Prince Edward Island
CANADA

Pension Sustainability

Making public sector pensions more secure and affordable

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Minister's message

Prince Edward Island's two large public sector pension plans, the Civil Service Superannuation Fund (CSSF) and the Teachers' Superannuation Fund (TSF), are facing unprecedented challenges.

Longer life expectancy, early retirements, a declining ratio of actives versus retirees, and lower investment returns are making it increasingly difficult for the CSSF and TSF to meet their commitments. As guarantor of these plans, the Province is facing escalating funding obligations.

Unfortunately, the problem cannot be solved by just raising contributions and waiting for higher investment returns. Because the security of these plans could be in jeopardy, we must act now.

Over the past year, government officials have been reviewing our public pension plans. There is a growing understanding that our pension issues must be addressed, and that the status quo is no longer an option.

This document outlines changes that will result in a pension system that is more secure, affordable and responsive to changing demographic and economic conditions. These changes have been designed to put our pension plans on a sustainable course, while allowing us to live within our means.

More than 8,900 active plan members and 4,900 retirees are counting on us to get these changes right. So, too, are Island taxpayers.

I can assure retirees and employees that the current pension base will continue to be fully protected. The amount of pension that retirees and employees are currently receiving, or have earned until the end of 2013, will not be altered or reduced. The changes outlined will be implemented on a go-forward basis. Some will be effective January 2014, while others will not take effect until 2019.

Government is committed to working closely with the pension plan boards and representative groups to effect changes that are necessary but fair, and to keeping all plan members well informed.

Working together, we can build a pension plan that will better serve everyone's needs for generations to come.

Sincerely,

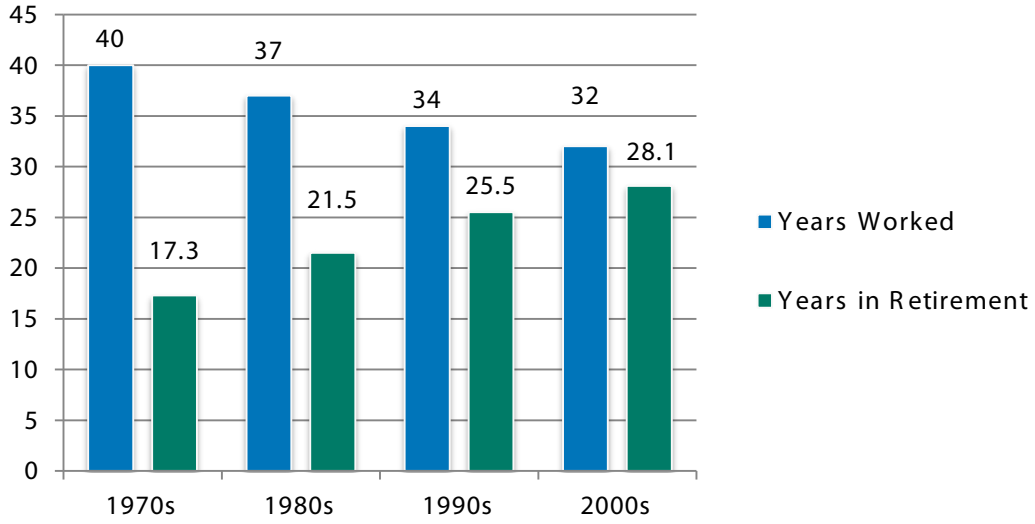
Wes Sheridan
Minister of Finance, Energy and Municipal Affairs

1. Current situation

Our pension plan models were designed over 50 years ago, when people spent more time in the workforce and less time in retirement. A greater number of people were paying into the plan versus drawing a pension and investment markets were stable.

