Pensions in Crisis

Bill Black
New Start Nova Scotia
15 February 2011


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. Let’s 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 Scotians 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 $0.456 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 trusteed 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) 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

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<th>AS AT 31/12/08</th>
<th>Public Service Superannuation Plan</th>
<th>Teachers' Pension Plan</th>
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<td>Funded Ratio</td>
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Regular Contribution

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<th>Public Service Superannuation Plan</th>
<th>Teachers' Pension Plan</th>
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<tr>
<td>Employee</td>
<td>70,088,000</td>
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<tr>
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Pensions in Crisis was updated three times after the original posting. The following is the update from May 2nd, 2010:

PENSIONS IN CRISIS – UPDATE

Pension plans make promises now about retirement payments to be made later. The cost of those promises is higher if the plan allows retirement with unreduced benefits at younger ages. It is also higher if the plan provides annual increases in benefit to match inflation. The biggest pension plans in Nova Scotia are the Public Service Superannuation Plan for civil servants and the Nova Scotia Teachers Pension Plan.

Our civil servants put almost 10% of payroll into the pension plan every year. This is matched by taxpayers. But the benefit promises are so generous that the value of those promises at the end of 2009 exceeded the assets by more than $1,500,000,000.

The Minister deserves credit for labeling the issue and taking steps to address it by increasing the retirement date for future employees and by reducing the amount of inflation indexing in existing pensions. But he did not go far enough, and he has caved in on a crucial point.

He should have gone farther on benefits by extending the early retirement date for some existing employees (say those at least ten years from retirement) and by providing for smaller inflationary increases to benefits. With these changes this plan could be brought to an adequate funding status without the need for additional contributions, and the plan’s benefits would still be far richer than those available to almost all other taxpayers.

He caved in on funding. The problem with the government’s proposed solution is that Nova Scotia taxpayers will now borrow an additional $536 million to close this gap. Furthermore, the government employees who will benefit from this pension plan aren’t being asked to contribute a single additional dollar. Previously, government employees were asked to match dollar for dollar contributions from the taxpayer. Is it any wonder Joan Jessome, the president of the Nova Scotia Government and General Employees Union (NSGEU), is so pleased about these pension plan changes? The government delivered more than a half a billion in new money, borrowed on behalf of Nova Scotia taxpayers, to her member pension plans without requiring any employee matching.
The authors of this plan will argue that the employees have given up more than taxpayers because the value of benefit reductions is about $1 billion. Taxpayers will argue that, at 10% of civil servants’ payroll, they are already putting a lot of money into the plan—much more than goes into their own retirement savings.

It is hard to get perspective on a number as large as $536 million. It is:

1. More than half the amount of money ($880 million) that the province received from the offshore accord.
2. Equal to two and a half years worth of the increase in HST
3. About $30,000 for every active member of the plan.

And there is no guarantee that this is a one time payment. Instead a bad precedent has been set. If future investment performance is less than assumed (possible) or pensioners live longer than expected (probable) will the taxpayers be asked to write another huge cheque?

Questions for the Minister:

1. Will he undertake that any future surpluses in the plan will be used to repay taxpayers before any benefit improvements are made?
2. Will he promise that there will be no more bailouts; that from now on the benefits will be made to fit what can be purchased with the regular employee and taxpayer contributions?
3. Will he avoid writing another huge cheque when sorting out the Teacher’s plan?
4. Will he ensure that universities, school boards, municipalities, and health care organizations are liable only for the regular annual pension funding (ie no big additional payments) so that taxpayers do not take another major hit on those plans?

Nova Scotians are being asked to accept the difficult measures necessary to return to balanced budgets. They cannot accept those measures if government is going to continue exposing taxpayers to huge risks that are not necessary in order to provide excellent pension plans to public sector workers.

The following is the Pensions in Crisis update from June 7th, 2010:

**ANOTHER PENSION BAILOUT?**

Reporters and other keen observers know that a news release late on Friday usually means that the government hopes it will not get much attention.

Thus on April 30 there was a little reported story that the Teachers Pension Plan is to receive a modest extra payment of $1.5 million from the province because it is in deficit. This looks very small compared to the $536 million payment into the Public Service Superannuation Plan (PSSP) announced a few weeks earlier. The associated financial reports were only released in May and a much darker picture becomes evident.

