

## **PENSIONS IN CRISIS**

Frequent media reports about private sector pension plans in crisis — General Motors, Nortel, Air Canada — have drawn attention to the potential inadequacy of retirement savings for most Canadians. The immediate concern for members of those plans has been their under-funded status and the difficulty in accessing corporate assets to make up for those deficiencies in the context of bankruptcy proceedings.

Members of those plans are understandably disappointed with the way their plans have been managed and regulated. Nevertheless they are better off than most Canadians. Sixty percent of Canadians (sixty-two percent of Nova Scotians) do not belong to any pension plan and most of them do not have any RRSP savings either.

Government must take steps to ensure that pension promises are properly managed, and their funding properly protected. It also has to take steps to encourage greater participation in retirement savings programs.

But this will only work if taxpayers have enough money left to save for an adequate retirement.

## **BALANCING THE BOOKS**

Nova Scotia's per capita debt levels remain among the highest in the country. If we do not return to fiscal responsibility our children will be left with unsustainable debts. Money that should be spent on health care and education will instead be paying for interest on the debts we leave behind.

Nova Scotia experienced chronic deficits for many years. The eight years prior to the recent financial crisis produced small but persistent annual surpluses. But as for many governments in Canada and elsewhere, Nova Scotia's budget for 2009-2010 will be much more adverse. The provincial government's recently released budget predicts a deficit of \$592,100,000 for the current fiscal year but a balanced budget for all future years. Although this number was inflated by accelerating various expenditures, a dramatic improvement will require a substantial reduction in spending.

Achieving that will be very difficult in any event. But a looming crisis in the cost of provincial pension programs threatens to make it impossible. Prompt and effective action on this front will be essential if the government is to meet its commitment to balanced budgets, and to prevent our provincial debt from spiraling out of control.

## **PUBLIC SECTOR PENSIONS**

There has been considerable recent publicity concerning the level of pensions provided in the public sector compared to what is available to private sector employees.

The year 2008 was extremely adverse for investors. Even well managed plans typically had asset returns that were 20% less than was needed to support liabilities. The result has been an acceleration of the national trend away from defined benefit plans in the private sector, in part because several of the largest plan sponsors have gone bankrupt or been severely downsized.

Public sector plans have shared in the same adverse experience, and many of them were already seriously underfunded. The status quo is not sustainable. Hard pressed taxpayers will be unwilling to support programs that are dramatically more favorable and more expensive than they themselves have. Lets consider the big ones individually.

## **PUBLIC SERVICE SUPERANNUATION PLAN**

This plan covers 16,629 pre-retirement employees and 11,341 current pensioners and beneficiaries. Benefits accrue at the rate of 2% per year of best average salary, reduced by CPP payments after age 65. Unreduced pensions are available after age 50 and 30 years of service. These are indexed to inflation up to 6%. Survivor benefits are provided for spouses and children, or to estates, for five years.

Nova Scotia's contribute a lot toward the cost of their plan. In addition to CPP contributions of 4.95% they contribute 8.4% of salary up to the CPP limit and 10.9% on the excess. All these contributions are matched by the province.

Nevertheless the plan is hugely in deficit. As of December 31,2008 the assets represented only 64.1% of the amount necessary to provide for the benefits. The amount of the deficiency was \$1.69 billion. This was up substantially from December 31, 2007 which was at the end of a long period of extremely favorable performance in the financial markets. While there will have been some improvement in 2009 as markets recovered this may be partially offset because today's low interest rates diminish the purchasing power of the assets. It is extremely unlikely that the benefit level can be sustained. The deficit of \$1.69 Billion represents \$100,000 for each member of the plan.

In fact this is not surprising. A member retiring today at age 55 with 30 years of service will likely have as many years of retirement pension as years of work. If her best average salary today is \$60,000 her pension is \$36,000. That will probably be more than the salary she started at in 1979. Even with some CPP offsets to the pension commencing at age 65 it is likely that the total pension payments received from the plan will exceed the total employment income earned over the thirty years. It is no wonder that the substantial combined contributions provided by members and taxpayers have proven so inadequate.

## **TEACHERS PENSION PLAN**

The plan provided to Nova Scotia's teachers is superficially similar to the PSSP. There are 13,742 active teachers and 11,089 people receiving benefits. Benefit accruals are the same as for the PSSP. Slight reductions in pension are required for those who want survivor benefits.

In addition to CPP contributions, members (matched by taxpayers) taxpayers contribute 8.3% of payroll up to the CPP maximum and 9.95% above. The teachers' pension plan is only funded to a level of 70.8% as of December 31, 2008, down from 91.0% a year earlier. The deficit is \$1.52 billion, up from \$1.456 billion. This is equal to \$110,000 per teacher.

The combined deficit on these two plans is \$3.2 billion or more than \$7,000 for every working Nova Scotian.