Today, many defined benefit pension plans are facing significant funding deficits because they have not kept pace with changing demographic and economic conditions, such as:

- **Longer life expectancy** – in the 1970s the average Canadian worked for over 40 years and spent 17 years in retirement - whereas today we work for an average of 32 years and retire for 28 years;



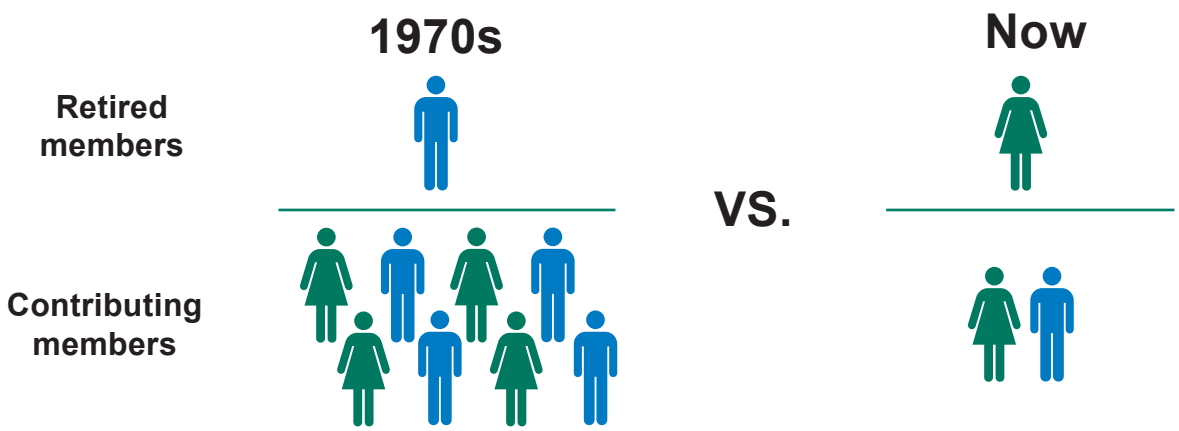
- **Early retirement** – our pension plans are now supporting an increasing number of people who are spending more years in retirement than they did working;
- **Ratio of pensioners to contributing members** – in the 1970s there were eight people working and paying into the pension plans for every retiree, and today this ratio is two to one; and
- **Lower investment market returns** – recent instability in investment markets, such as the global downturn, is having a huge impact on the cost of operating pension plans.

The Province's two largest public sector pension plans, the Civil Service Superannuation Fund (CSSF) and the Teachers Superannuation Fund (TSF) are facing the same challenges as many public and private sector plans across North America.

Together, these plans serve more than 8,900 active members and over 4,900 retirees from across the province.

Despite high contribution rates, millions of dollars of special payments by the Province, current assets of $1.9 billion and investment returns on par with other public sector pension plans, the two plans face unfunded liabilities totalling over $400 million.

Even if interest rates rise and returns on investments continue to improve, the CSSF and the TSF will continue to face significant risk because of the maturity of the plans and improved longevity. Mature plans rely heavily on investment earnings to pay for pensions, but if investment returns fail to keep pace with the rising cost of benefits, a mature plan can quickly see a large shortfall develop.



Over the past two decades, both the CSSF and TSF have had a large drop in the ratio of contributing employees versus retirees. In 1970, there were over eight employees who were working and paying into the pension plans for every retiree. By 2011, the number of actives supporting each retiree had shrunk to two. This places an increasing cost burden on current members and employers.

Higher interest rates and strong investment returns in the future would help, but the plans cannot risk the chance that the opposite may happen. In any case, the risks facing the plans will not go away.

Action must be taken to set our pension plans on a course that will lead to a sustainable system without putting undue financial stress on today's employees, taxpayers or pensioners.

Government is committed to protecting the existing pension base. Any benefits earned for service up to the end of 2013 will be unaffected, and any changes will ensure that the plans continue to be excellent retirement savings vehicles that provide reasonable, cost-effective and highly secure pensions.

2. Principles

The changes have been developed based on the following principles:

- benefits already earned will be protected;
- contributions will be affordable and sustainable for employers and employees;
- a high degree of benefit security is essential; and
- the changes will consider the needs of new hires, actives, retirees and the taxpayers.

3. Proposed Changes

Changes will take place over the next few years. Some will begin immediately and others will take effect in 2019.

