



Public Sector Pension Schemes – General Principles and the Canadian experience

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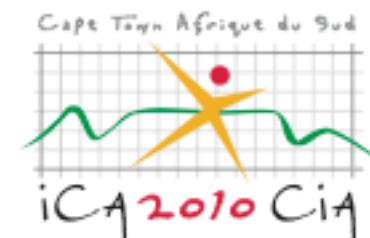
1. General Principles

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Public Sector Pension Schemes – General Principles and the Canadian experience



1. General Principles

a. Integration with Social Insurance

- § Public service pension often existed prior to social insurance
- § Integration vs. coordination (or combination)

b. Existing Regulations for private sector pension schemes

- § Should public sector and private sector schemes be under the same regulatory regime?
 - § Public sector schemes often perceived as half way between private schemes and social insurance
 - § Defined benefit public sector schemes stakeholders are ultimately the taxpayers
 - § Political issues (when large reserves pose political economy problems , there could be more reliance on PAYG than External Funding)
 - § Level of governments impacts the regulatory regime (eg. In federations)

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1. General Principles (con't)

c. Transition issues from PAYG to funded public sector schemes

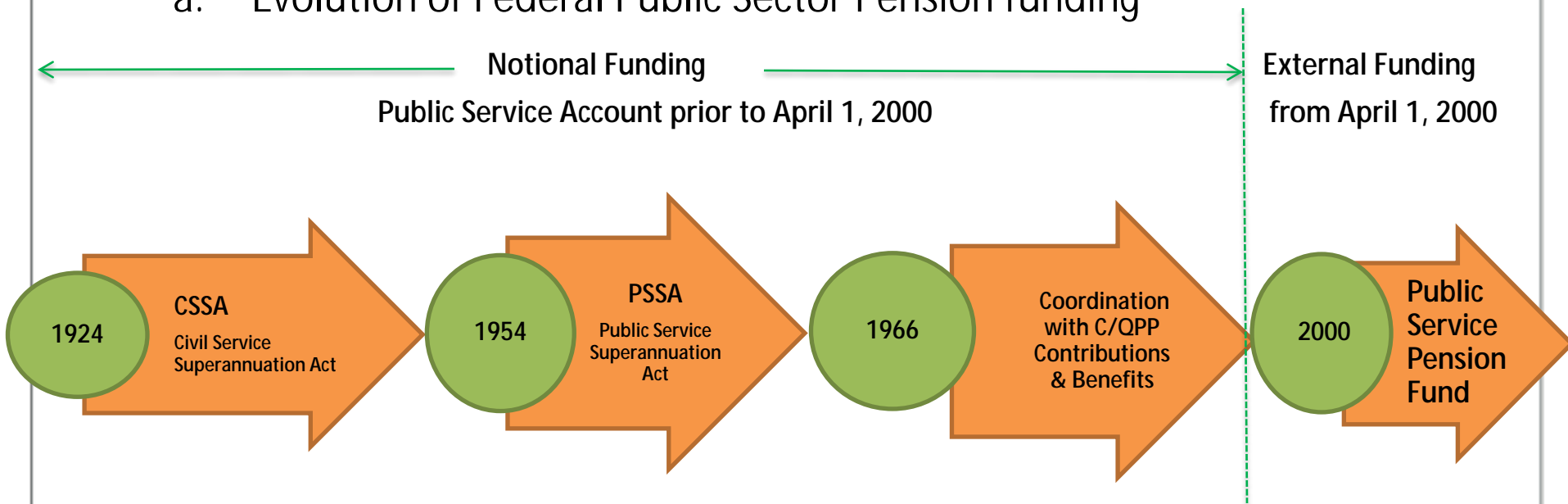
- § Smoothing over a long timeframe;
- § Funding at highest level of government also implies that an entity, associated or not with the Government, holds a large amount of marketable assets (political issue);
- § Significant liabilities at stake ;
- § Who should bear the explicit debt to finance the transition?
- § Steps to be considered
 - § Multi-year move from implicit debt to explicit government bonds backing the liabilities;
 - § Introduce full accruing of pension accounting within the government budgeting process;
 - § Move ultimately towards reserve or real pension funds invested in private sector assets;

