Legislative Assembly of Alberta

The 28th Legislature
Second Session

Standing Committee on Alberta's Economic Future

Bill 9, Public Sector Pension Plans Amendment Act, 2014
Bill 10, Employment Pension (Private Sector) Plans Amendment Act, 2014
Stakeholder Presentations

Tuesday, June 3, 2014
8:30 a.m.

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Standing Committee on Alberta's Economic Future

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8:30 a.m. **Tuesday, June 3, 2014**

[Mr. Amery in the chair]

The Chair: Good morning, ladies and gentlemen. I would like to welcome all members, staff, and guests in attendance at today's meeting of the Standing Committee on Alberta's Economic Future.

I would like to call this meeting to order and ask that members and those joining the committee at the table introduce themselves for the record. Please indicate if you are attending as a substitute for a committee member. Mr. Bikman and Mr. Hehr will be joining us by teleconference.

I will start. I am Moe Amery, MLA for Calgary-East and chair of this committee.

Mr. Fox: Rod Fox, MLA for Lacombe-Ponoka and deputy chair of this committee.

Ms Kubinec: Good morning. Maureen Kubinec, MLA, Barrhead-Morinville-Westlock.

Ms Kennedy-Glans: Good morning. Donna Kennedy-Glans, MLA for Calgary-Varsity.

Mr. Moore: I'm Bill Moore, staff actuary with Alberta Treasury Board and Finance.

Mr. Gilmour: Ray Gilmour, deputy minister, Treasury Board and Finance.

Mr. Prefontaine: Mark Prefontaine, assistant deputy minister, Treasury Board and Finance.

Ms Nygaard: Ellen Nygaard, executive director, pension policy, Alberta Treasury Board and Finance.

Mr. Luan: Jason Luan, MLA, Calgary-Hawkwood. Good morning, everybody.

Dr. Massolin: Good morning. Philip Massolin, manager of research services.

Mrs. Sawchuk: Karen Sawchuk, committee clerk.

The Chair: Thank you, all.

Just a few housekeeping items to address before we turn to the business at hand. The microphone consoles are operated by *Hansard* staff. Please keep cellphones, iPhones, and BlackBerrys off the table as these may interfere with the audiofeed. Audio of the committee proceedings is streamed live on the Internet and recorded by *Hansard*.

Now we all have seen the agenda. Can I have a motion?

Ms Kubinec: So moved.

The Chair: Ms Kubinec moved that the agenda for the June 3, 2014, meeting of the Standing Committee on Alberta's Economic Future be adopted as circulated. All in favour? Any opposed? Carried. Thank you, all.

The second item on the agenda today, ladies and gentlemen. We will be receiving presentations from a number of experts relating to the committee's review of Bill 9, Public Sector Pension Plans Amendment Act, 2014, and Bill 10, Employment Pension (Private Sector) Plans Amendment Act, 2014. I am pleased to welcome our guests participating in this first panel, which is intended to provide comprehensive background information on pension plans and on bills 9 and 10 to assist the committee as it commences its review.

Mr. Gilmour, our schedule provides a two-hour time slot for the Treasury Board and Finance overview. I would ask that you have the last 30 minutes or so for questions from the committee. Please go ahead. The floor is yours.

Treasury Board and Finance

Mr. Gilmour: Thank you, Mr. Chairman. Thank you and good morning to the members of the committee. We are here today to discuss the governance and sustainability of Alberta's public-sector pension plans and the regulation of private-sector plans as you further consider bills 9 and 10. Additional materials as well as a slide show that we will be presenting will be made available to this committee. I should point out that the slide show will also be available to members of the public in a few moments on the Alberta Treasury Board and Finance website.

We all appreciate the opportunity to be here. As already was done, beside me on my right is Mark Prefontaine, who is the assistant deputy minister of financial sector regulation and policy. To his right is Ellen Nygaard, who is our executive director of pension policy, and Bill Moore, to my left, is the staff actuary for Treasury Board and Finance.

Behind us in the gallery the other department staff members include Chris Bourdeau, who is our director of communications; Dale Beesley, our incoming executive director of pension policy; David Mulyk, senior manager, risk management; and Briegh Anne Albert, director of strategy and planning.

Bills 9 and 10 are each the result of studies by experts and extensive consultation with stakeholders. Both address stresses on workplace pension plans that are affecting pension plans virtually worldwide. In the private sector those stresses have caused some employers to shut down their defined benefit pension plans or convert them to less costly and risky defined contribution plans. While this has dealt with corporations' balance sheet risk, it's also exposed employees to more risk and sometimes left them to their own devices to save for retirement. Experts are expressing growing concern that this will result in many future private-sector workers suffering a drop in their standard of living in retirement.

Bill 10 offers employers and unions additional options for managing their pension plans to encourage them to establish and maintain workplace pension plans. In the public sector, where defined benefit plans are the norm, the concern is the high cost and risk to members, employers, and taxpayers of providing defined benefit pensions that have several costly features. Bill 9 enables the government to set the public-sector plans on a sustainable path and ensure they are well governed for the long term.

In announcing his vision for public-sector pension reform, Minister Horner set out the government's principles, including preservation of benefits already earned; provision of highly secure, competitive benefits; and a system that is robust and adaptable to changing circumstances. With the changes public servants will still have excellent pension plans with secure and predictable benefits at a reasonable price.

Mr. Chairman, with your consent I will now turn the chair over to Mark Prefontaine, who I mentioned is our ADM, and he will address bills 9 and 10. Mark has been working in the financial sector for over 19 years, and along with his ADM duties he is also the superintendent of pensions, superintendent of insurance, and superintendent of financial institutions. He is a certified financial planner, a chartered financial analyst, and has his certification from the Institute of Corporate Directors. He is also currently the chair of the Canadian Association of Pension Supervisory Authorities. I will now hand the floor over to Mark to take us through the presentation.

Thank you.

The Chair: Before we do that, I'd like to ask Mr. Lemke and Mr. McDonald and Mr. Eggen and Mr. Bikman to introduce themselves for the record, please.

Mr. Lemke: Thank you, Chair. Ken Lemke, MLA, Stony Plain.

Mr. McDonald: Good morning. Everett McDonald, Grande Prairie-Smoky.

Mr. Eggen: Good morning. My name is David Eggen. I'm the MLA for Edmonton-Calder.

Mr. Bikman: Gary Bikman, Cardston-Taber-Warner, sitting in for Pat Stier.

The Chair: Thank you.

Mr. Prefontaine.

Mr. Prefontaine: Thank you very much, Mr. Chair. Good morning, and thank you for the opportunity to be here to make a presentation regarding Bill 9, the Public Sector Pension Plans Amendment Act, 2014, and Bill 10, the Employment Pensions (Private Sector) Plans Amendment Act, 2014.

What I'd like to do today is walk through a review of some of the pension basics that you were provided earlier with some of the reference material provided to the committee, leading to a discussion on some of the challenges that the deputy minister referred to regarding pension plans, both from a sustainability perspective and a governance perspective; challenges that plans are facing in Alberta, both private and public sector; challenges that plans are facing across the country, across North America, and in fact around the world. I will certainly talk about some of the specifics of Bill 9 and then some of the specifics of Bill 10, and after some closing comments I will be more than happy to take any questions the committee members may have.

Both bills 9 and 10 deal with workplace pensions. A workplace pension is a pension paid regularly to a plan member following their retirement for their lifetime. Workplace pensions can come in many forms, whether they be defined benefit, defined contribution plans, target benefit plans, hybrid. Certainly, the most prevalent workplace pension is the Canada pension plan. However, there are many other forms of workplace savings arrangements that employers and sponsors often use, whether they be group RRSPs, savings plans, profit-sharing plans, or shared-purchase plans as examples. For pension plans as registered pension plans under the terms of the Income Tax Act, they will receive favourable tax treatment. Specifically, contributions to these plans will be deductible from income. As well, any earnings in the plans in the pension fund are going to be tax deferred.

Here in Alberta we have many public-sector pension plans. Bill 9 specifically addresses four such plans. Alberta's Public Sector Pension Plans Act governs the local authorities pension plan, which is made up of the sectors of municipalities, health, colleges, and the nonteaching staff of school divisions. The public service pension plan is made up of nonmanagement employees of government and its agencies, and universities' nonacademic staff. The management employees pension plan is made up of management staff of government and its agents. Finally, the special forces pension plan is specific for police officers for seven municipalities here in the province. All told, these four plans have close to \$35 billion in assets and currently around \$42 billion in liabilities, 200,000 active members and close to 120,000 inactive members. I'll define some of these terms further on in the presentation.

8:40

As mentioned, the Alberta public-sector plans are set out in the PSPPA and its associated regulations. The PSPPA provides the legislative framework for the four plans as well as providing the government the authority to make regulations regarding the plans. Those regulations take the form of both the legislative provisions regulation, which are provisions that apply to all four plans such as board member appointments and indemnities for board members, and then the plan rule regulations. There is a separate regulation for each of the plans that deals with the terms of the plan, setting benefits and contribution rates, et cetera. Bill 9 amends the Public Sector Pension Plans Act.

The Alberta Employment Pension Plans Act sets minimum standards for private-sector pension plans. These plans are registered under the EPPA and are sponsored by employers or sponsored by employers and unions. They need to be registered with the superintendent of pensions, and they're overseen by the superintendent's office. These plans, as mentioned, take the form of either defined benefit plans, defined contribution plans, or target benefit plans. Currently in the province we have close to 700 pension plans that are overseen by the superintendent's office, that represent 247,000 active members, give or take, and close to 143,000 inactive members. As well, these pension plans represent \$34 billion in assets.

Plan sponsors are the entities that set the deal. Regarding private-sector plans, these are voluntary, meaning that the sponsors can determine whether or not they are going to establish a plan and whether or not they're going to alter the plan and whether or not they're going to terminate the plan.

Turning to the issues of sustainability, as I previously mentioned, these are issues that affect all pension plans, not just the public sector but the private sector as well and not just Alberta plans but outside the province as well. Looking at sustainability through the lens of a public-sector plan, we define sustainability as a plan that can consistently over time deliver an appropriate level of benefits with an appropriate range of costs for members, employers, and taxpayers.

There are many challenges threatening the sustainability of public-sector pension plans: improvements in life expectancy, low interest rates, volatile investment returns with lower expectations for future returns, and the fact that our plans are maturing. I'll deal with each one of these in succession, but the total of these means that we're leading to higher contribution rates, that directly impact members and employers and indirectly impact taxpayers.

Turning first to life expectancy. The good news is that we are living longer. That is good news, but it does represent a challenge for pension plans. Starting with life expectancy for someone that is 65 years old, if we look at 1966 – and we picked that date because that's the date that the Canada pension plan was established – a male that was 65 was expected to live to the age of 79. Fast-forward to 2014: a 65-year-old male is expected to live to the age of 88. A female in 1966: to the age of 82. Fast-forward to 2014: expected to live to the age of 90.

