policy objective of providing workplace pensions is no longer met, and we need policy options to deal with that
  - CPP expansion

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Pension Crisis?

Intergenerational inequities?

- Two versions of this argument:
  - Good version: similar people should pay similar amounts for similar benefits
  - Bad version: each cohort (however defined) should only reap its own benefits, and not share gains or risks with other cohorts
- Risk-sharing or pooling is the whole point of a DB plan – a little inter-generational difference is expected and should be managed over time to ensure fairness
  - Hence importance of joint governance
- The solution proposed by employers (target benefit plans) is actually worse, because in most target plans, if costs rise, the future benefits of current active employees must be reduced (retiree benefits cannot be reduced by law, even though that cohort paid less for a greater benefit).

Pension Crisis?

Longevity improvements?

- CIA updating mortality tables- UP94 updated – longer life expectancy
- More costly? Yes, but how much?
- Not sudden; not a ‘crisis’
- Trend only, which will not continue at same rate (healthcare-related improvements are flattening out)
- Differential impact – managerial v. negotiated

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Target Benefit Plans

- The “solution” to the “pension crisis” is the target benefit plan
  - Where did they come from?
  - What are the major issues to be aware of?

Target Benefit Plans

Where did they come from?

- Two sources or models for the target benefit plan – the Dutch pension system, and the multi-employer pension system
- Dutch system has target benefits, but:
  - 90% union density in all economic sectors, ensuring joint governance and high participation rates
  - 90% replacement rates from pension plans, and higher average industrial wages
- Each ensure stability of plans and mitigate risks/costs of benefit reductions

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Target Benefit Plans

Where did they come from?

- MEPPs are a kind of target benefit plan but are designed for special circumstances
  - Primarily a model for construction sector and any industrial sector where there are a large number of small employers with relatively high turnover or insolvency, or closed shop sectors
  - A centralized plan mitigates effect of “churning” of employers, requires union governance, accommodates sector-wide bargaining.
  - These mitigate effect of risk of benefit reductions

Target Benefit Plans

- Where are we seeing them in Canada?
  - Imposed on drastically under-funded pension plans in NB (where employer had created crisis by under-contributing for years)
  - Imposed on relatively healthy plan in PEI
  - Imposed on public sector plan in Alberta
  - Most recently, Saskatoon City plan has adopted this model
- In most cases, was resisted by bargaining agents and/or retirees
- Being proposed actively at BPS bargaining tables in Saskatchewan

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Target Benefit Plans

- Features of target plans:
  - Contributions are capped (like DC)
  - Often combined with reduction in benefit formulas on go-forward basis
  - Employers see significant improvement in balance sheet liabilities
  - Accrued or future benefits may be reduced (or both)
  - Heavy reliance on actuarial modelling and projections 10, 15 and 20 years into future

Target Benefit Plans

- Features of target benefit plans
  - No certainty of benefit at retirement
    - Prediction relies heavily on actuarial modelling
    - Untested in Canada
  - Pressure to absorb any cost increase through reduction in active benefits (more difficult to decide to lower retiree benefits)
  - In effect, plan members bear ALL market risks, and active employees likely to bear most of them

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Target Benefit Plans

Issues to watch out for:

- Target plans are "shared risk"
  - Not true: employees and retirees bear the market risks, employers costs are capped
  - Risk is shared among plan members, not with employer
- Target plans are more sustainable
  - If sustainable means capped costs, true, but if it means certainty of benefits, not true

Target Benefit Plans

(cont'd):

- "Benefits are protected or more secure in target plans because of funding approach"
- In our experience target plans
  - Include cuts made on conversion
  - Projections about "risk" of underfunding based on long-term actuarial models not easy to challenge or understand
  - Transfer **ALL** market risk to members
  - Provide **LESS** security and protection than real DB plans

Target Plans

Tools for resistance:

- Has the employer provided the most recent plan funding information?
- Have you asked an independent actuary whether the funding assumptions are appropriate? Can they be challenged? Is your longevity profile in play?
- Are there margins or other conservatism built into the costings which unnecessarily increase the cost of the plan?
- Can you identify other options that would manage the costs of the plan?
- Is the plan jointly administered so members can participate in key decisions about funding?

Summary

- Beware of the hostile regulatory environment, develop strategies to mitigate its effect.
- There is no “pension crisis”: this is merely hard bargaining by employers seeking to transfer costs to employees.
- “Sustainable” only means “low cost” and will lead to “two tier” benefit structures.
- Beware of the actuarial “smoke and mirrors” that make these changes sound fair or inevitable.
- Remember the lessons from Air Canada

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