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2. The Canadian Experience

a. Evolution of Federal Public Sector Pension funding



- i. Funding is shared by employees and employer (Federal Government)
- ii. System changed from long term superannuation grants to pension entitlements in 1954

Source: Treasury Board of Canada Secretariat

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2. The Canadian experience (con't)

b. Multi-level governmental entities

i. Federal public sector pension schemes

- § Three main schemes cover employees of federal governments, Royal Canadian Mounted Police and Canadian Forces
- § Public Sector Pension Investment Board – PSPIB Created in 2000
 - § Prior to 2000, Superannuation Accounts (Accounts of Canada) were credited with contributions and interest, and debited with benefit payments and accrual of liabilities;
 - § Since 2000, employer and employee contributions are deposited into the PSPIB for investment in financial markets
- § PSPIB investment strategies
 - § Absolute performance: return net of expenses to meet rate of return determined by Chief Actuary;
 - § Relative performance: return exceeding the policy benchmark return by 50 basis points.
 - § Underlying liabilities have long duration (allows higher exposure of portfolio in equities)

Source: Public Sector Pension Investment Board – 2009 Annual Report

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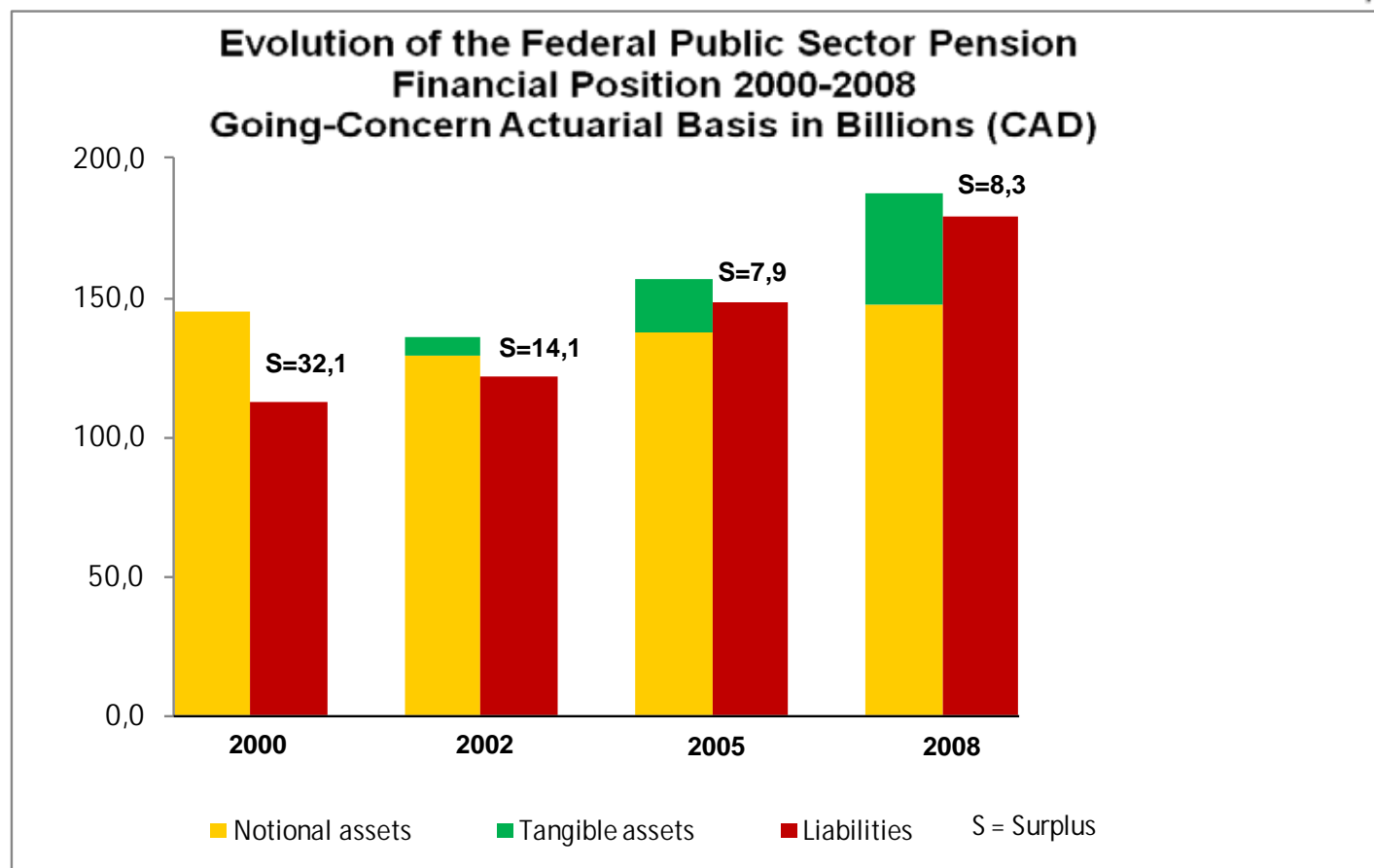
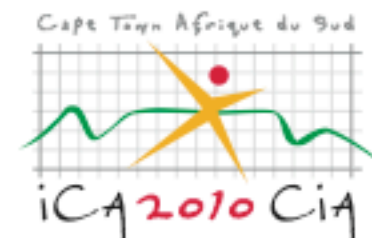
2. The Canadian experience (con't)