Again, increasing life expectancy is good news, but this does pose a problem for pension plans that, as mentioned, will pay a pension to a person for their lifetime. This has been exacerbated by the fact that just this year the Canadian Institute of Actuaries released a new Canadian pensioner mortality table that for the first time provides the opportunity to use Canadian data for establishing the life expectancy of pensioners.

Previous to this, U.S. data was used to produce mortality tables for pension plans in Canada. What the introduction of this new mortality table means in Canada is that for the public-sector plans here in Alberta it's estimated that costs will increase in the range of 2 and a half to 4 per cent of salary, dependent upon the plan. In fact, this was just recently confirmed by the local authorities pension plan board, that provided a letter to the Alberta Association of Municipal Districts and Counties that confirmed that the estimation for the local authorities pension plan, because of the introduction of the new Canadian pension mortality table, was that costs would rise by 2.6 per cent of salary for that plan.

Again, increasing life expectancy is a good thing, but it does pose a challenge for a pension plan that's paying income for someone's lifetime. Pensions cost more in a low-interest-rate environment. Using the example of the public service pension plan, the cost to provide a pension for 50 per cent of salary for Joe Albertan, public servant, in 1995, based on an average income in that plan of $35,000, was $162,000. That pot of $162,000 would provide a lifetime income for Joe Albertan. Fast-forward to 2013. We now have average income in the public service pension plan at $64,000, and we can see that the cost to provide a pension of 50 per cent salary to Joe Albertan, public servant, who retires in 2013, has now increased to $475,000.

A portion of this is due to the fact that the salary has increased, and a portion of this is due to the fact, as I just mentioned, that people are living longer. However, more than half of the increase is due to the fact that interest rates are lower. To use the analogy of a mortgage, for those of you that have had a mortgage, you would understand that when interest rates come down, that's a good thing when you're borrowing money to buy a house because you're borrowing a fixed pot of money, the purchase price of the house or some lesser amount, and promising to repay fixed monthly installments, for example, until you amortize that mortgage.

It's the exact opposite for a pension plan. The pension plan has got to accumulate a pot of money to pay the fixed pension for your lifetime. What that means is that as interest rates go down, we need a bigger pot of money to pay that fixed stream of income for that lifetime. So in an environment where we have lower interest rates and longer life expectancies, that poses challenges for pension plans.

Looking at Joe Albertan today retiring from the public service pension plan, he quite likely would have the profile of the average retiree that's retiring from the plan currently. In 2012 there were 435 retirements from the public service pension plan. The average age of retirement in that year was the age of 62. The average years of service of that average retiree was 28 years, and the average annual pension that that individual is retiring with is $28,000 per year. For the local authorities pension plan the average age for people retiring today is 62. They're retiring with 21 years of service on average and with an annual pension of $23,000.

In your packages you have slide 11, which shows historical interest rates. For those of you who recall – and I referred to mortgages earlier – if you had a mortgage in the '80s, you understood that interest rates were quite high. Interest rates have come down substantially, and in fact we know that we're now in a sustained period of a low-interest-rate environment, not unlike what we've seen previously.

8:50

What this leads to partially is a lower expectation of investment returns into the future. In fact, the Alberta Investment Management Corporation is projecting that pension funds will earn an average of 5.7 per cent over the next 10 years. What they've done to produce that number is looked at an average portfolio of investments for a pension fund over that period of time. As an average, what that means is that there's about a 50 per cent chance – it's not exactly 50 per cent, but there's about a 50 per cent chance – that investment returns are going to be lower than that 5.7 per cent, just as there's about a 50 per cent chance that they'll be higher than that 5.7 per cent. When we look specifically at the four plans here in Alberta, they're assuming investment returns in the range of 5.75 per cent to 6.3 per cent.

When we look at the public service pension plan, as an example, what this particular slide shows you is that no plan actually earns in any given year the average investment return. Returns are much more volatile than that. Since 2000 we've seen dramatic swings in investments, and in fact the Ontario municipal employees retirement system just recently published a report that concluded that volatility exists and is increasing in pension plans.

The next item that poses a challenge for public-sector pension plans, specifically here in Alberta, is that our plans are maturing. What this graphic represents is that in 1993, for every two inactive members – and, for clarity, what an inactive member is is either someone that's terminated their employment and left their benefit in the plan, a deferred member, if you will, as well as retirees, someone that's actually retired and drawing an income from the plan. Inactive members continue to have benefits, either remaining with the plan or drawing from the plan, but they're no longer contributing to the plan. In 1993 for every two of those we had four contributing members, a 2 to 1 ratio, on average across all four plans.

Fast-forward to today. What that looks like now is that we have four inactive members being supported by six contributing members. Six out of 10 members in our Alberta public-sector pension plans are contributing to the plan. What this means is that while active members are increasing – simply, the number of contributors, the number of active members accruing a benefit in the plan is increasing – the number of inactive members is increasing at a faster rate. This poses a problem for a pension plan that gets its contributions from active members and employers because it's those active members that then shoulder the risk for all members in the plan. As the proportion of inactive members increases compared to active members or contributing members, the risk for contributing members increases. This trend is expected to continue, especially as baby boomers move into ages and periods where they're eligible to retire.

To elaborate on this a little bit further, using the public service pension plan as an example, if there is a 10 per cent loss, each active member for the public service pension plan has got to shoulder the burden not only for his or her accrued liability, which would represent an $11,300 hit, but also shoulder the burden for the liabilities regarding former employees or inactive members, which is slightly higher, at $11,400. Now, under the terms of the Public Sector Pension Plans Act these losses can be funded over a 15-year period, but it's still representative of the fact that active members in this plan are shouldering the burden for both their liabilities as well as those that have gone before them. What this represents is a significant risk that already high contributions may need to be increased further. That can be seen using the local authorities pension plan as an example.

Specifically, what this graph represents is the growth of assets, represented by the blue bars, and the growth of liabilities, represented by the red bars, in the local authorities pension plan since 2000. The green line represents the contribution rate as a percentage of salary that's required to fund the plan. You can see, going back to 2000, when that rate was slightly higher than 10 per cent, that since then it has climbed in increments over a period of time close to 25 per cent.

When we look at what's happened regarding contribution rates for all four plans, the blue bars represent the total contribution rate as a percentage of salary in the year 2000. The dark blue bars represent the total contribution rate as a percentage of salary in the year 2014. You can see stark increases. When I compare this slide, which shows for the local authorities pension plan incremental increases in those contribution rates, versus this slide, which shows the contrast between what they were in 2000 and what they are today, I can't help but think of the boiling frog syndrome and what the reaction from employers and members might be if these contribution rates went immediately from 10 per cent in the case of the local authorities pension plan to 24.2 per cent rather than the gradual, incremental increase that we've seen over time.

One of the developments that's occurred recently is that the public service pension plan commissioned an interim valuation report as at the end of 2012. The figure you see here of 25.6 per cent as a total contribution rate for PSPP was based on a valuation filed with the Canada Revenue Agency as at December 31, 2011. The interim valuation for the public service pension plan showed that had it been required to file that valuation, the contribution rate would actually be 26.38 per cent.

Now, what I will say is that we cannot predict what the future funded status of any pension plan might be. However, we can consider the possibilities. All defined benefit pension plans are required to have an actuarial valuation conducted, at minimum, every three years, private sector and public sector alike. These valuations are needed in order to determine the contribution rates that are required to fund the plans. Those valuation reports are based on one single set of assumptions that produce one single future scenario. This is most often referred to as deterministic analysis, using a single set of assumptions to look at a very specific potential outcome or determine what that outcome might be.

By contrast, stochastic modelling can be performed to determine the probability of a number of various future outcomes. Rather than using one set of assumptions, we look at: what's the possibility of a variety of outcomes? As I mentioned, using the illustration of the public service pension plan and the volatility of the investment returns in that plan, no plan actually earns the average investment return. Experience in the real world is actually more volatile than that.

The stochastic modelling that we've conducted shows that future contribution rate increases are likely. Specifically, our evidence points to that there's a 1 in 3 chance that in 2025 contribution rates will exceed those of 2014. This is based on, again, stochastic analysis, where we've done many different scenarios, at least a thousand equally likely scenarios of asset returns based on the asset distribution, asset modelling of each specific plan. As a starting point, the assumption that's used is the most recent investment assumption in the most recent actuarial valuation report. For the local authorities pension plan what that means is that we've used the discount rate or the investment assumption used in its December 31, 2012, analysis, for the public service pension plan I've already referred to the interim valuation that was conducted as of December 31, 2012, and for the management employees pension plan the valuation that was conducted, again, as of December 31, 2012.

9:00

We then apply a measure of volatility based on the historical rates of return for each one of these plans. That measure of volatility is referred to as a standard deviation, and that comes out to around 10 per cent for each one of the plans. Again, what this shows us, based on many different scenarios run time and time again, multiple times, by our staff actuary, Mr. Bill Moore, is that there's a 1-in-3 chance the contribution rates that we have today will be higher in 2025.

With the combination of increasing life expectancy, a low interest rate environment, volatile returns that are expected to be lower into the future, and maturing pension plans that have an increasing and high probability of increased contribution rates, the conclusion is that changes are required. Seven point four billion dollars has been a number often cited regarding the unfunded liabilities total for these plans, and these unfunded liabilities are scheduled to be paid off by 2026. That is true. But that's not where the risk lies. Where the risk lies is if new unfunded liabilities develop, and what that means is that it will take even longer to pay the plans, to put them back into a fully funded status. Certainly, history is not indicative of future performance. That said, it is curious to note that in 17 of the last 22 years these plans have been in deficit. So in spite of high investment returns that have been earned recently, the plans' funded status remains a concern for the issues that I've already outlined because liabilities are growing quickly.

As well, we've heard from stakeholders, members, employers, and taxpayers alike of the concerns they have about further increases in the contribution rates. At or above 25 per cent of earnings already, many stakeholders have told us that these are getting to be too high, but we're not the only ones that have had this opinion. In 2012, in its annual report, the local authorities pension plan board reported, "Asked what they are prepared to pay, most sponsors and members said they do not want contributions to rise beyond a combined . . . 25% of pay." That tells us that we are quickly running out of wiggle room on contribution rates and will need to look at other options for paying future unfunded liabilities. Further, the Public Service Pension Board, in their winter 2013 newsletter, that went to members, said, "We can't rely on contribution increases as the only way to manage costs into the future – the Plan needs to remain affordable to members and employers. That's why we're looking at other ways to manage rising costs."

As stated on the slide, it's simply not prudent to rely solely on good investment returns or expect good investment returns to address the funding issues. The volatility of those investment returns puts these plans at risk. The changes that are enabled by Bill 9 will lower the costs and risks, making them better able to address future unfunded liabilities, because it's the possibility of those future unfunded liabilities that poses the most significant risk to these plans.

