Ensuring Sustainability of the Public Service Pension Plan

Technical Briefing

September 2014

Why Pension Reform?

- To ensure all pension plans are sustainable for employees, retirees and all taxpayers.

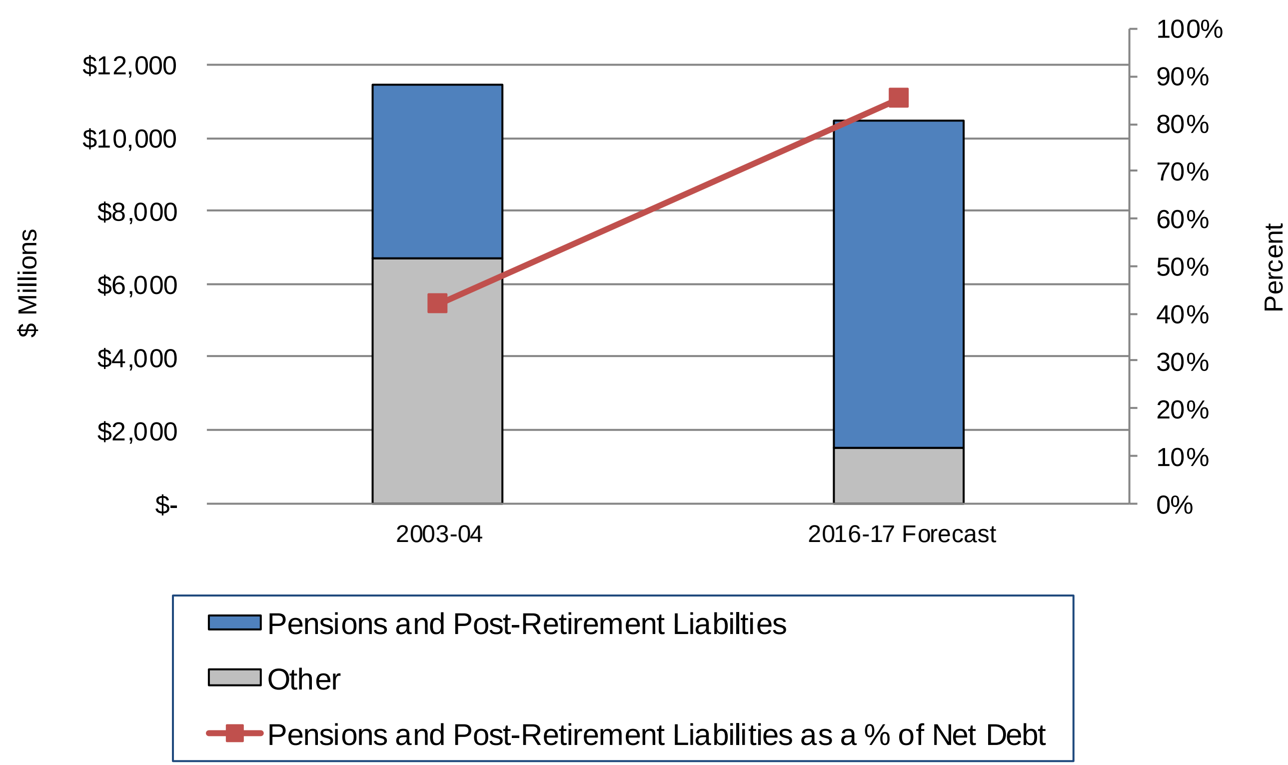
- To address significant growing unfunded liability in pensions and other post-employment benefits
    - 2014-2015: 74% of net debt
    - 2016-2017: 85% of net debt

- $373M pension interest expense (2013-14)

- Overall, pension plans are 60.8% funded (as at December 2013)