b. Multi-level Governmental Entities (con't)

ii. Provincial, municipal and other local public sector pension schemes

- § Significant number of plans by provinces (cover employees of provincial, municipal and other local agencies)
- § Schemes with external pension funds
- § Transfer agreements assure portability between schemes
- § Significant liabilities and assets concentrated in small number of large schemes (eg. Teachers pension schemes at provincial levels)

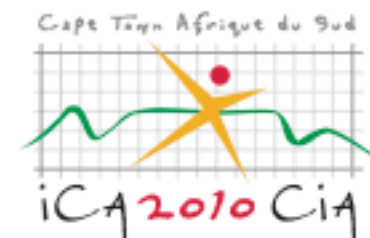
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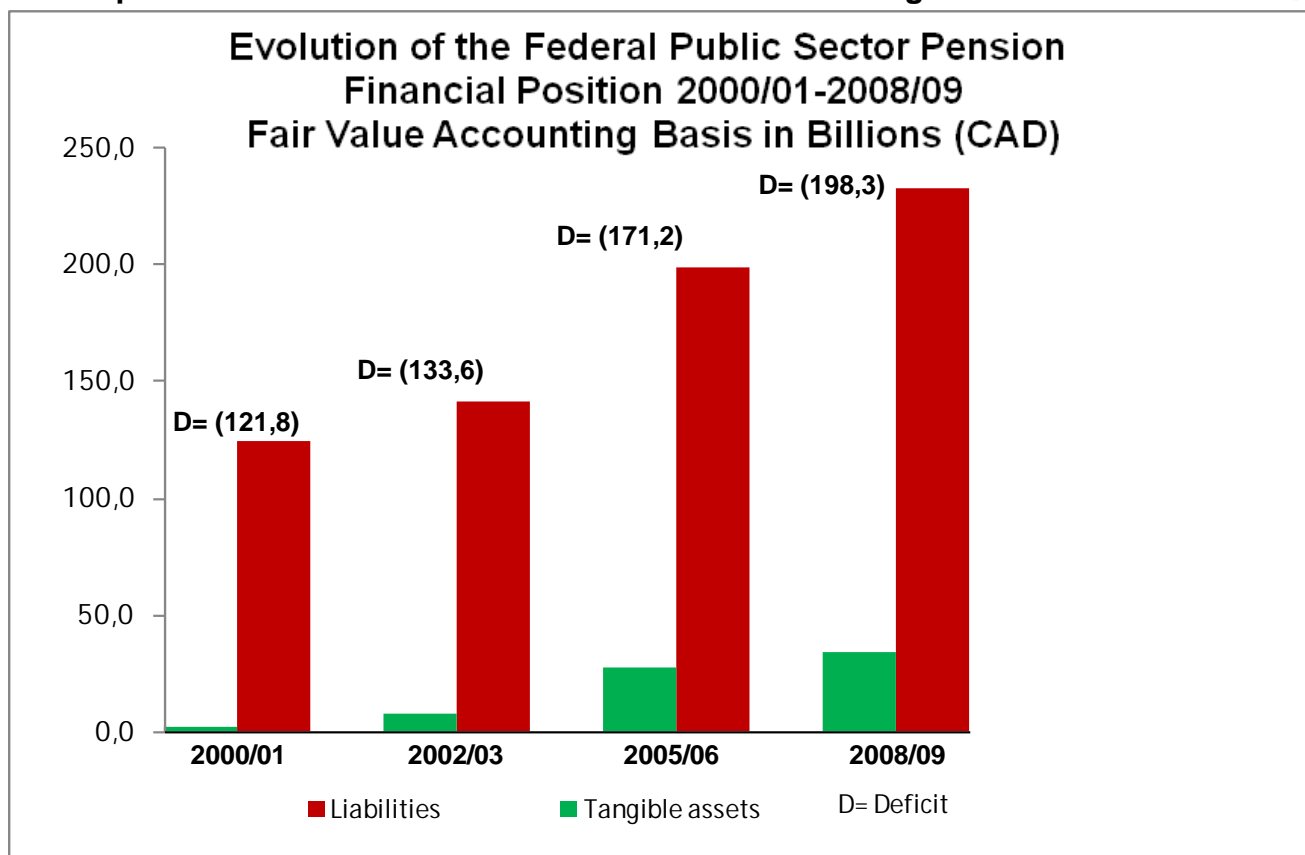
Note: Legislative provisions granted authority to debit some actuarial surplus of \$14.8 billion in 2002