As I mentioned previously, Alberta is not alone in this issue. Increasing life expectancy doesn't stop at the Alberta border. The low interest rate environment doesn't stop at the Alberta border. Pension plans that are maturing are not unique to Alberta. Volatile investment returns are not unique to Alberta. As such, many jurisdictions, both in Canada and outside Canada, have had to take steps to address risks and costs in their public-sector plans.

In Nova Scotia what this meant was reducing benefits, including those benefits that have already been earned or accrued. In New Brunswick it meant moving from a defined benefit plan to a target benefit plan, a plan they call their shared risk plan. In Prince Edward Island what it meant was changing unreduced early retirement to the age of 62 with at least 32 years of service. In Ontario we've seen public-sector plans there move to contingent cost-of-living adjustments, and just recently four Ontario jointly sponsored pension plans froze employers' contributions for five years. At the federal level, regarding their public servants, they've recently announced that they're going to be moving to a 50-50 cost-sharing arrangement as well as increasing the unreduced retirement age by five years for members hired after 2012.

The Ontario municipal employees retirement system is currently looking at a number of options for addressing changes to benefits in its plan. Specifically, they're considering reducing the unit of benefit from 2 per cent to 1.85 per cent, which is the amount of pension a person earns in any given year; eliminating unreduced early retirement before age 60; and reducing cost-of-living adjustments. They're even considering a moratorium on cost-of-living adjustment payments for five years. Now, I will point out that they're not looking at this as a package of options – they're looking at each one unto itself – but they are certainly considering those benefit changes.

Now, just before I turn to the issue of Bill 9, I do want to comment briefly on the governance of the Alberta public-sector pension plans. This process which has led to Bill 9 has been about the sustainability of those plans as well as the governance, with the desired outcome that they are sustainable and that they are well governed. The Canadian Association of Pension Supervisory Authorities defines governance as the structure and processes for overseeing, managing, and administering a pension plan to ensure that the fiduciary and other obligations of the plan are met.

Here in Alberta the governance structure is really a construct of the Public Sector Pension Plans Act, and the rules of those plans are set out in regulations. The President of Treasury Board and Minister of Finance is the trustee for all of these plans. Each of the plans does have a board. Those boards are representative of both employees and employers. The boards have a number of statutory obligations such as setting contribution rates as well as a number of possibilities, including the possibility of recommending changes to the plan rules.

For a period of time now plan stakeholders have felt that a different governance structure would help to address the sustainability of these plans, help to address the challenges that they're facing, and help them become more adaptable to changing economic and demographic conditions. We agree with that opinion. Pension plans that are going to pay pensions for the lifetime of members and retirees need to be able to operate over long time horizons. During those time horizons we're going to have changes in economic and demographic realities. History has told us that. These plans must be adaptable to those changing economic and demographic realities.

Mostly commonly, you'll hear stakeholders talk about three key levers that will help a plan remain sustainable over the long term. Investment strategy is certainly one of those levers. Making sure that the assets of the plan are invested in accordance with the liabilities and cash-flow needs will help ensure that the plans remain sustainable.

Contribution rate changes are certainly required in a defined benefit plan environment, where the funded status of any given plan is going to be determined by the actuary evaluation, which will be looking at a snapshot in time in setting contribution rates. So both contribution rates, both increases and decreases, are an important lever to help a plan remain sustainable.

Finally, reviewing plan benefits, if you're going to be looking at a pension plan that's going to be paying pensions to individuals over long time horizons, plan benefits must be a lever that's looked at for managing that plan. Here in Alberta the first two levers, investment strategy and contributions, have been used and used often. I showed you evidence of the contribution rate increases that have occurred since 2000, and I've showed you evidence of the investment volatility for these plans. The third lever, plan benefits, is a lever that has not received very much attention in our plans.

9:10

In 1999 the government commissioned a report regarding the governance of our public-sector plans. It's commonly referred to as the Cortex report. What that Cortex report showed was that there was broad agreement amongst all stakeholders on a number of principles, specifically that the functions of sponsor and trustee must remain separate and that parties exposed to significant risk through a pension plan must have the authority to manage their risk exposure. From the outset parties exposed to significant risk must have direct and active involvement in establishing the pension deal. The pension deal must provide for the alignment of interests among all affected parties. As I previously mentioned, in the context of a public-sector plan the affected parties would be, directly, members and employers and, indirectly, taxpayers. Mechanisms must exist for transparent accountability. The current governance structure for our pension plans does not meet all of these principles.

The work that we've done regarding a review of the sustainability of these plans as well as the work that's been done previously regarding the governance of these plans, as I mentioned earlier, leads to the conclusion that change is required. That change was to be facilitated by Bill 9, the Public Sector Pension Plans Amendment Act, 2014. What I'd like to do is quickly walk you through the consultation timeline that's been used regarding this bill and then speak to the specifics of the bill. I will speak to what Bill 9 does not change and what in fact Bill 9 does change.

Consultations on sustainability in our public-sector plans here in Alberta actually date to prior to when the government got directly involved in the conversation. In 2010 the special forces pension plan and its board began consultation with its stakeholders regarding sustainability and governance concerns. In 2011 the local authorities pension plan and its board began consultation with its stakeholders on the same issues.

In 2012 the trustee for these plans, the President of Treasury Board and Minister of Finance, called representatives from each plan together in July of that year and expressed concern about the sustainability and governance of these plans in the long run and asked each one of the boards to go back and either continue the work that they were doing or in some cases begin the work on reviewing those issues and to come back with recommendations on how we can assure ourselves that these plans are sustainable and well governed in the long term.

In 2013 each of the boards reported back, but there were no recommendations on changes to benefits from the local authorities pension plan or the public service pension plan. They did make recommendations on plan governance, however. Later that year the government, using in part the analysis that the boards had used for their own work as well as the government's own analysis, announced proposed changes to plan benefits and governance and began its own consultation in September. That consultation concluded in December of 2013, and based on the feedback received from stakeholders, there were changes made to the proposed benefit changes, making them more modest than those that were originally proposed. Those were announced in February of 2014, followed by the introduction of Bill 9 later that spring.

Bill 9 does not do a number of things. I'd like to take this opportunity to point out some of those specific issues. Bill 9 does not change the defined benefit nature of these plans. Bill 9 does not change the current pension formula or the core benefit of these plans. Specifically, Bill 9 does not change the final average salary provision for core benefits. Bill 9 does not change benefits for service before 2016. Bill 9 does not change benefits for current retirees. I'm going to say that one more time. Bill 9 does not change benefits for current retirees. Bill 9 does not change the normal retirement age for these plans, age 65. Bill 9 does not change the ability for any given member to retire as early as age 55.

So what does Bill 9 do, then? Bill 9 gives the government the authority to make changes to plan rules for benefits earned after 2015. Specifically, what the government has announced is that changes would be made to at what point a person qualifies for an unreduced pension for early retirement. Changes that have been announced include what the reduction would be for members who retire before being eligible for an unreduced pension. What's been announced are changes to how the cost-of-living adjustment provision works for these plans. The details of each of these changes would be contained in the regulations because, as I mentioned earlier, the plan benefits for each of these plans is contained in a specific regulation for each plan.

Bill 9 also closes the management employee pension plan to new entrants. Managers hired or promoted after December 31, 2015, would join the public service pension plan and accrue the benefits that are paid from the public service pension plan. Bill 9 provides for a new governance arrangement, specifically a joint sponsorship model, for the local authorities pension plan, the public service pension plan, and the special forces pension plan. One of the recommendations that came from the special forces pension plan was to collapse its separate indexing fund, the fund from which it pays current cost-of-living adjustments, into the main fund. Bill 9 imposes a benefit improvement moratorium until 2021, which would give the plans the opportunity to actually see traction on the benefit changes without introducing any additional risk through benefit improvements.

Bill 9 also enables a number of regulations. One would be to set a mechanism for the cap on contribution rates. Currently there is a consultation paper on the topic of the contribution rate cap. That's open to the end of July, and we've had a number of stakeholders already provide input on that contribution rate cap paper. Bill 9 also enables the change to the contribution cost-sharing model between employees and employers. As well, it introduces different provisions regarding early retirement for employees in public safety occupations.

Those are the changes that Bill 9 would facilitate.

How would these changes help? I'd like to look at that question by looking at the specific stakeholders to Bill 9, first and foremost, members. As mentioned earlier, Bill 9 does not change the defined benefit nature of these plans; that is preserved. That's a key principle that was used through this entire process, and this is certainly something that members will benefit from. Benefits earned up to the end of 2015 are not changed. While I can make no assertions on what will happen with contribution rates, I can assert that the costs of these plans would be reduced with the changes that have been announced, meaning that there would be less likelihood of further contribution rate increases. As well, for short-term employees the introduction of immediate vesting provides a benefit, and for long-term employees the removal of the 35-year cap on pensionable service will enhance benefits for those members.

9:20

For existing retirees Bill 9 preserves the existing benefits, including the cost-of-living provisions that they're currently afforded.

For employers, just as with members as these are jointly funded plans, with the changes that have been announced concurrent with Bill 9, costs would be lower than they otherwise would be. Again, making no assurances on what would happen with contribution rates in the future by taking costs out of the system, we can mitigate the likelihood of further contribution rate increases.

Plans updated to meet the needs of today's workforce. These plans were developed at a time when early retirement was actually a good thing for the workforce. We're now into an environment where we're talking about labour shortages and talking about difficulty attracting and retaining staff. Employers will benefit from these changes because incentives to retire early are going to be reduced.

For taxpayers costs are going to be lower than they might otherwise be. As I've indicated earlier, in the context of a public-sector pension plan taxpayers have an indirect interest in what those costs are going to be. The risks are reduced in these plans, making them more adaptable in the future, which would limit the exposure for taxpayers to any potential future unfunded liabilities.

For all stakeholders the new governance model that would be enabled by Bill 9 would allow sponsors to make the important decisions regarding costs, risks, and benefits, again making the plans more adaptable in the long term.

Next we have Bill 10. Bill 10 is the Employment Pension (Private Sector) Plans Amendment Act, 2014, and it amends the Employment Pension Plans Act that has yet to be proclaimed from 2012. I'll talk briefly about the timeline that has led to Bill 10, I'll give a brief summary of Bill 10, and then I'll talk quickly about the most contentious issue, as we see it, regarding Bill 10, and that's the conversion to a target benefit environment.

I would like to point out and remind the committee of a comment I made earlier, and that is that pension plans are voluntary. There's no legislation that requires an employer to offer a pension plan that would be registered under the Employment Pension Plans Act. Sponsors, whether they be the employer or the employer and a union, would come to an agreement to actually establish a plan, but it's a voluntary decision.

The Employment Pension Plans Act and its associated regulations set the minimum standards for these private-sector workplace pensions. The pension plans covered by the Public Sector Pension Plans Act are not registered under the EPPA. They do follow some of the standards established by the EPPA such as investment rules, but they are not registered with the office of the superintendent, and generally the EPPA does not apply to the four public-sector plans that we've been talking about.