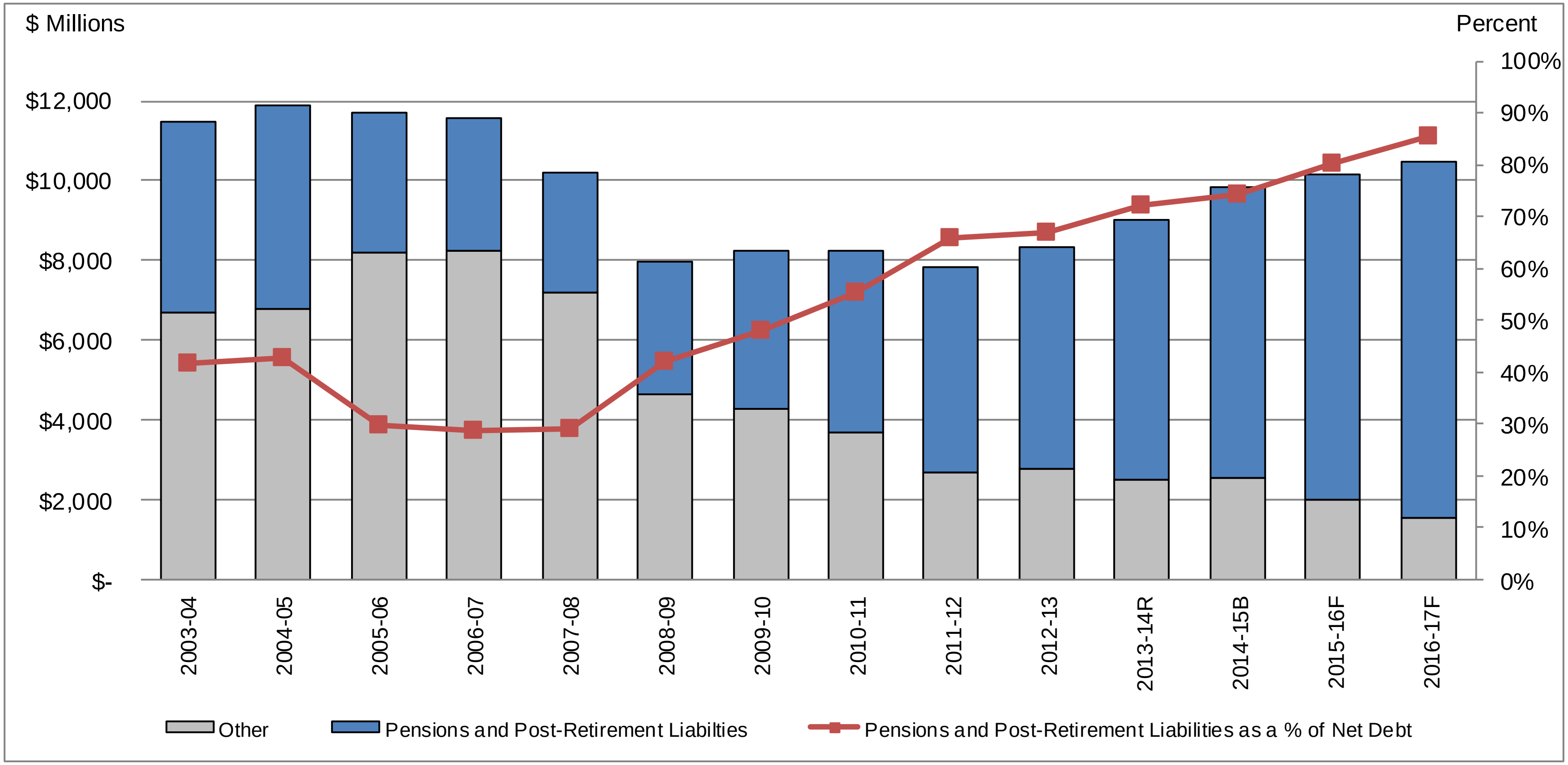
Net Debt: Pension and Other Post-Employment Liabilities Growth

Newfoundland Labrador



Special Payments since 2003: $3.6 billion

Net Debt: Pension and Other Post-Employment Liabilities Growth



Auditor General Comments

"….Since 2007-08, the unfunded liability has increased, such that, at March 31, 2013, the total unfunded liability is now greater than it was at March 31, 2005, despite in excess of $3.6 billion in special payments over that period. This reflects the inherent volatility related to this unfunded liability and the risks borne by the taxpayers of the Province for the retirement benefits of public employees."