Source: Actuarial Reports from the Office of Chief Actuary - Canada

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A completely different picture evolves under Fair Value Pension Accounting...



Note: Reported assets and liabilities under the Federal Government's balance sheet are different than under Fair Value Accounting due to smoothing mechanism on plan assets and a different discount rate methodology to measure plan liabilities.

Source: C.D. Howe Institute Study No. 122, December 2009

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2. The Canadian experience (con't)

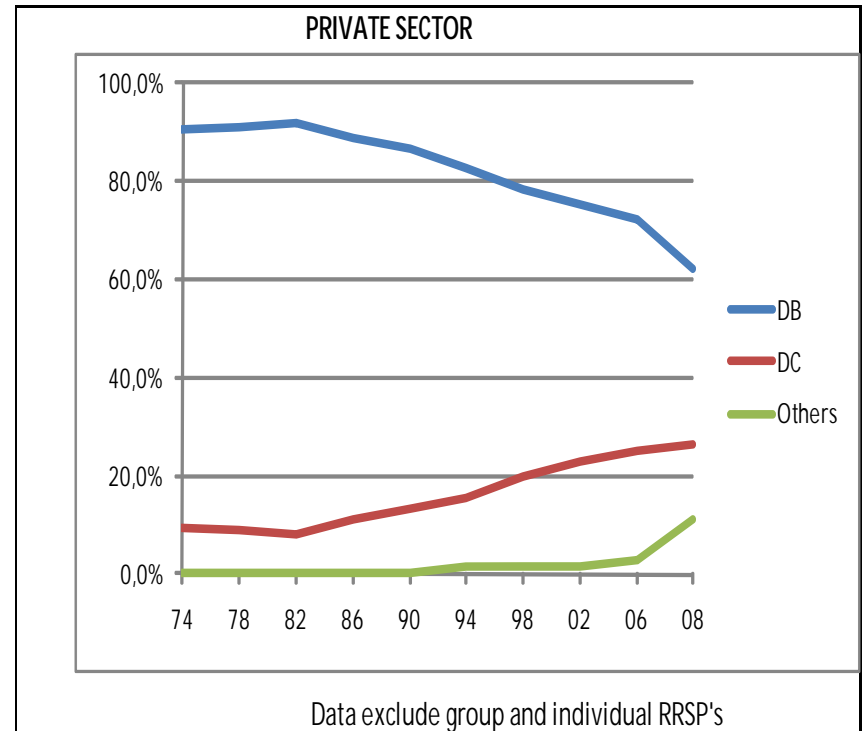
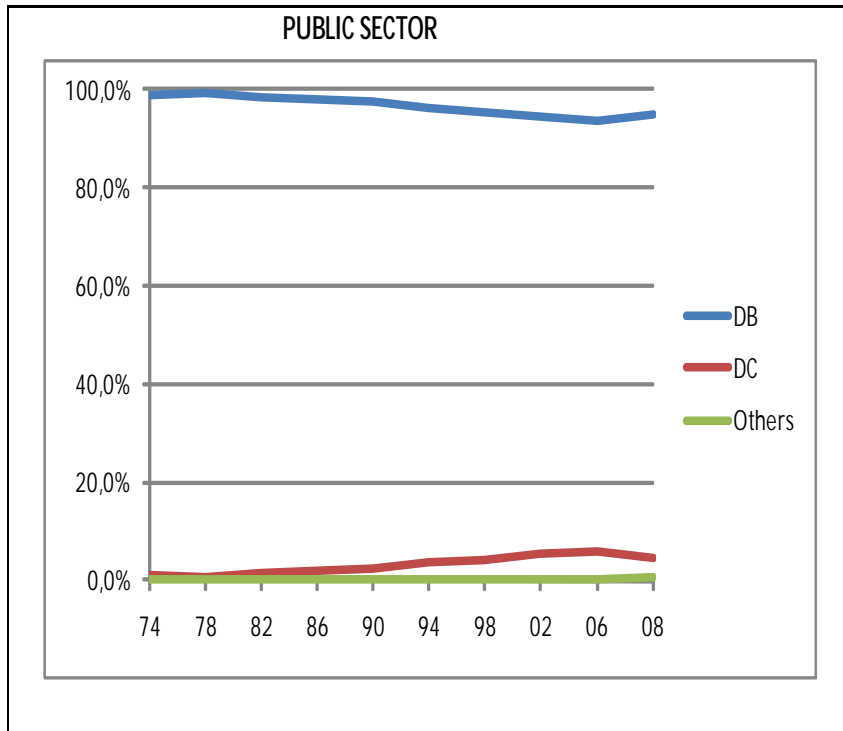
c. Emerging issues & trends in membership