In 2007 Alberta and British Columbia established the Joint Expert Panel on Pension Standards, that was tasked with the specific purpose of reviewing private-sector pension legislation and determining what changes, if any, would be necessary. That process concluded in 2008, when the joint expert panel reported back to the respective ministers of finance in each province. In 2009 there was a public consultation on the report of the Joint Expert Panel on Pension Standards and the recommendations that that group made. That process led to the introduction and passage of the new Employment Pension Plans Act that has not yet been proclaimed. In 2012 that new Employment Pension Plans Act, which, coincidentally, was also titled Bill 10, passed with unanimous consent of the Legislature. In 2014 Bill 10 was introduced to amend that yet-to-be-proclaimed Employment Pension Plans Act. As well, there's ongoing work regarding the regulation that would be needed to actually enact the Employment Pension Plans Act.

Following a similar pattern, let me speak to what Bill 10 does not do. Bill 10 does not impact the plans covered by the Public Sector Pension Plans Act. Bill 10 does not force plan sponsors to convert their plans either prospectively or retroactively to a target benefit model contemplated by the Employment Pension Plans Act.

There has been some confusion regarding the application of Bill 10 to the public-sector pension plans here in Alberta. The reason for that confusion is that the Employment Pension Plans Act contains provisions for publicly funded pension plans. Let me be clear that the public-sector pension plans are not publicly funded pension plans as contemplated and defined by the Employment Pension Plans Act. Specifically, examples of a publicly funded pension plan would include the universities' academic pension plan and some of the supplementary plans that we have that are supplemental to the local authorities pension plan; for example, for firefighters and managers of municipalities. Again, there has been some confusion about the application of the Employment Pension Plans Act and Bill 10 to those publicly funded pension plans and the interplay with the public-sector pension plans. It does not impact the public-sector pension plans.

What does Bill 10 do? Bill 10 allows private-sector sponsors the option to convert to a target benefit plan retroactively. The Employment Pension Plans Act of 2012, already passed but not yet proclaimed, allows the option for plan sponsors to convert a pension plan to a target benefit plan prospectively. Bill 10 would extend that option to allowing it to occur retroactively. Again, I would emphasize that in the context of a sponsored pension plan, that would either be an employer who is the sponsor or an employer and a union who are joint sponsors. Bill 10 also makes a number of housekeeping changes to the unproclaimed Employment Pension Plans Act from 2012.

However, there's no question that the greatest level of concern about Bill 10 that's been raised is the provision in Bill 10 that amends section 20 to allow plans to apply the target benefit provision to benefits already accrued. I'll say again that the amendment to section 20 does not force nor require pension plans to move to target benefit. It simply provides an option. To ensure the fair treatment of members, stakeholders will be consulted, and rules on how the conversion will be permitted will be set out in regulation. The key feature to this process will be the need for employee consent. Consultation regarding this type of conversion has already begun and been had with collectively bargained multi-employer plans, predominantly construction trade plans, here in the province. The feedback that we've received is that they're very eager to move to this model.

Target benefit plans actually represent a middle-ground solution. As I've mentioned a few times, private-sector plans are voluntarily sponsored by employers and/or unions. They can be terminated at any time by the sponsor. Our experience shows that we've seen many terminations of defined benefit plans for the issues that I talked about previously that are producing cost pressures in these plans. Our evidence shows that there are many defined benefit plans that have been converted to a defined contribution plan because of the costs and pressures that I've already talked about. The conversion from a defined benefit plan to a defined contribution plan transfers the risk solely onto the shoulders of the members of that defined contribution plan. They take the longevity risk. They take the investment risk. It transfers that risk to them. A target benefit structure would actually be a middle ground to the transfer of that risk. What this would allow and enable is the plans to be proactive in managing their issues as they develop, those shifting economic and demographic conditions that I referred to earlier.

9:30

Target benefits do not represent the beginning of the end for defined benefit plans. Rather, they would help mitigate those observations we've already had about conversions and terminations of defined benefit, and, in fact, stakeholders have indicated to us that we would likely see conversions of defined contribution plans to target benefit plans, transferring, again, risk from plan members back to employers.

In summary, regarding Bill 9 and our public-sector plans for the issues that I've addressed earlier – increase in life expectancy, low interest rate environment, volatile investment returns that are expected to be lower into the future as well as the maturity of these plans – changes are needed to ensure that they're sustainable and well governed into the future. Alberta's public-sector pension plans are very good pension plans. Bill 9 would ensure that they would remain very good pension plans.

One of the significant changes contemplated by Bill 9 is enabling joint governance, something we've heard from stakeholders since the government commissioned the Cortex report in '99, and Bill 9 provides advantages for members, employers, and taxpayers alike.

Bill 10 provides more choice, more choice for an environment where sponsors have the option of establishing, terminating, or amending pension plans, which would represent the middle ground between the distribution of risk between employers and members. As such, this would encourage the continuation of active pension plans and, again, likely see risks that are currently being borne by members actually shared in a different model with employers.

Now, I understand you're at the beginning of what will likely be a very interesting and, on some days, feel like a long process. It's my understanding that you're going to be hearing from the Auditor General later this morning. I take great pleasure in playing the spoiler role in providing some insight into what you're likely to hear from the Auditor General. In February of this year the Auditor General issued a report on our review of public-sector pensions in Alberta. In that report the Auditor General said: "Alberta's public sector pension plans have significant unfunded liabilities and contribution rates that have risen to levels where some employers and employees do not want to pay more." That report was followed by comments made at a Public Accounts Committee meeting in March of this year. When asked if pension plan changes were premature, he responded: "No. To consider these plans at this time is imperative because the contribution rates have reached, in the view of many people, an unaffordable level. So something has to be done."

With that, Mr. Chair, we really appreciate the opportunity to make this presentation this morning, and we'd be happy to take any questions the committee may have.

The Chair: Well, thank you very, very much, and I must admit, Mr. Prefontaine, that your presentation has been the longest so far in this committee and the most informative and most comprehensive. Thank you very, very much.

But before we go to the questions, I'd like to ask Mr. Quadri and Mrs. Sarich and Kent Hehr to introduce themselves for the record.

Mr. Quadri: Hi. Sohail Quadri, MLA, Edmonton-Mill Woods. I just got stuck on Jasper.

The Chair: The main thing is that you're here.

Mrs. Sarich.

Mrs. Sarich: Yes. Good morning and welcome. Thank you very much, Mr. Chair. Janice Sarich, MLA, Edmonton-Decore, and my apologies; I arrived way earlier in this presentation. There were traffic problems in our big metro centre.

The Chair: And Mr. Hehr, are you with us?

Mr. Hehr: Yeah. I'm here. Good morning. I, too, joined the conference some time ago, but I didn't want to interrupt the progress that had been made.

I'd like to thank you for your presentation and working through this issue throughout the rest of the day.

The Chair: Thank you, sir.

I have a list of questioners.

Ms Kennedy-Glans: I would just like to be added to the list. Thank you.

Ms Pastoor: I just was going to say that I was here.

The Chair: Okay. Go ahead.

Ms Pastoor: Good morning. Again, it's Bridget Pastoor, MLA, Lethbridge-East, and my apologies for being late. I'd like to blame it on my new iPhone, that I don't know how to work. The alarm didn't work.

The Chair: Okay. Acceptable excuse.

All right. I have a list of questioners here, and we'll start with Mr. Luan.

Mr. Luan: Thank you, Mr. Chair.

The Chair: Mr. Luan, you have a question and a supplemental question.

Mr. Luan: Okay. How many? Two minutes?

The Chair: Go ahead.

Mr. Luan: All right. Thank you for the presentation. Yes, the chair says it's long, but I also find it has very much information, an in-depth analysis.

I just wanted to ask a question related to your presentation on pages 11 and 13. When we talk about the historical, long history of a low-interest environment and a spike of 15, 14 per cent during the 1976 to 1986 period of time, comparing that chart with the next slide, which is on page 13, talking about the rate of return: I think the two go hand in hand if I follow your early conversation. The interesting difference is that the first chart goes from 1936 all the way to '76; the second one is only 2000 to 2012, so it's hard to have a meaningful comparison that way. Is it possible to draw the same charts for the same time periods so that we can clearly see the correlation between the two?

People have questions about our ministry's protection of the low-interest environment associated with their 5.7 per cent rate of return, which is a point of tension, I understand. Some people dispute that. I just want to get down to the basic facts about that, and I want to hear from the experts. What's your view on that?

Mr. Prefontaine: Thank you very much for the question. Regarding the comment on the length of the presentation, you should have seen the first iteration of it.

Regarding the comparison or the correlation between interest rates and investment returns, there's no question that there is a correlation and that in a low interest rate environment the expected return of an asset pool or a pension plan fund is going to be reduced in that low interest rate environment.

We could certainly work to providing a graph to the committee that would show the correlation or on the same graph that historical interest rate movement and the fund return from PSPP. We won't be able to specifically align the timeline because the public service pension plan has only been a defined benefit plan since 1947. We won't be able to match them up perfectly. We can certainly extend the period that we've shown for investment returns in the plan. What we've used there was readily available data to produce that graph.

Mr. Luan: Thank you very much. That would be very nice. By the same token, if you can extend that a little bit further for the forecast, for the next 15, 20 years, in a similar fashion so that we can clearly see from our ministry's forecast what the correlation is between the two.

Mr. Prefontaine: Right. So what we'd be looking at there is simply adding the forecast that the Alberta Investment Management Corporation has produced regarding the average pension plan, and that's a 5.7 per cent expectation over the next 10 years. We can add that.

Mr. Luan: Thank you.

The Chair: Thank you, Mr. Luan.

Mr. Prefontaine, may I ask that if you're directing any new information to the committee to come directly to the committee clerk so she can post it, and everybody will be able to see it.

Mr. Prefontaine: Yes.

The Chair: Thank you.

Mr. Fox.

9:40

Mr. Fox: Thank you, Mr. Chair. Thank you for coming and giving us a lot of information here today. I do appreciate it. This is quite a complex issue.

I guess my first question here is that on page 5 and page 6 of the report of the Auditor General it says that the

> pension plan boards have, to varying degrees, implemented risk management systems. However, no one organization has clear responsibility for coordinating and monitoring the performance of the plans or taking a consolidated approach to managing risk.

It's recommended that "the department establish an Alberta public sector pension plan risk management system." I'm wondering what changes are being proposed to fulfill this recommendation of the Auditor General.

Mr. Prefontaine: Right now we're working with two different contingencies. One is the new governance structure that's contemplated by Bill 9, which would result in different requirements for a risk management strategy that would apply broadly to the Alberta public-sector pension plan system because now there'd be different responsibilities, different accountabilities for stakeholders. So in a jointly sponsored environment for each plan you would have a table of sponsors made up of employer and member representation as well as a board of trustees for each plan that would be charged with actually managing and administering the plan under the rules set out by the plan sponsors with some enduring provisions contemplated by Bill 9.