Auditor General's 2013 Report on the Audit of the Financial Statements of the Province

Consultation with PSPP Stakeholders

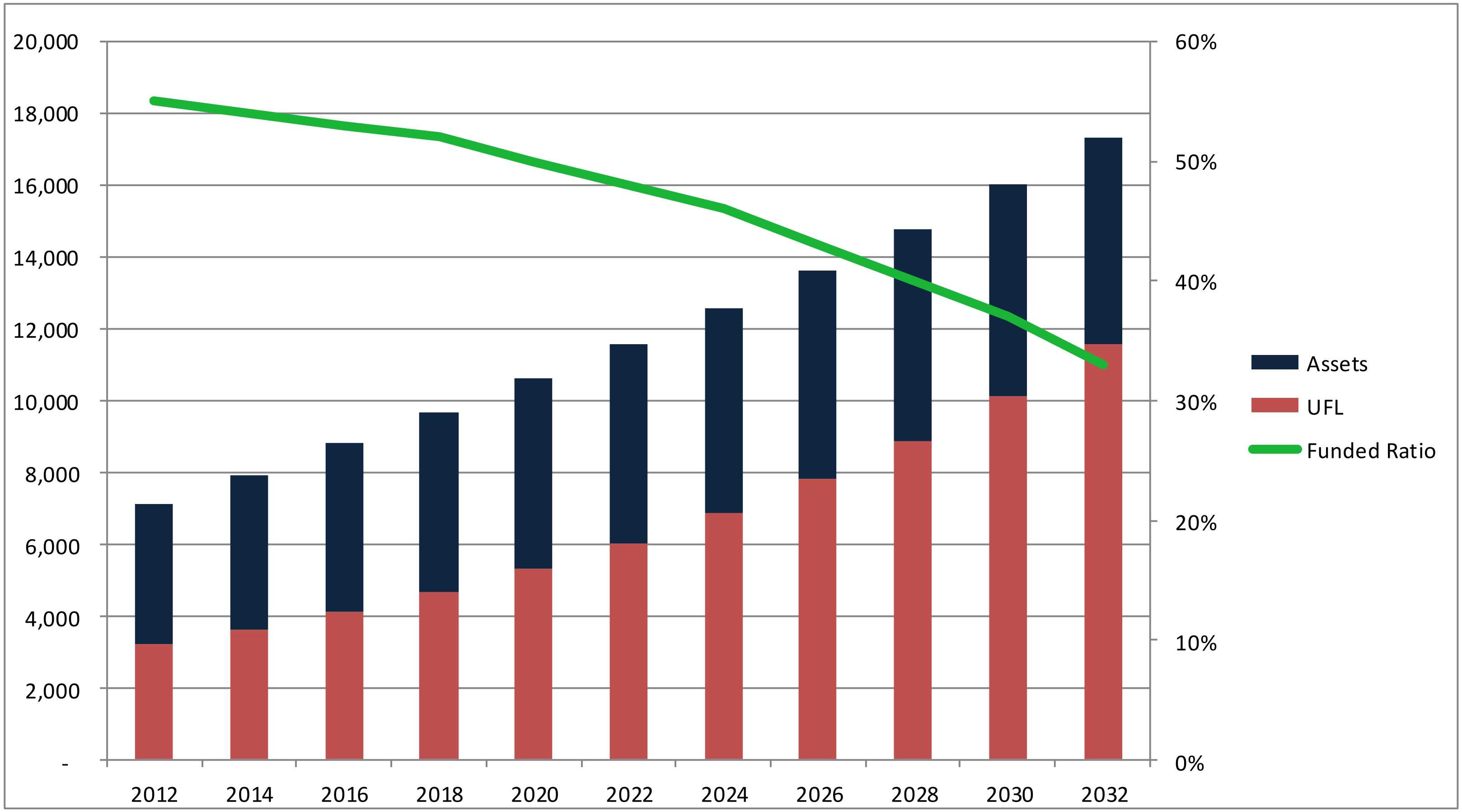
- Government engaged in consultations with unions of the PSPP as well as the Pensioners' Association from December 2012 to August 2014
- Worked closely with unions of the PSPP:
  - Newfoundland and Labrador Association of Public and Private Employees (NAPE)
  - Newfoundland and Labrador Nurses' Union (NLNU)
  - Canadian Union of Public Employees (CUPE)
  - Association of Allied Health Professionals (AAHP)
  - International Brotherhood of Electrical Workers (IBEW).
- Engaged pension experts
- Common goal: Sustainability of the PSPP