Unlike the PSSP, the Teacher’s plan has received a number of prior extra payments, totaling over $400 million. So the accumulated total extra payments for the two plans is closing in on one billion dollars, or more than four years worth of the HST increase just imposed.
The financial statements for the Teacher’s Plan reveal a deficit at the end of 2009 of $1.274 billion. The April 30 letter from the trustee contained this optimistic statement:

“It will definitely take some time to recover from the effects of recent market conditions and restore the funded status of the plan, but it is moving in a positive direction.”

Most readers would conclude from this that it will only be a matter of time until investment returns solve the problem. In fact the most likely outcome is that it will get worse. The deficit calculation assumes that future investment returns will be consistent with historical averages. So it is equally likely that actual returns on invested assets will be better or worse. But because the plan is under funded, there will be no investment return on the $1.274 billion of assets that are not available to be invested.

So who owns this very large problem? As things stand taxpayers are responsible for half of it. Under an agreement between the teachers and the province, the pensions starting on or after Aug 1 2006 only receive indexing if the plan meets certain funding criteria. In a year (such as 2009) when funding is inadequate the taxpayer makes extra payments into the fund equal to half the value of the indexing that those pensions did not receive. Of course most of the pensions being paid started before Aug 1 2006 so the current year’s down payment was small—only $1.5 million. But it will grow very rapidly as more and more of the pensions are affected by the provision. If investment returns are consistent with historical averages taxpayers will end up with extra payments into the plan equal to half of the current deficit—$637 million—plus interest.

This is outrageously unfair to taxpayers, most of whom have no pension plan at all.

The current collective bargaining agreement between the teachers and the province expires on July 31, 2010. The next agreement must put the province in a position that restricts taxpayer liability to regular payments into the pension plan—which amount to almost 10% of salary, matched by the teachers. Provisions for early retirement and inflation indexing will need to be adjusted to bring the plan to a sound financial position. The resulting plan would still be among the most generous in the province.

Taxpayers have already made extra contributions to these two public sector pension plans of almost a billion dollars. It is time for taxpayers to get some relief.

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The following is the Pensions in Crisis update from February 8th, 2011:

PENSION CRISIS – CONTINUED

There has been considerable public discussion and media attention on all three fronts: Teacher’s Pension Plan, MLA pensions, and Public Service Superannuation Plan. The Feb 1 Herald editorial captures an emerging consensus:

“The debate isn’t ideological. The problem is a simple affordability issue …. Pensions will have to compete for public funds with other demographic time bombs, like health care. It would be foolish to expect voters to give priority to public-sector pensions that are much better than their own.”

It is worth emphasizing that this is not a campaign against public sector workers. Rather at a time when provincial resources are stretched to the breaking point and most Nova Scotians face doubtful retirement prospects it is an effort to bring a reasonable balance between the interests of public sector workers and their neighbours.
Teachers Pensions

At present this is the biggest problem. As discussed in earlier postings, there was a $1.276 billion deficit at the end of 2009. The present structure will cause ongoing volatility and the bias will be for further deterioration.

It is encouraging to hear the Minister clearly acknowledge the problem as reported in the January 31 Chronicle Herald although it would be nice to see a firmer commitment to resolution.

“Finance Minister Graham Steele said the government is talking to the teachers union about its pension plan, but those discussions are separate from ongoing contract bargaining. And while he agrees the teachers plan is in financial difficulty, he is vague about solutions.

“An unfunded pension plan is not good for anyone,” said Steele. ‘There are discussions ongoing . . . but no one should assume that there is a particular timetable, or indeed that anything is going to be done at all.”

Steele said the teachers plan appears to have ‘no reasonable prospect’ of returning to full funding based solely on returns from market investments.

“If nothing is done they (unfunded plans) get worse, but they get gradually worse and then they accelerate,” said Steele.”

It is not just taxpayers who will suffer if nothing is done. Under present arrangements those who retired before August 2006 are making no contribution to reducing the deficit. So those who retire after, especially the younger teachers, will in dwindling numbers be left to deal with their half of the large and growing problem.

MLA Pensions

There appear to be very few supporters of the current regime beyond its immediate beneficiaries. The new Speaker has announced a review, which is good. But how the question is framed will be crucial.

If the direction is to create a plan that is within the range of what other Nova Scotians experience, an acceptable result will emerge. But if the principal point of reference is the plan for elected officials in other provinces and the federal government, the result will be most unsatisfactory.

The suggestion by the speaker that special consideration be made for transitions back to public life does not stand up to scrutiny. Almost all MLA’s are earning more in those roles than they did in their previous jobs. The majority that come from the public sector (see Who Represents You?) are typically able by union contract to pick up where they left off. If transition support is to be provided, it should be for those not already protected. Expensive pension entitlements that apply to everyone are the wrong instrument for the job.