In the absence of Bill 9 we'd have the existing governance structure with, again, different roles, different accountabilities, and different responsibilities. What we need to look at is a risk management system that would be workable in either contingent situation, that would include all of the players in the system, which are the pension plan boards, the pension service providers, specifically, Alberta Pension Services Corporation and the Alberta Investment Management Corporation, as well as the department of

Treasury Board and Finance and the trustee, the President of Treasury Board and Minister of Finance. So for all of those players we need to look at accountabilities, authorities, reporting to develop that risk management system.

Mr. Fox: Thank you. A follow-up here, Mr. Prefontaine. You mentioned in your presentation that the government used a stochastic model to project future investment returns. Now, these models can be helpful to explore scenarios but can be poor predictors of actual outcomes at times. For example, the best stochastic models did not predict the economic downturn in 2008, and the global collapse in 2008 was an outlier in terms of the best models that were run a few years previously.

To better understand the outcome from the models, we need to know the assumptions that you used. What assumptions were used for the projections of the new mortality tables on the LAPP and the PSPP? You show an impact of 3.3 per cent on the PSPP and 3.1 per cent on the LAPP, but the actuary Brendan George of George & Bell found the impacts to be 1.9 per cent for the PSPP and 1.4 per cent for the LAPP. Will you release those assumptions in writing to this committee so that we can understand why there is a difference between your impact percentages and those of Brendan George, on the pension plans?

Mr. Prefontaine: In just a minute I'll ask Mr. Bill Moore, our staff actuary, to elaborate on my response to the question. If I understand the first part of the question, talking about stochastic analysis and its ability to predict future outcomes, stochastic analysis is not used to predict what future outcomes will be as much as what the possibilities of those outcomes are, which is why our conclusion based on our stochastic analysis is not that there is a definitive outcome that we're expecting as much as what's the probability of things getting worse than they are today. Again, our analysis concluded that there's a 1 in 3 chance that contribution rates in 2025 would be higher than they are today for each of the plans.

Now, regarding the assumptions, we have no issues in providing the assumptions that were used in that analysis. We did in the presentation refer to the fact that the analysis was based on the most recent valuation for each of the plans conducted by their specific actuaries with some extrapolation to make that information more current.

You referred to the work done by the firm George & Bell regarding the local authorities pension plan and the public service pension plan. In that report they specifically referred to the fact that what they've used are the December 31, 2011, valuation reports produced by those specific plans' actuaries and extrapolated that information forward. We certainly, when we began our work, used the most recent data that was available, which included previous valuation reports. As we've continued that work, we continue to use the most recent data available, which would be the December 31, 2012, valuation reports. Again, Mr. Moore has extrapolated that liability information forward for the purposes of doing the stochastic analysis. We can provide clarity on what those assumptions are, but they are the assumptions that each plan board uses for its own valuations.

On the asset return side, where the stochastic modelling has the greatest impact, the starting point is the investment return assumed by each one of the plans. As I indicated in the presentation, that varies by plan, ranging from 5.75 per cent to 6.3 per cent. We then apply the volatility measure, standard deviation, which has been derived from the specific asset classes, or asset mix, of each plan. That turns out to be in and around 10 per cent for each one of the plans.

Mr. Moore, can you expand?

Mr. Moore: Yes. I guess I would point to the difference between an econometric model that might be used to forecast the economy – and they certainly did miss the market meltdown in 2008. The stochastic model is based on the principle that's been long observed that capital markets, publicly traded capital markets, operate on a random walk basis. This understanding goes back well over a hundred years. The random walk aspect is that you can't forecast what the market is going to do next year or the year after, but what we can observe is the frequency distribution from the past.

The thing we call a standard deviation is quite well illustrated in graph 13, just showing the volatility in past returns. The stochastic model takes that volatility and looks off into the future and does, in this case, at least a thousand simulations of what the future might look like. Each one of those is equally likely, so from that you can develop the range, the frequency distribution of what the plan is going to look like in the future. The concept of stochastic modelling is about 30 years old now. It was developed by the actuaries in the U.K. and the U.S. and very quickly adopted here in Canada, too.

Mr. Fox: Thank you.

The Chair: Okay. Thank you.

Mr. Eggen: Thank you so much for your presentation. It was comprehensive and very thought-provoking, I think, as well. There are many, many Albertans that are listening and will be following what is probably going to be one of the biggest things that we've done here in the Legislature in terms of a public inquiry into legislation.

I guess my first question is, then – you've quite extensively defended your position on both bills 9 and 10, but I think it's worthwhile to reflect on: why are we here now? What happened where there was such a dramatic change that bills 9 and 10 were pulled from the legislative agenda and brought into this committee? It's interesting that I have some documents here, that I was looking at this morning, that say that you, in fact, did not do a comprehensive actuarial study of your own, nor did you incorporate any others that had been used to study the public pensions here in regard to Bill 9.

You know, part of this just really inflamed, I think, a lot of people. It's interesting that Bill 9 says – you talk about consultation and so forth, but you wonder why we're here – that, in fact, the government will retain its ability to dictate issues like contribution rates and composition of sponsor boards. It's not just talking about sustainability. Certainly, we want to strengthen these pensions, both public and private, but it's a question of power and control. If you are constantly moving by every small increment more power and control into the government's purview, then of course people are going to react against this, and of course there is good, justifiable reason to do so.

9:50

So why are we here? Did you actually do a full actuarial study and incorporate others, or is this just, you know, an extension and a reflection of a political document with the intention of reducing pensions and moving power and control more to the government and to business?

Mr. Prefontaine: Thank you very much for the question. I'll try and address the points raised in your question, and hopefully I catch them all. Regarding the work that was done and the actuarial analysis that was conducted by the department as part of this process, I will stipulate that there is no one actuarial report that's been produced by our department that says: this is X. What we have done is what any other party that's going to be looking at these plans can do in the absence of actually owning and holding the data necessary to produce actuarial valuation reports. The data that's required to produce an actuarial valuation report is all of the member data – age, service, salary information, and so on and so forth – so that you can determine what the liabilities are in these plans. That data is owned by the plan boards, which is why the plan boards conduct actuarial valuations at minimum every three years. As I referenced, for example, the Public Service Pension Board conducted an interim valuation as at the end of December. So just like other stakeholders that are going to do an analysis, in the absence of being able to own the data and actually have the member-specific data, you have to start with the plan board actuarial valuation reports.

The George & Bell report specifically states – in fact, bear with me for a minute. What I'm looking at is page 2 of the Review of Future Sustainability for the Local Authorities Pension Plan and Public Service Pension Plan, conducted by George & Bell Consulting on behalf of the Alberta Federation of Labour coalition on pensions. What page 2 says in this report is to "note that the starting date for our analysis is December 31, 2011 for LAPP and PSPP, since this is the . . . most recently filed valuation reports for [these] Plans." They used, specifically, the valuation reports for those plans as the basis of their work and extrapolated the liabilities forward. It's exactly what we did because, again, in the absence of owning that data, that's what you have to do.

That said, what we've done is continually update our work based on the most recent data. As I mentioned, there are now December 31, 2012, valuation reports available. Our staff actuary, using the models that we've developed, is able to take that information, extrapolate the liabilities going forward as well as use that stochastic analysis to determine what the possibilities for the future might be regarding the risks to these plans. A lot of that information has previously been posted to our website regarding contribution rate volatility in the public service pension plan as well as a number of other pieces of information that we've produced. So while we don't have a specific valuation report that people might expect to see regarding a pension plan, that's for a very good reason. We don't own the data, just like no other stakeholder can own that data.

Now, regarding the work that we've done, I've already quoted the Auditor General a couple of times. I'd like to take the opportunity to do that again, and I'm looking at page 17 of his report, regarding the work that we've done for sustainability.

> The department has completed significant research and analysis on plan design, governance and sustainability risks as part of its review. This analysis supported the advice it provided to the minister. The department's review covered a sufficient range of the relevant issues but the depth of analysis on some issues was constrained by the time limits for the review.

We've certainly done the analysis, and we've continued to do the analysis. We won't have one actuarial report, however, but we can provide much more information than we've already provided to the committee as a result of this analysis.

Further, regarding your questions about what I'll refer to as enduring provisions or enduring powers contemplated by Bill 9 for the government, Bill 9 does propose and enable a new governance structure for these plans, specifically joint sponsorship. For instance, any discussion on benefits for these plans would be in the power of the joint sponsors once the plans come out of statute, when they would be required to register with the office of the superintendent of pensions. That discussion on benefits would rest with the sponsors at that time, and government would not have a role save for any potential plan that it has a sponsorship role as an employer.

Regarding further enduring provisions, for instance, of a contribution rate cap, as I mentioned, there is an existing consultation occurring on both what the algorithm or formula or actual rate cap might be as well as how that rate cap might get set and who would be party to that discussion. But regarding the enabling provision for a regulation regarding a contribution rate cap, as I mentioned earlier, the position is that the stakeholders to these plans include members, employers, and taxpayers, which would require, then, the government to have some form of enduring provision to make sure that the interests of taxpayers are represented.

The Chair: Mr. Eggen, do you have a supplemental question?

Mr. Eggen: Thank you. Yes.

The Chair: I hope it's a lot shorter than your first one.

Mr. Eggen: Well, it might be; it might not be. We're going to be together a long time here, so we have to make sure we're amicable, of course.

Well, I just find it difficult to believe that we've come to this place in time. Let's not mince words. This is a historical moment, where we remove two large pieces of legislation, and it's not just because there was some misunderstanding or lack of explanation. There was a fundamental change in the way both private and public pensions would be delivered and where the power structure of both of those pensions would be delivered from.

For example, you mentioned in your presentation around Bill 10 that there are many private-sector workers and groups and unions that are very eager to move to this new model. You know, I'd like to know who those are. Certainly, the private-sector pension holders and so forth that I've spoken to have (a) not been consulted on this and (b) are not enthusiastic about it at all. This idea that we're moving to some sort of smooth transfer, where everything is amicable: I mean, nothing could be further from the truth. Again, why do you think we are here? It's because this has been a been a very aggressive, adversarial, nonconsultative process that has resulted in a real crossroads. For example, I'd like to know who you talked to with around Bill 10, workers that were enthusiastic for these changes.

Mr. Prefontaine: So just broadly speaking regarding the issue of why we are here, I think the presentation today is evidence that this is a very complex matter, that there are a number of nuances to these issues that are not well understood. We certainly appreciate the opportunity that this process has afforded to provide clarity to some of these issues, to ensure that these complex matters, to the best of everyone's ability, are understood.

I believe the term power structure was used for Bill 10. In fact, the power structure considered in Bill 10 doesn't change. As I mentioned earlier, in the private-sector environment pension plans are sponsored voluntarily, and in the context of a collectively bargained environment that would mean representation from members and from employers. Bill 10 talks about enabling regulations regarding the mechanisms for converting a defined benefit pension plan with a private-sector employer to a target benefit plan. Those regulations would need to include some form of member consent in order to make that happen. That consultation has yet to occur on that specific issue, but it is planned as part of the development of those regulations.