PSPP – How Big is the Deficit?

Newfoundland Labrador

- December 2013 – Eckler Consultant and Actuaries Modelling
  - $4B deficit projected from 2012 valuation of $3.2B
  - Model assumptions included:
    - New mortality tables
    - De-risking of the plan - change in asset mix from 75% to 50% equities
    - Lower discount rate – from 6.75% to 6%
  - Incorporates 22.4% pension fund returns in 2013

PSPP Projected Unfunded Liability Without Pension Reform



PSPP Reform Objectives and Commitments

- 100% funded within 30 years
- Unfunded liability shared
- Plan governed by Joint Trustee
  - Jointly sponsored
  - Expert Board of Directors
  - Actuarial surpluses and deficits equally shared
- GNL Commitments
  - Current retirees’ pensions not impacted
  - Defined benefit plan maintained
  - A transition period provided
  - Accrued pension benefits protected

Basis for Agreement

Plan Conditions that are Changing…
Contribution Rates
Unreduced Early Retirement
Reduced Early Retirement
Pension Calculation Formula
Other Post-Employment Benefits

Contribution Rates

- Last increase: October 1, 2002
- Earnings up to Year's Maximum Pensionable Earnings (YMPE) – increase 2.15%
- Earnings in excess of YMPE – increase 3.25% (2.15% + 1.1%)
- Impact examples, per pay period[1]:
  - $40,000 annual salary = $24 net contribution increase
  - $60,000 annual salary = $35 net contribution increase
  - $70,000 annual salary = $43 net contribution increase
  - $135,000 annual salary = $89 net contribution increase

[1] Income tax savings noted assume a person claiming only basic personal amount; other credits and deductions may significantly change these numbers.

Basis for Agreement – Contribution Rates Changes

Newfoundland Labrador

Current PSPP	*Agreement for Reformed PSPP*
First $3,500 earnings – 8.6% $3,501 to Yearly Maximum Pensionable Earnings (YMPE) – 6.8% Above Yearly Maximum Pensionable Earnings – 8.6%	First $3,500 earnings – 10.75% $3,501 to Yearly Maximum Pensionable Earnings – 8.95% Above Yearly Maximum Pensionable Earnings – 11.85% Implementation - January 2015

Basis for Agreement – Unreduced Early Retirement Changes

Current PSPP	*Agreement for Reformed PSPP*
Age 55 with minimum 30 years service Or Age 60 with minimum 5 years service	Age 58 with minimum 30 years service Or Age 60 with minimum 10 years service → With five year transition under old rules Implementation – January 2015

Basis for Agreement – Reduced Early Retirement Changes

Current PSPP	*Agreement for Reformed PSPP*
Age (minimum 55) plus Years of Service equal 85 Or Age 50 with 30 years service Or Age 55 with 5 years service	Age 53 with 30 years service Age 59 with 29 years of service Age 55 with 5 years service → With 5 year transition under old rules Implementation – January 2015

Who is Grandparented?