Public Sector Superannuation Plan

The Minister has taken great exception to the characterization of his actions as a bailout.

His letter and my reply (as they appeared in AllNovaScotia.com) appear below.

Re: Bill Black Blasts $500-million Pension Bail-Out

January 14, 2011

“I was disappointed to read that Bill Black is, again, spreading misinformation about the Public
Service Superannuation Plan. As the sole trustee of the PSSP, I have an obligation to ensure that my public comments about the Plan are measured and accurate. Bill does not operate under the same constraints.

Before the reforms, the PSSP was facing an unfunded liability at $1.5 billion and growing. This unfunded liability represented permanent insecurity for pensioners and members, as well as a significant cost to taxpayers.

The PSSP was reformed as part of the April 2010 budget. A section of the Budget Speech described what we are doing, and why. The reforms were in the Financial Measures Act that was introduced, debated, and passed in the House of Assembly.

The FMA was on the floor for debate from April 13, 2010 to May 20, 2010. There is a verbatim transcript of the debate on the FMA. Any member of the public was entitled to appear before the Law Amendments Committee to speak to the bill. It is difficult to image a more transparent or public process.

The Major reform was to make indexing dependent on the health of the plan, rather than guaranteeing it regardless of the overall health of the plan. These, and a few other smaller changes, were worth close to $1 billion. This effectively represents the members’ contribution to the unfunded liability and to suggest there has not been a misunderstanding of the issues involved.

In addition, $536 million of the liability was refinanced at a lower interest rate, producing annual savings to taxpayers of between $160 million and $200 million per year. Bill chooses to characterize these reforms differently, and he is wrong. No matter how times he repeats his analysis, he is still wrong.

As a result of the reforms, the PSSP is healthier and more secure than it was been for many years.

In addition, taxpayers will see a significant reduction in public-service pension expense.”

Graham Steele
Minister of Finance
January 31, 2011

My response to Minister Steele’s letter published on January 14:

As the Minister knows both my written and spoken comments on the topic of public sector pensions have congratulated him for addressing a difficult topic too often ignored by his predecessors. The decision to amend PSSP benefits in order to reduce the deficit was bold and necessary.

I work hard to make my comments on public policy accurate and would invite the Minister to indicate if any of the following statements are incorrect:

1. The province has put $536 million into the PSSP plan with no matching dollars from employees. This eliminated the remaining funding deficit in the plan but he was not legally obliged to do so. This was the first time that taxpayers have put in money that was not matched by employees.

2. His benefit changes addressed about $1 billion of the problem. He could have made further benefit changes—for example, gradually phasing in later retirement for existing employees or further reducing inflation indexing—to address the remaining deficit, in which case the $536 million injection would not have been needed to bring the plan into balance.

3. After such changes, the PSSP members would still have pensions far better than almost all other Nova Scotians, 60% of whom have no pension plan at all.
4. The legislation makes no provision for taxpayers to get their money back. In fact it provides that any future surpluses will be used to enhance benefits.

5. These arrangements were discussed with union leaders prior to being announced to the public.

6. The Minister’s predecessors have topped up the Teacher’s Pension Plan by more than $400 million over the years. Nevertheless it had a deficit of $1.274 billion at the end of 2009. Under present arrangements, taxpayers will be responsible for half of that, and historical experience suggests that additional deficits can be expected in future years. The Minister’s intentions for addressing this are not known at present.

7. The Minister has not yet revealed any plans to bring transparency to the MLA pension plan.

The above are questions of fact. There are other matters on which reasonable people can differ:

1. The Minister and union leaders describe the arrangement as “sharing” the pain—employees have benefit expectations reduced while taxpayers put in more money. I prefer to characterize it as a “bailout”. The benefits have been chronically under funded by both employer and employees. What should happen is a reduction in benefits to whatever those payments would provide.

2. The Minister describes the $536 million injection as “refinancing”. I find this description puzzling. If so, when do taxpayers get their money back? Why don’t future surpluses go back to taxpayers? Had the Minister instead made additional benefit changes that $536 million would be available for other public purposes. Hence I prefer the word “bailout”.

The Minister’s stated intention is to bring the province’s books back into balance. The postings on newstartns.ca are in support of that worthy goal. If any of the facts above are in error I will be glad to correct them. On matters of opinion, let’s agree to respectfully disagree.

Bill Black

At time of writing, the Minister has not contested the statements of fact.