Now, regarding who's been consulted regarding Bill 10 – and I'd even take that one step further and talk about the previous iteration of Bill 10, the not-yet-proclaimed pension plans act – the consultation on those issues included actuarial firms, law firms, fund holders, third-party administrators, actual plan administrators, and, most importantly, the boards of trustees of the collectively bargained pension plans. Again, here in Alberta those are dominated by the construction trade associations, trade unions. So there was extensive consultation. In fact, the Joint Expert Panel on Pension Standards had representation from unions both in Alberta and British Columbia.

10:00

The feedback that was received regarding the Joint Expert Panel on Pension Standards' recommendations for converting those existing defined benefit plans to a target benefit plan structure was quite unanimous, and in fact it's one of the reasons, I would point out, at least in my opinion, that Bill 10, the Employment Pension Plans Act, that has yet to be proclaimed, received unanimous passage in the Legislature at that time.

Regarding who's been consulted, there are actually going to be some people that you'll be speaking to during the next three days that have been consulted as part of that process. Representation from the construction trade unions will be making presentations to this committee. I would argue that there's been extensive consultation on Bill 10 and the issues considered in Bill 10.

Mr. Eggen: Thank you.

The Chair: Thank you, sir.
Ms Kennedy-Glans.

Ms Kennedy-Glans: Thank you, Mr. Chair. Thank you again for the presentation. The materials are very comprehensive, and I'm sure that they'll be read by many.

My questions are related to Bill 9, and they don't relate to the what of the issues, although that's very, very interesting, but more to the how, and they really come from my constituents. When we make changes to something like pensions, it's a very big, big change. Underfunded pension liabilities are something that's been talked about all over North America and Europe, and people get very frightened. As a lot of people say, frightened people are resistant to change, and I certainly have a lot of frightened people in my constituency.

In digging through the material, I have questions for you about the process, not what you're doing but the how. When I look at experts, like the experience in New Brunswick as outlined in *The Third Rail*, I see the endorsement of the idea of hiring independent pension-consultation experts to personally explain the changes to reluctant plan members and labour leaders. Then I look at the U of C research, which talks about the Cortex governance report and how you make changes to governance. Eaton and Nielson and Milton also say at the very end that they recommend the appointment of independent pension experts respected by employers and sponsors to act as facilitators and a source of information.

I can't help but come to the conclusion that there's something missing in our process here. I think our what and our experts are incredible, but the how is not. I'm not sure that it's easy – I haven't seen anybody do this in an easy way – but I'm just wondering if you've actually considered the idea of doing what these other jurisdictions and these experts suggest, that we go and hire independent experts who can explain these changes to union members and, frankly, even to the taxpayers because there's a lot of confusion here.

I'm just going to throw in my supplemental question at the same time here because it relates to the first question. We're talking about changes to benefits. We're talking about changes in governance. I'm a big fan of governance change, and I like what you're suggesting. I totally endorse it. I'm wondering if it's just too much at one time for people to comprehend. What needs to come first, the governance changes or the changes in the plans and the benefits? I go back to the research by the U of C researchers, that you had asked for, and they're cautioning. They're saying, you know: doing governance changes at the same time that you're doing plan design changes is pretty aggressive.

I guess, gentlemen and lady, I'm back to: are we doing this the right way? I don't know that there's a right way, but it just feels like there's a sticking point here, and it's really gumming up the works. If I can't get my constituents comfortable that this change is essential, politically and economically, we're going to have a real challenge in rolling this out.

I'll ask you those questions.

Mr. Prefontaine: Excellent question. Your focus is on the how and the process, and I can understand that. One of the things that I pointed to earlier is that this is not an Alberta-only issue. You certainly referred to a jurisdiction, New Brunswick, where they've undertaken some significant change. I've referenced the Ontario municipal employees retirement system. Just this month they're going to be making some significant decisions regarding benefit changes.

When we look at the Alberta situation and all those issues previously outlined in the presentation, the conclusion is that there is a sense of urgency that's required. We talked about the public service pension plan and its interim valuation, that it conducted as of December 31, 2012, which, had that been required to be filed, would have required an increase in the contribution rate from 25.6 per cent to 26.3 per cent. These pressures that these plans are under are real today.

The question of which should come first. Some have asserted: make changes to governance, and then let the new governance structure deal with any potential changes. I believe that the research that you referred to from the University of Calgary would have likely led you to conclude that that would be quite an extensive process, and in order to do it well, you'd actually have to put in some significant time and effort. We'd be looking at least two to three years out before we would see an actual, new governance structure prepared to take on the challenge of dealing with some of the questions that we're dealing with today.

When we start talking about the how, it was quite deliberate in the beginning to make this process about sustainability and about making sure that the plans are well governed as a concurrent process so that when we get to the point of joint sponsorship – and that transition is actually happening. It's happening with a level of confidence that the plans are sustainable at that time and that they will become well governed.

The changes that are being contemplated only affect add-on benefits or ancillary benefits, and they only affect changes in the future for service accrued after 2015. As I mentioned, the Ontario municipal employees retirement system is actually considering a change to its core benefit, to the accrual rate that it earns.

These issues aren't necessarily going away because of the issues that we've outlined. Is there a better process? Potentially, but when we look at the issues that we currently have, there is a sense of urgency that's required because if we delay for too long, the risks to these plans can just get greater.

The Chair: Thank you.
Are you done?

Ms Kennedy-Glans: Oh, no, but I'll stop now.

The Chair: Okay. Good.
Mrs. Sarich.

Mrs. Sarich: Thank you very much, Mr. Chair. The presentation on the two fronts, Bill 9 and Bill 10, is comprehensive, but there are always extra questions.

I'd like to start with Bill 10. I actually have the piece of legislation, and I'm hoping that you do because in your presentation on page 38 it says:

> Bill 10 amends section 20 of the EPPA . . .

which is the Employment Pension (Private Sector) Plans Amendment Act, 2014,

> . . . to allow plans to apply the target benefit provision to benefits already accrued.

Let's share with the public where exactly – so if they're looking at this particular bill, where in the bill are we talking about that section 20? Which page? I'm wondering if you could just take a look at that and clarify the words on the paper for the public. That would be my first question.

The second question refers to Bill 9. In your presentation you had pages 29, 30, 31, 32, and 33. I'm wondering if you could step through: what is the sense of urgency? What are the pressures? What are the consequences of no change? The fourth angle would be: if you are new to the public service, what does this mean for you? I'm asking the question because constituents that have approached me in Edmonton-Decore that currently have been working a long time with the public service are addressing not only looking after themselves and finding out what it means to them, but they also have questions about: what does it mean for new people starting with the public service? I really didn't hear too much of that.

I'm going to stop there. Thank you.

10:10

Mr. Prefontaine: The first question, if I understand correctly, is regarding Bill 10 and the reference to the amendment allowing the conversion of a pension plan to a target benefit pension plan for provisions retroactively. If we look at page 2 of Bill 10, specifically section 5, it says:

> Section 20 is amended
>
> (a) by repealing subsection (1)(a) and substituting the following.

Then it goes on to amend section 20 of the new Employment Pension Plans Act, that, again, has yet to be proclaimed. That's where we find the wording regarding the conversion of those benefits. It goes on to page 3 as well. So it starts on page 2 and goes on to page 3 of Bill 10.

Regarding Bill 9 and the sense of urgency, as I talked about during the presentation, the real risks of a sustained low-interest-rate environment, increasing life expectancies, volatile investment returns, and ever-increasing maturity of these plans are what create a sense of urgency. We've seen that with, again, the introduction of a new Canadian pension mortality table, which will immediately increase costs in these plans. The local authorities pension plan board has already estimated that that will be in the magnitude of 2.6 per cent for its pension plan. It's 2.6 per cent of salary, so it's actually adding, potentially, 2.6 per cent to the total contribution rate for the plan.

The sense of urgency is also found, again, in the Public Service Pension Board's most recent valuation report, that shows that as of the end of 2012 there was yet another unfunded liability that would have developed and would have had to have been funded had that report had to have been filed, increasing the contribution rate total from 25.6 to 26.3 per cent.

Regarding the sense of urgency: the issues of maturity. As I mentioned, these plans are getting more mature each day. The rate of increase in active members is being outweighed by the rate of increase in inactive members. Those active members are bearing a bigger and bigger burden as time goes on. That creates a sense of urgency.

What's the impact of no change? Well, the impact of no change would be found in the potential for increasing contribution rates as a result of developing unfunded liabilities. The unfunded liabilities that exist already have amortization schedules that are already built into the established contribution rates, but the risk is that there will be new unfunded liabilities that develop. The risk is that contribution rates will have to go higher because of the potential for those new unfunded liabilities.

What's the impact on new public servants? Well, the impact on new public servants is that they clearly understand the deal at the time they're accepting employment. What we're talking about when we're talking about new public servants – and I certainly don't want to paint everyone with the same brush, but for illustration purposes let's assume that it's someone that's younger, someone that's new to the workforce. They likely have 30 to 40 years in the workforce from this point on. We are going to undergo substantive changes in the economic and demographic environments during that period of time. These pension plans need to be adaptable in order to be sustainable in those changing economic and demographic times.

If a new public servant had come in in the year 2000, the local authorities pension plan would have had a total contribution rate, split between them and their employer, of just over 10 per cent. That's now at 24.1 per cent. That's where a sense of urgency comes from. For a new public servant that's where the concern should lie: are these plans sustainable into the long term, what mechanisms are there so that they're adaptable, and what mechanisms are there so that they can assure themselves that as members they have the requisite voice in managing those risks? That's where the changes regarding plan design and changes regarding governance come in.

I will for the record assert that we are not in a pension crisis. We are not suffering from the same circumstances that, for instance, the city of Saint John, New Brunswick, was suffering from when the employer, the city, was facing the potential of a 50 per cent salary contribution rate just as the employer, not including the member contributions. That's a crisis. In making incremental changes in this period of time, we're trying to avoid having to make far more drastic changes, because of those risks that we've outlined, into the future. So that's what a new public servant should expect when they join these plans.

Mrs. Sarich: Thank you for that.

I'll just close with this one. You had quoted out of the Auditor General's report, and you referred us to page 17. I just want to pick up in that area on the sustainability review. The last statement says that "the department's review covered a sufficient range of the relevant issues but the depth of analysis on some issues was constrained by the time limits for the review."

You indicated today that you can provide more information if requested by the committee because the department continued its review. I'm wondering, through the chair, if it would be appropriate to give consideration for this information to come to the committee at another point in time. I'm not clear if this is the time or if we have the opportunity at the end of the public consultation for a stakeholder group to come back. I'm asking: should the information flow through now, or should there be another opportunity to come back and present the information that you have garnered over that time for review, that you could share with the committee, to allow you the opportunity to present in a comprehensive way to the committee?

The Chair: Apparently, we talked about that a bit before you arrived, Mrs. Sarich, and we asked the presenters, if they have any extra information, to direct it to the committee clerk, and then it will be distributed to the members.