- Two ways to grandparent
  (*at the end of the 5 year transition period*)
  - Active or deferred pension members with 55/30 or 60/5 can receive early unreduced retirement anytime after the transition period
  - Active or deferred pension members with 30 years service can receive early unreduced retirement anytime after the transition period after they reach 55 years of age

- Window option
  - Any member who is eligible to retire with a reduced benefit will have the old rules apply during the transition period; after the transition period, the new rules apply

Basis for Agreement – Pension Calculation Formula Changes

Current PSPP	*Agreement for Reformed PSPP*
Best Average Earnings (BAE) - best 5 years	Best Average Earnings – best 6 years (frozen BAE 5 for past service) Indexing on future service suspended (no impact on current retirees) Implementation – January 2015

Basis for Agreement – Other Post-Employment Benefits Changes

Current PSPP	*Agreement for Reformed PSPP*
Pension eligibility with minimum 5 years service	Pension eligibility with minimum 10 years service → With 5 year transition under old rules Implementation Date – January 2015

Other Post Employment Benefits (OPEB) Eligibility

Newfoundland Labrador

- Retired employees can continue membership in the group health and life insurance plan
- Employees, who retire or reach eligibility for an unreduced pension, during the five year transition period, will continue to require a minimum five years of service
- Employees, not eligible for grandparenting, will require pension eligibility AND a minimum of ten years service
- Employees, who have already terminated employment and deferred their pension, must retire at the end of the five year transition period to retain OPEB eligibility
- Employees who terminate in the future must retire in order to retain OPEB eligibility

Basis for Agreement - Summary

Newfoundland Labrador

Plan Conditions	*Current PSPP*	*Agreement for Reformed PSPP (effective January 2015)*
Contribution Rates	The total of: • First $3,500 of earnings – 8.6% • $3,501 to YMPE – 6.8% • Above YMPE – 8.6%	The total of: • First $3,500 of earnings – 10.75% • $3,501 to YMPE – 8.95% • Above YMPE – 11.85%
Unreduced Early Retirement	• Age 55 with minimum 30 years service • Age 60 with minimum 5 years service	• Age 58 with minimum 30 years service • Age 60 with minimum 10 years service → 5 year transition
Reduced Early Retirement	• Age (minimum 55) + Years of Service equal 85 or • Age 50 with 30 years service or • Age 55 with 5 years service	• Age 53 with 30 years service or • Age 59 with 29 years service or • Age 55 with 5 years service → 5 year transition
Pension Calculation Formula	Best Average Earnings (BAE) 5 years	Best Average Earnings 6 years (frozen BAE 5 for past service) Indexing on future service suspended (no impact on current retirees)
Other Post-Employment Benefits	Pension eligibility (minimum 5 years service)	Pension eligibility (minimum 10 years service) → 5 year transition

Joint Trusteeship

- In conjunction with the Plan changes and Government's promissory note of $2.685 billion, government and unions have agreed to a Joint Trusteeship arrangement
  - To equally share any actuarial surpluses and deficits
  - Creation of an independent corporation to oversee and manage the Fund
  - Act as Sponsors responsible for future plan design changes and make decisions by their common agreement
  - Framework and Funding Policy to be determined

Funded Status (Eckler Modelling)

Newfoundland Labrador

Current PSPP	*Agreement for Reformed PSPP*
Funded Ratio (median) 5 years – 61% 15 years – 57% 30 years – 53% Probability of Being Fully Funded in 30 years – 24%	Funded Ratio (median) 5 years – 69% 15 years – 99% 30 years – 163% Probability of Being Fully Funded in 30 years – 84%

Best Average Earnings (BAE) and Early Retirement Impacts – Example 1

Emily (age 35, started work at 29, 6 years services)