- § Very generous DB formulas with generous ancillary benefits
- § Designed for traditional workforce, not adapted to today's reality?
- § Slow political process to redesign plans
- § Significant risks
 - § Fertility / longevity/Inflation/ Investment
 - § Impact long term sustainability
- § External funding implications
 - § Potential for higher long-term real returns
 - § Increased volatility in funding levels (eg. financial crisis and subsequent recovery)
- § Trends in membership
 - § Different patterns in public sector vs. private sector (see graphs next page)

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Comparative trends in percent of plan membership by type of schemes from 1974 to 2008 for Public Sector and Private Sector



Source: Underlying data from Statistics Canada

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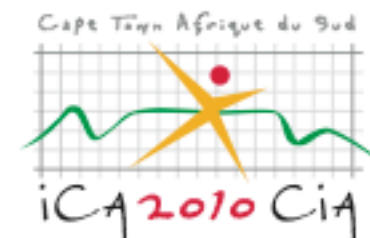


2. The Canadian experience (con't)

d. Proposed alternatives

- Pooling of risk already exists – Multi-employer (eg. municipalities)
 - Opportunities for more pooling
 - Shifting risk to plan participants (eg. member-funded pension plan (MFPP) in Québec)
- Proposed reforms of Canadian retirement system
 - C.D. Howe Institute (Keith Ambachtsheer)
 - » Introduce the Canadian Supplementary Pension Plan
 - » Expand coverage and mandatory higher benefits (60% of earnings) with opt out option
 - Canadian Labor Congress
 - » Double the Social Insurance benefit (C/QPP)
 - » Phase in a fully funded add on benefit over 35 to 40 years
- Both reforms would impact Public Sector Schemes through integration / coordination features

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2. The Canadian experience (con't)

e. Concluding remarks

§ Moving from notional to external funding for Federal schemes has been positive

§ Long transition period to assure plan sustainability;

§ Long duration of liabilities allows opportunities for incremental real returns.

§ Do we need more advance funding of public service schemes?

§ Should the direction taken in 2000 remain the option?

§ Advance funding is not a panacea.

§ Recommendations to improve current system include:

§ Proper accounting and reporting of plan liabilities and costs by governments

§ Full integration of pension costs into compensation policies

§ Plan design may not adapt to today's workforce;

§ Total compensation policies should not be overly generous when factoring in pension costs;

§ Proper balance between cash and non-cash compensation should be targeted.

§ More disclosure and transparency

§ Further analysis on how better to use the funds

§ High percentage of non-covered workers (ultimately the taxpayers who pay for the public service pensions);

§ Redistribution of wealth across all Canadians should encourage full employment.

Q & A's

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