Mrs. Sarich: All right. But I also believe that it might be an opportunity. I'm looking at this as an opportunity to present as well at the end, when we finish. That would be sometime, if my understanding is correct, in September. Could you provide the information and then it would be open to an opportunity to present?

Mr. Prefontaine: Certainly, and we would really appreciate that opportunity. I will point out that the presentation that we walked you through today is the result, in part, of that continued analysis, that continued work. The work that the Auditor General reviewed would have been reviewed in or about July of 2013. The work certainly continued during this intervening period, and the presentation that we made today, the conclusions or the assertions that there's a 1 in 3 chance that contribution rates will be higher in 2025 than they are today, is based on very recent work. Some of that work is evidenced by some of the reference material that we provided to the committee earlier. We're certainly happy to expand on that information as well as come back and answer any additional questions that you might have in the future as you work through your process as well as provide much more information than we've already provided. There's no question that a key part of this process is understanding that it is evidence based, and we're more than happy to provide that evidence.

Mrs. Sarich: Thank you.

The Chair: Are you okay with that?

Mrs. Sarich: Yeah.

The Chair: Good. Thanks.
I have Mr. Fox, followed by Mr. Eggen.

Mr. Fox: Thank you, Mr. Chair.

The Chair: You told me that you're going to be brief.

Mr. Fox: I am going to be brief. It's just a quick question.
On Bill 10, Mr. Prefontaine, one thing that struck me and that I found a bit interesting is on the conversion of private pensions to a target benefit pension. It reads that all the rules that will govern this will be put into regulation, and I'm curious as to why. Is there a specific reason why something so important would not be put into statute?

10:20

Mr. Prefontaine: There are a number of moving pieces to make conversion of a pension plan to a target benefit plan possible. There are a number of pieces that we continue to analyze. There are the provisions around member consent. To the extent of how member consent will work, we continue to consult with those parties as well as with others that I referred to earlier. Is it possible that provisions around mechanisms to convert to a target benefit could be in statute? Yes. In terms of process moving forward, there would be the consultation regarding those conversion mechanisms to a target benefit. In terms of what the reason is for it being in regulation versus being in the act, it's not for us to actually make that decision. So there are a number of moving parts to it.

Mr. Fox: What would be your preferred method, then, as the ADM? Would you prefer to have this in regulation, or would you actually like to see us legislate it so you know what the process is going to be every time?

Mr. Prefontaine: I believe the response would be that I'd be indifferent. I have two hats. One is that of the ADM responsible for pension policy, and one is that of the superintendent of pensions, responsible for overseeing private-sector pensions. I can tell you that as the superintendent I've had no issues with being able to oversee and supervise the 700 plans here in Alberta with the construct of having some rules set out in legislation and some set out in regulation. That system has worked very well.
The issues regarding the conversion of pension plans to target benefit don't just cover, however, member consent. There are many other issues that need to be considered when we look at what would be part of the regulations, including the actual rules of conversion, disclosure requirements required of those plans to members and to stakeholders as well as what the funding rules would be. If we look at the Employment Pension Plans Act and its associated regulations, both the existing and the yet to be proclaimed, there is a lot of consistency. A lot of the details are found in regulation.

Mr. Fox: If we're making changes to this particular portion of the act and we haven't yet identified what rules need to be in place and why we are actually making a change at all to that particular portion, if we don't have the information and we haven't done the outreach on it yet, isn't it a little bit premature to be making a change to these conversion rules?

Mr. Prefontaine: One of the key tenets that came out of the Joint Expert Panel on Pension Standards was: principles where possible, rules where necessary. The feedback that we received from stakeholders as the consultation ensued regarding the Employment Pension Plans Act, 2012, that has yet to be proclaimed, as well as its associated regulation as well as Bill 10 points to a strong level of interest – and I'm confident you'll hear that as you hear from experts and stakeholders over the next period of days – to allow the conversion of target benefits retroactively for pension plans. That certainly came out loud and clear from the collectively bargained environment we have for private-sector plans here in Alberta, and it's certainly come out regarding employers that sponsor pension plans here in Alberta. That principle is contained in Bill 10.
Where required, the rules – and this is where some additional work definitely is needed and where we need some additional consultation – would be contained in regulation. It's consistent

with one of the key tenets that the Joint Expert Panel on Pension Standards outlined.

Mr. Fox: Thank you. Will you release that stakeholders list so we know who you've approached?

Mr. Prefontaine: We can certainly consider what opportunity we might have, recognizing any information privacy issues that we might have.

Mr. Fox: All right.
That's all. Thank you.

The Chair: Thank you, Mr. Fox.
Mr. Eggen.

Mr. Eggen: Thank you again. It's becoming more clear to me that it's essential that we take the very longest view when we make provisions to strengthen pensions, both public and private, not just over a period of years but even intergenerationally, quite frankly.

You know, I found it interesting that you mentioned that the unfunded liability would be completed in 2026. I mean, I kind of imagine what the answer is, but then what happens to the contribution rates afterwards, when we meet that number and that goal? It seems to me that the contribution rates would drop considerably.

I'm just wondering if there are ways by which we can protect both our public and private pension funds against sort of this knee-jerk reaction to make a change when there is some deviation in the economy or interest rates and with a view to looking at a much longer gain and analyzing sort of the intergenerational sustainability of our pension funds.

Mr. Prefontaine: Thank you very much. Regarding the existing unfunded liabilities for these plans, which are currently scheduled to be amortized or paid off by 2026, as I mentioned during the presentation, that's not the risk. What the risk is is that during this intervening period there are new unfunded liabilities that develop, and the evidence I have for that is that interim valuation that the public service pension plan conducted which showed that contribution rates would have had to go up if that valuation got filed.

That 2026 time frame, that $7.4 billion: those unfunded liabilities that exist don't include the information contained in that December 31, 2012, report. That's information based on the December 31, 2011, report that was required to be filed. So the risk is that there are new unfunded liabilities that develop in the intervening period; as a case in point, the new Canadian pensioner mortality table, which, as the local authorities pension plan board has already determined, would introduce additional costs that have not yet been accounted for, including new unfunded liabilities for these plans. For the local authorities pension plan it's estimated that it's going to be 2.6 per cent of salary. The range that we've estimated based on our analysis is between 2 and a half and 4 per cent, depending on the plan that you're speaking about. So the risk is that there are new unfunded liabilities that develop. Again, history isn't an indicator of future performance, but what we have during the last 22 years is that all four of these plans have at least 17 years of deficit.

I agree that we need to take a long-time, horizon perspective and look at these plans into the future, but I cannot guarantee that come 2026, because all these unfunded liabilities that were previously established have been paid off, contribution rates are going to come down. We don't know what the future holds.

Mr. Eggen: Thank you.

Well, certainly, I think it's incumbent upon us not to throw out the very strongest, most secure version of a pension just because of, you know, emerging new liabilities. In fact, we can help to buttress and strengthen the best system by confronting those liabilities. On one of them I think I would ask you: to what degree did you consider the fact that by making cuts to our public service workforce, in fact cutting the public interest and reducing government service and the people that do provide those services, it is in fact threatening our public service pension, the fact that at the front end, the people that pay into the pension, those jobs are being eliminated so that the public service pension is jeopardized on the back end? Of course, there's a solution, that we just stop making unreasonable cuts to our public service workforce.

Mr. Prefontaine: I'm the assistant deputy minister responsible for financial sector regulation and policy, so workforce decisions are not part of my sphere of influence.

Mr. Eggen: But did you calculate that into your thing?

Mr. Prefontaine: We certainly look at and part of the analysis includes: what is the rate of growth in the active membership versus what the rate of growth is in the inactive membership? So the active membership growth would come by way of increases in the public service for these plans. We're a taker on that assumption, on what history has shown us.

10:30

In the public service pension plan, for example, if we look at what the active membership level was in the early '90s compared to what it is today, it's flat. We have the same level of active members today that we had in the early '90s. And, yes, in the local authorities pension plan, in fact, active membership has increased. It's doubled since the early '90s. The problem, however, in the local authorities pension plan is that the inactive membership has nearly tripled. The rate of growth of that retiree population and deferred members has outpaced the rate of growth in public service. From the perspective of alignment of interests, again, I'm not responsible for workforce decisions, but that said, the taxpayer does have an indirect interest in these pension plans, and I'm sure they would have an indirect interest in workforce decisions for the public service.

Just regarding the other issues, again, there's no question that the real risk here is the potential for further unfunded liabilities developing. That said, there isn't a crisis, which has afforded us the ability to retain the core benefit, the defined benefit nature of these plans, which by far is the most valuable component of these pension plans. The changes considered for the ancillary benefits, the early-retirement provisions, and the cost-of-living adjustments are significantly outweighed by the core benefit that's contained in these plans.

In fact, one of the common misconceptions that we hear and see is that people are going to have to work significantly longer to get the same level of pension in the new environment that's being considered versus the current state of affairs. In fact, that's in periods of months, not years, because the changes only affect service after 2015 and affect only the ancillary benefits, not the core benefits.

The Chair: Well, thank you very, very much.

We have come to the end of our first portion of today's meeting. I would like to thank all members for participating.

Ms Nygaard, Mr. Prefontaine, Mr. Gilmour, and Mr. Moore, I'd like to thank you for your participation and for your presentations

– it has been very informative, very comprehensive – and also for answering the committee's questions. You can access the *Hansard* transcript of the full day's proceedings via the Legislative Assembly of Alberta website later this week. The audio of the meeting is also available via the Assembly site. Thank you very much. It was a pleasure having you here.

Now we will break for 15 minutes. Please be back here at 10:45 sharp.

[The committee adjourned from 10:33 a.m. to 10:45 a.m.]

The Chair: Well, good morning, ladies and gentlemen.

We are back on the same issue and the same subject. I would like to welcome the Auditor General, Mr. Merwan Saher, and his staff.

Let's go around the table and introduce ourselves. I am Moe Amery, MLA for Calgary-East and the chair of this committee.

Mr. Fox: I'm Rod Fox. I'm the MLA for Lacombe-Ponoka and deputy chair of this committee.

Ms Kubinec: I'm Maureen Kubinec, MLA, Barrhead-Morinville-Westlock.

Ms Kennedy-Glans: Donna Kennedy-Glans, MLA of Calgary-Varsity.

Ms Pastoor: Bridget Pastoor, MLA, Lethbridge-East.

Mr. Rogers: George Rogers, MLA, Leduc-Beaumont.

Mr. Sittler: Jeff Sittler. I'm a principal with the office of the Auditor General.

Mr. Saher: Merwan Saher, Auditor General.

Mr. Ireland: Brad Ireland. I'm an Assistant Auditor General.

Mrs. Sarich: Good morning and welcome. Janice Sarich, MLA, Edmonton-Decore.

Mr. Dorward: David Dorward, MLA for Edmonton-Gold Bar.

Mr. Luan: Jason Luan, MLA, Calgary-Hawkwood.

Mr. Eggen: David Eggen, MLA for Edmonton-Calder.