The base pension of both the TSF and CSSF shall continue to be administered as a guaranteed defined benefit plan. While indexation will no longer be guaranteed after 2016, it is expected to be delivered a very high percentage of the time. This confidence that indexation can be awarded a majority of the time is founded on the following:

- in future, surplus funds must be used to pay for indexation;
- the benefit changes outlined in this document, in conjunction with a long-term funding commitment from the Province, will move the TSF and CSSF into a significant surplus situation;
- the funded status of the CSSF will increase from 78% in 2011 to 122% after these changes; and
- the funded status of the TSF will increase from 77% in 2011 to 119% after the changes.

It is these sizable surpluses that provide a high probability that indexation can be awarded most of the time.

These changes will put the plans on solid footing, one that will provide sustainability into the future.

3.1 Retirees

It is important to understand that the pensions retirees are currently receiving will not be reduced.

Retirees will, however, see a change in how and when they are awarded future cost-of-living adjustments, commonly known as indexation. Cost-of-living increases are calculated using the Consumer Price Index – Canada All Items (CPI), which is calculated and issued by Statistics Canada.

CSSF retirees currently receive an annual increase to their pension to offset inflation that is equal to 100% of CPI (to a maximum of six (6) percent in any given year). In 2013, CSSF retirees received a 1.5% increase to their pensions.

TSF retirees currently receive an annual increase to their pension to offset inflation that is equal to 60% of CPI (to a maximum of four (4) percent in any given year). In 2013, TSF retirees received a 0.9% increase to their pensions.

For the next three years, the cost-of-living increase for the CSSF and TSF shall equal 1.5% and 0.9% respectively. In other words, the increase you received in 2013 is the increase you shall receive in each of the next three years.

Starting in 2017, the annual cost-of-living increase for CSSF and TSF retirees will become contingent on the individual plan's ability to pay. This is called "contingent indexation" and is a common practice of many pension plans in Canada.

The funded level of the plans becomes very important under a "contingent indexation" approach. As was outlined above, because of these benefit changes and the long-term funding commitment of the Province, the CSSF and TSF will start this new approach funded at 122% and 119% respectively. In future, indexation will be awarded as long as the plans are over 110% funded.

By using this approach for indexation, the current maximums or ceilings can be removed. For example:

1. CSSF currently has a cap on annual indexation of six (6)%. If inflation were to spike to seven (7)% in a future year and if the CSSF has the funds available it could award a seven (7) % cost-of-living increase.
2. TSF currently awards annual indexation equal to 60% of CPI. If inflation is 2.0% in a future year and if the TSF has the funds available it could award a full 2% cost-of-living increase instead of the current maximum of 1.2% (2.0 x 60% = 1.2%).

   It is also important to understand that once indexation is awarded, it becomes part of the protected base benefit

This approach has been introduced to provide the plans with the flexibility they will require to safeguard the base pension while still providing indexation a majority of the time. Retirees can expect to receive their cost-of-living increase about four out of every five years.

3.2 Current Members

Current members should note that benefits earned to December 31, 2013 will be protected.

For future service only, active members will see:

A. a change in the way average salary is calculated

B. an increase in the number of years of service and age a member must attain to receive an unreduced pension benefit; and

C. temporary increases in contribution rates when the funded level of the plans drops below a pre-determined level.

A. Salary calculation

For service to the end of 2013

Pension benefits earned to the end of 2013 will continue to be calculated based on the average salary rules as follows:

- for the CSSF, the average salary is based on the "best three years of pensionable earnings"; and
- for the TSF, the average salary is based on the "best five years of pensionable earnings".

The pension benefit that results from the calculated average salary as at December 31, 2013 will then be indexed each year until your year of retirement.

For service beginning in January 2014 (applies to both plans)

Pension benefits earned after 2013 will be calculated based on new average salary rules as follows:

- the new average salary calculation shall take into account all post-2013 earnings;
- post-2013 earnings will be indexed with cost-of-living adjustments each year leading up to your year of retirement;
- these indexed, or updated earnings, will be used to calculate your average salary (average of indexed earnings) for service after 2013; and
- this indexing, or updating, ensures that your average salary is based on "current dollar equivalent earnings" and will offset the effects of inflation over your career.