- Under the current plan, Emily would be eligible to retire with an unreduced pension at age 59 with 30 years of service

- Under the new plan, she would still be eligible to retire at age 59

- Emily would need to work an extra 5 months to get the same pension that she would have earned under the old rules or she could choose to work longer to receive a higher pension

Best Average Earnings (BAE) and Early Retirement – Example 2

George (age 46, started work at 23, 23 years service)

- Under the current plan, George would be eligible to retire with an unreduced pension at age 55 with 32 years of service
- He would need to work an extra 15 months to get the same pension that he would have earned under the old rules
- George could work until he was 58 and receive a higher pension

Best Average Earnings (BAE) and Early Retirement – Example 3

Dawn (age 52, started work at 25, 27 years service)

- Under the current plan, Dawn would be eligible to retire with an <u>unreduced</u> pension at age 55 with 30 years
- Dawn would need to work an extra 4 months to get the same pension that she would have earned under the old rules
- Dawn could choose to work longer and receive a higher pension

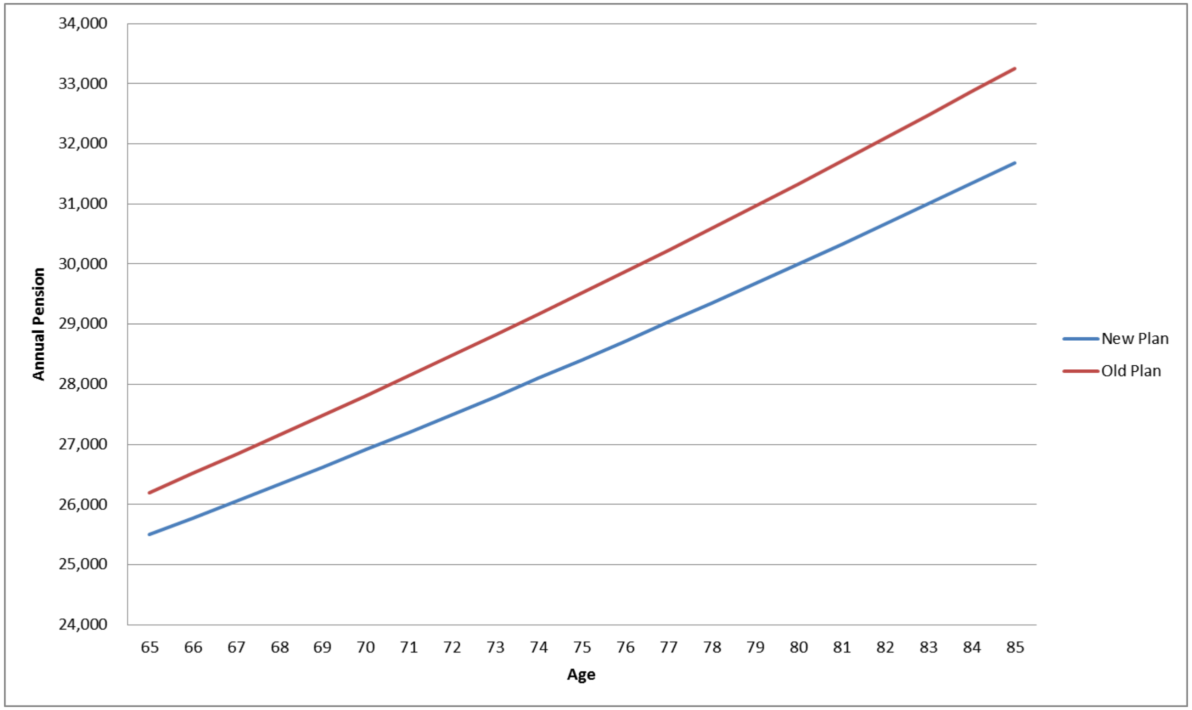
Indexing, Best Average Income (BAE) and Normal Retirement – Example 4