Nova Scotia already has a massive deficit challenge. The government is already talking about tax increases even before addressing the pension issue. At the same time more than 60% of taxpayers have no pension plan at all, and many have seen their own RRSP's and other savings slashed by the same market conditions that have devastated public sector plans. Under the circumstances it is extremely difficult to explain to them why they should be responsible for topping up these public sector plans.

## **A WAY FORWARD**

In fact the teachers' plan already contains many elements of a long term solution, as described in a 2005 agreement with the teachers' union. Indexing is only provided if the funding status is healthy—not at all a near term prospect. As well, if the plan is in deficit, it is required to work toward a proper funding status, either by increasing contributions or adjusting benefits. The plan is jointly trusted which means that employee representatives participate equally in the difficult choices which must be made. Unfortunately the current plan is not at all sustainable by current contributions and adjustments will have to be made.

This is not just a matter of being fair to taxpayers. It is also a question of being fair to younger teachers and civil servants who will soon be outnumbered by retirees and who will otherwise inherit an even worse problem in future years.

Government must present its response to this issue as a central part of the next budget.

An approach which provides cost transparency and certainty to the taxpayer is a target benefit plan. These are frequently used by multiple employer pension plans, especially in the construction trades. They retain many of the expense savings and risk pooling elements of defined benefit plans. Under these arrangements:

1. One hundred percent of all employee and employer contributions are committed to providing pension benefits. The employer does not have the right to receive any future surpluses.
2. The plans are each managed by a Board of Trustees including equal numbers of employer and employee members. Their job is to provide the best possible benefit program to the members from the available resources, bearing in mind the need to treat members equitably.
3. The available resources are the current assets plus future contributions. It is proposed that the province be willing to match employee contributions up to a maximum of ten percent of total payroll. This is more than is being contributed at present but recognizes the need to begin working on the deficit. This would represent the limit of the province's obligation.
4. Even with the increase in contributions the trustees will have difficult choices to make to bring the plan into balance. Making these choices soon will restore an equitable relationship between younger and older members. At the same time the province can proceed with future budgets knowing for certain what its future pension costs will be.
5. To bring the cost under control, trustees will have to consider some combination of gradually increasing the age for unreduced retirement, only providing future inflation indexing when the funding is adequate (the Teacher's Plan already does this), and reducing the rate of future benefit accrual. Of course if the pension fund subsequently has very positive experience, the entire resulting surplus should be made available to improve benefits.

6. There are minimums which should not be violated. Current retirees should not have their benefits reduced. Future retirees must receive a benefit level not less than what is accrued at the time of program change plus something more than what their own subsequent contributions would purchase.

## **MLA PLAN**

The pension plan for MLA's is even more generous. It also completely lacks transparency. It provides a 5% per year benefit accrual, receivable at 55 as long as the member has five years of service. That means that an MLA with 15 years of service will be eligible to receive a 75% pension at age 55. (For MLA's who are between 55 and 71 with 15 years of service the plan is actually quite adverse—they could retire and receive a 75% pension, so they are really working for the remaining 25%).

MLA's contribute 10% of pay. There is no separate fund—all liabilities belong to the government's consolidated account.

The plan provides two and a half times the benefits in the PSSP plan for about the same employee contributions. If the PSSP plan is only 64.1% funded one can only imagine what a proper accounting for the MLA plan would reveal.

## **Join the conversation...**

Comments of all kinds are welcome. Here are some questions on which we would particularly like to hear:

1. Are you a member of a pension plan? Do you believe that you have adequate provision for your retirement?
2. How do you feel the deficits in the public sector plans should be shared between taxpayers and participants?
3. Is it important to you that the province commit itself to balanced budgets?
4. Do you agree that transparency is required for the MLA pension plan?
5. **Do you agree that it is urgent that government present its response to these issues at the next budget?**
6. **Do you agree that 10% of total payroll is the maximum future contribution that the province should make to the plans?**

## INFORMATION

The Nova Scotia Pension Agency is the administrator for all three plans mentioned above. The agency has an excellent website ([novascotiapension.ca](http://novascotiapension.ca)) that provides good information on both benefits and funding status. The information taken from there for this report has been simplified to improve readability, which means some of the characterizations are approximate. Readers interested in further details will find the website a worthwhile visit.

## Appendix A

AS AT 31/12/08	Public Service Superannuation Plan	Teachers' Pension Plan
Assets	2,990,987,000	3,736,286,000
Funded Ratio	64.1%	70.8%
<b>Regular Contribution</b>		
Employee	70,088,000	61,272,000
Taxpayer	70,088,000	61,272,000
Unfunded Liability	1,688,200,000	1,512,300,000
Active Members	16,629	13,742
Pensioners & Survivors	11,646	11,089
Inactive	1,885	4,954
Pensions Paid	205,800,000	315,000,000