In summary:

- the “best five” or “best three” calculation will still apply to service up to the end of 2013;
- the new “average of indexed earnings” will apply to service after 2013;
- the two pension amounts resulting from the two calculations will then be added together; and
- this means that the closer you are to retirement the less you will be impacted by this change.

Contingent Indexing for Actives:

It is important to note that for service after 2013, the annual indexation or updating of earnings that is explained above is also contingent on the funds being available. For actives, the threshold for awarding indexation is set at 100% funded level. This treatment shall apply to both pension plans.

B. Rule to access unreduced pension

Currently members of both the TSF and CSSF may retire with an unreduced pension when they attain age 60, or between age 55 and 60 when the member attains 30 years of pensionable service (commonly called the 30/60 rule).

The current 30/60 rule will stay in force until the end of 2018. Starting in 2019, the rules will be modified so that:

- members of both the TSF and CSSF may retire with an unreduced pension when they attain age 62, or between age 55 and 62 when the member attains 32 years of pensionable service.

For current employees:

- the existing 30/60 rule will still apply to service up to the end of 2018;
- the new 32/62 rule will only apply to service after 2018;
- the two pension amounts that will result from the two calculations will then be added together;
- this means that the closer you are to retirement, the less impact this change will have on your retirement plans.

B. Contributions

This new arrangement works due to a major funding commitment by the Province and benefit changes from plan members. The Province will make special annual payments beyond dollar for dollar matching of regular contribution of $25 million for the next 20 years. Plan member benefits will be impacted as noted above.

Extra contributions equal to 1% of pay for employees and 2% of pay for employers will automatically commence if the funding level drops below 110%. These special contributions will cease when the funded level goes over 115% funded.

Further employer contributions equal to 2% of pay will automatically commence if the funding level drops below 100%. These special contributions will automatically cease when the funded level goes over 105% funded.

If these extra payments from the employees and employers are not sufficient to get the plans back to 100% funded within five years, then the Province shall be required to make sufficient additional payments to get the plans back to 100% within five years.

These funding rules apply to both plans but the plans shall operate independent of each other.

Benefit / Contribution Summary

The combination of contingent indexation and extra funding (that is pre-determined) provides the CSSF and TSF with ready defenses if future funding challenges arise. This will provide the security and sustainability that is so highly valued by members. The plans are also situated such that even modest investment returns will allow the plans to provide members with a very high level of pension coverage.

3.3 Governance

Government is committed to developing a new governance structure in consultation with stakeholders. The new structure will operate within reasonable constraints that protect contributing members, retirees and taxpayers from excessive costs, while providing highly secure and predictable pensions.

Currently, there are several committees involved in the administration of the pension plans, including the CSSA Administrative Advisory Committee, the Teachers Superannuation Commission and the Master Trust Investment Advisory Committee. These committees have important duties to keep the current pension plans running. Along with the major employee and employer stakeholders, they will continue to have important roles until the new governance arrangements are put in place.

In the coming months, Government will seek advice from all parties, including the plans' actuary and other experts as needed. As Plan Sponsor, the Province will ensure that plan members and employers are well informed on what is being proposed and why.

4. Fall 2013 Legislation

In the Fall Sitting of the Legislative Assembly, the Minister of Finance, Energy and Municipal Affairs and the Minister of Education and Early Childhood Learning will be introducing amendments to the Civil Service Superannuation Act and the Teachers Superannuation Act. When these amendments are passed, they will become law effective January 1, 2014.

Changes to legislation respecting governance will come at a later date following consultations with stakeholders.

5. Key Commitments

Government's approach to future pension plan design and governance is designed to achieve the following commitments:

- Our defined benefit pension plans will continue to provide adequate, competitive, affordable, cost-effective pensions with a high degree of benefit security
- Benefits already earned will be preserved, and members and employers will be given adequate notice of the changes
- Pension plans will be more adaptable in changing circumstances – in good times or bad
- Any changes will be fair to active contributors, retirees, taxpayers and future generations
- Employees will have a greater say in the governance of their own pension plans

Further information is available at ***gov.pe.ca/pensionplans*** or by calling Island Information Services. They are available on Monday to Friday from 8:30 a.m. to 5:00 p.m. at 902-368-4000 or toll free: 1-800-236-5196