Age at Retirement: 65 Service at Transition: 27 Service at Retirement: 30

<u>Pension</u>

Current Plan : $26,200

New Plan: $25,500 of which *22,950 (Indexed)* + *$2,550 (Non Indexed)*



Indexing, Best Average Income (BAE) and Early Retirement – Example 5

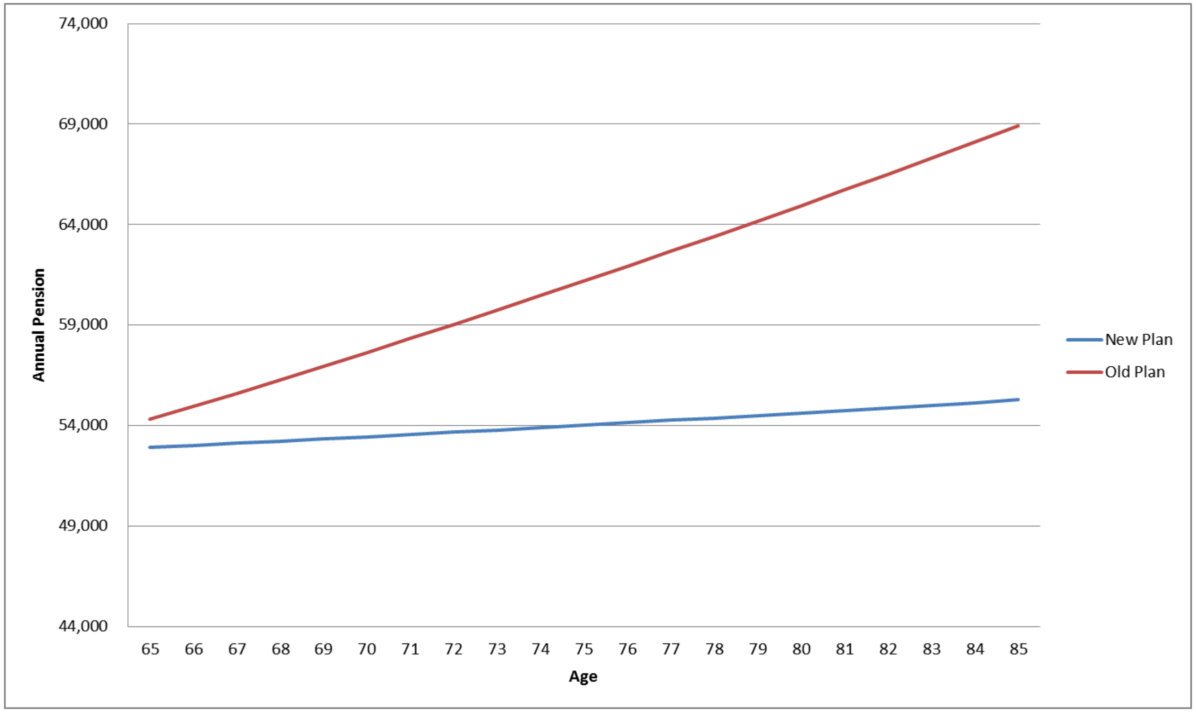
Newfoundland Labrador

Age at Retirement: 60 Service at Transition: 5 Service at Retirement: 30

Pension

Current Plan : $54,300

New Plan: $52,900 of which *8,817 (Indexed)* + *$44,083 (Non Indexed)*



Next Steps

- Finalize discussions and Sign Joint Trusteeship Agreement
  - Parties to develop the framework including type of corporation, parties, content of Funding Policy and Sponsors Agreement
- Amend legislation in Fall Sitting
  - Contribution Rates, BAE Change, new Early Retirement options (effective January 2015)
  - Remove deficiency guarantee
  - Fully exempt from PBA (does not provide for jointly sponsored plans)
- Establish the Corporation, enact bylaws, appoint members and provide fiduciary training
- Consult on other defined benefit plans