Dr. Massolin: Good morning. Philip Massolin, manager of research services.

Ms Sorensen: Rhonda Sorensen, manager of corporate communications and broadcast services.

Mrs. Sawchuk: Karen Sawchuk, committee clerk.

The Chair: Who do we have on the phone?

Mr. Hehr: Kent Hehr, MLA, Calgary-Buffalo.

The Chair: Okay. Anybody else?

Okay. Mr. Saher, the floor is yours, and I would ask that you leave the last 20 minutes of the allotted time for questions from the committee members.

Auditor General

Mr. Saher: Thank you very much, Mr. Chairman. My colleagues have introduced themselves. I'll just add a little bit of colour to their backgrounds. Jeff Sittler, on my left, is the engagement leader who took charge of the work that we reported in February, our work on pensions, so he's knowledgeable on the subject matter, and Brad Ireland, on my right, is the Assistant Auditor General who has oversight of this area of our audit work. I'd like to thank the Standing Committee on Alberta's Economic Future for the invitation to make a presentation regarding public-sector pension plans.

Before we start, I'd like to put something on the record. My colleagues and I are members of a legislative audit office. Part of my mandate is to call attention to cases where appropriate and reasonable procedures could be used to measure and report on the effectiveness of programs, but those procedures are not established. This is the mandate that allowed us to look into the pension program – and we'll talk about that shortly – but my mandate does not allow me to comment on government policy; for example, is Bill 9 a good policy or a flawed policy? What the mandate does do is to encourage us as auditors to look at the quality of the information used by those who make policy and the quality of the systems used to implement policy. So in the context of information driving policy and systems to implement policy, we'll be pleased to speak to the matters contained in our February 2014 report on oversight systems for Alberta's public-sector pensions plans.

Along with the information that the committee will obtain from other experts and stakeholders, I believe that our report identifies some of the significant matters that the committee should take into account before making a recommendation to the Legislature as to how to proceed with Bill 9.

We have no comments to offer on Bill 10 except insofar as our observations on pension-plan risk management may apply more generally to all pension plans.

After a brief presentation we'll do our best to answer questions. To start, I'll ask Jeff Sittler to summarize our recent report.

Over to you, Jeff.

Mr. Sittler: Sure. We started a project on pension plans in 2011 because of concerns expressed by elected officials, the media, and the public about the financial health of Alberta's public-sector pension plans. As part of our audit planning we met with those involved in Alberta's public-sector pension system, including plan board members, officials from the department, and others. We sought to understand the roles and responsibilities of the various entities within Alberta's public-sector pension plan system and the risk management systems that they used.

During our audit planning we decided to focus the scope of our audit on assessing the adequacy of systems used to manage risks within Alberta's public-sector pension plans. We did this because the sector did not appear to have well-functioning risk management processes that made use of clearly articulated objectives for the plans with clear targets and tolerances for the costs of the plans. We also chose to focus our audit on the department's systems because of its role in supporting the Minister of Finance, who is the trustee and administrator of the plans. The department supports the minister through the development of public-sector legislation policy.

In September 2012, as you know, the minister asked plan boards to consult with stakeholders about the sustainability of the plans and to submit proposals to ensure that the plans continue to do three things: be affordable, be sustainable, and offer secure benefits. The department asked us to consider adding a second objective to our audit, focused on assessing the adequacy of the department's sustainability review support processes, and we agreed to that request. We knew that the sustainability review would not be complete by the time we had finished our audit;

however, we wanted to provide the department with timely recommendations on areas where its sustainability review, the support processes, could be improved. This would allow the department time to evaluate our recommendations and consider necessary actions to enhance its processes. We examined the department's sustainability review support processes up to July 2013, and we formally provided our report to the department in December of that year.

We audited the department's systems to monitor and evaluate the performance and sustainability of the local authorities pension plan, the management employees pension plan, the public service pension plan, and the special forces pension plan. Our objective was to assess if the department has adequate processes to monitor and evaluate whether the plans are meeting their objectives, considering the risks, costs, and benefits, and to evaluate proposed plan design and governance changes and the likelihood that they will improve the plan's sustainability and the ability to meet their objectives.

Alberta's public-sector pension plans are facing funding challenges. Contribution rates have risen to levels where some employers and employees do not want to pay more, which leaves fewer options to deal with further unfunded liabilities that will very possibly arise. As of December 31, 2012, past unfunded liabilities totalled $7.4 billion. Unfunded liabilities, simply put, are the amount of money needed to be put into the plans today to fully support promises made to retirees and current employees for services already provided. Unfunded liabilities, however, do not include amounts required to pay for benefits related to future service. To fix the plans, the minister needs to ensure that plan benefits are secure and commensurate with an affordable and available amount of funding from both employees and employers.

Alberta's public-sector pension plans are not unique. Many other defined benefit plans face the same problem. They have significant unfunded liabilities, and they risk having insufficient assets to meet their obligations unless they change something. Recent experience has shown that the actual plan costs are much higher than the estimated costs originally used to set contribution levels. The plan's objectives and tolerance for risk have not been clearly articulated by the plan's sponsors in the past. Therefore, it is unclear whether the plans are meeting their objectives or operating within sustainable tolerances for risk. The plans are facing significant funding challenges, and these plans are a significant cost to employers and employees. Therefore, a process to review the risks and costs facing the plans is necessary.

There are better tools available to manage risk. The plans have used traditional pension-industry methods to manage risk, primarily by spreading the effects of bad experience across contribution rates over a long period of time, but these methods allow the risks and costs of defined benefit plans to accumulate and be less transparent to stakeholders. Defined benefit pension plans are starting to use better tools and strategies to assess and mitigate their risks. With proper standards and guidance Alberta's public-sector pension plans can use these risk management techniques to increase the likelihood that the plans are sufficiently funded to meet their obligations and that costs do not become more than plan sponsors can afford or are willing to pay.

Who should pay to fix the plans is the key question, and the options are limited. Employers, who are funded typically by taxpayers, can pay higher contributions to the plans. In some exceptional circumstances former employees may be asked to receive reduced benefits, or current and future employees can pay higher contributions and take lower benefits. But it's hard to reform a pension plan that owes a lot of money to former and current employees. This is because future and current employees help pay these costs, but they likely won't want to contribute more to plans that will pay them fewer benefits than their predecessors received when they retired.

10:55

To varying degrees the pension plan boards have implemented risk management systems; however, no one organization has clear responsibility to co-ordinate and monitor the performance of the plans or take a consolidated approach to managing risk. The department has managed risk to some extent by providing policy support to the minister.

Regarding the sustainability review, the department has completed a significant amount of research and analysis on plan design, governance, and sustainability risks. This analysis did support the advice that it provided to the minister. The department's review covered a sufficient range of the relevant issues, but the depth of analysis on some of the issues was constrained by the time limits for the review.

The department's options for reform were also constrained by the existence of significant unfunded liabilities for past service that needed to be funded. An option used in the private sector to manage pension risk is the conversion of defined benefit pension plans to defined contribution plans. This option was considered by the department in its analysis but was not pursued because of the existence of these significant unfunded liabilities, that are being paid for jointly by the contributions of employers and current employees. If the defined benefit plans were changed to defined contribution plans, it would be more likely that employers would have to pay a much larger share of the current unfunded liabilities than they are currently paying under the existing joint funding model.

We made three recommendations to the department about what we think needs to be done. First, we recommended that the department set standards for the plan boards to establish funding and benefits policies that include tolerances for the cost and funding components, alignment between plan objectives and benefit, investment, and funding policies, and predefined responses when tolerances are exceeded or objectives are not met. Secondly, the department should establish an Alberta public-sector pension plan risk management system to support the minister in fulfilling his responsibilities. Lastly, as part of its ongoing sustainability review the department also needed to validate the objectives for the review with stakeholders, evaluate and report on how each proposed change meets the objectives of the review, cost and stress-test all proposed changes to assess the likely and possible future impacts on the plans, conduct or obtain further analysis on what effect the proposed changes might have on employee recruitment and retention, and prepare a detailed plan for implementing the proposed changes.

We have based these recommendations on the department's current responsibilities within the public-sector pension system. These recommendations will continue to be relevant even if responsibility for implementing them needs to shift if the current governance structure of the plans changes.

The financial health and design of Alberta's public-sector pension plans can affect the government's and other plan employers' ability to cost-effectively deliver public services, attract and retain quality employees, and provide a level of benefit security for plan members. Albertans need to know if Alberta's public-sector pension plans are sustainable. The plans face retirees who are living longer and low interest rates, resulting in large unfunded liabilities. The minister and department need performance measurement systems to help them assess whether the plans are continuing to meet their objectives.

The promissory relationship between employers and employees created by defined benefit pension plans makes it difficult to change plan benefits once established. Therefore, it is critically important to properly cost plan benefits and assess the likelihood that they can be funded at a contribution rate acceptable to the sponsors while withstanding risks. Otherwise, the sponsors may bear a higher cost than intended, or beneficiaries may receive less than promised. The first and most important step in managing risk in defined benefit pension plans is to only make promises that have a high probability of being kept. Even so, not all risks can reasonably be foreseen, and there will be times when plans experience circumstances that take them beyond the tolerances they were designed to withstand.

Our recommendations are intended to help ensure that each plan's objectives and tolerances for its cost and funding components are clearly articulated. Clear objectives and risk tolerances will help the minister and department monitor plan performance. They will also help all stakeholders reach a consensus about what to do when a plan exceeds its tolerances. This should prompt timely response to such risks as they arise. Furthermore, an improved approach to pension risk management should make it clear in advance who will bear which risks and costs when plans exceed their tolerances.

Mr. Saher: Thank you, Jeff.

My colleague has just recapped for you a systems audit on the Department of Treasury Board and Finance's oversight systems for Alberta's public-sector pension plans. This audit was reported publicly in February of this year. Mr. Chairman, I'd like to make some additional comments on this piece. In the main these are the same comments I made to the Public Accounts Committee when briefing that committee on our audit. I've been told by many people that it's a complicated piece. Yes, it's complicated because pensions are a complex subject, so my comments are designed to help you get at the essence of what we were saying.

In this piece we're essentially advocating for disciplined risk management. The first thing people say is: what risk do you mean? The risk that we're talking about is the risk of the pension promises not being met. When we talk about risk, it's always in that context. The real risk is the pension promise out there. These pension plans, each of them, have a pension promise. The risk is that the promise can't be met. That's why in our language we talk about risk management. If the department were to look at our recommendations and accept them and move towards more focused risk management, we think that the pension system in Alberta would be better managed in the sense of better information being produced at the right time to allow the people who have to make decisions to make informed decisions.

When I talk about people making decisions, there are really two parties. There are the employers – in many cases that's the government itself – and there are employees. We believe that the decision-making has to be based on the participants having all of the information that they need to make a good decision, so that's why we talk about risk management.

There are two big questions that have to be answered. One of you as a member of this committee might want to ask me this question. It's being asked in the media, and we're being asked as an audit office why we don't answer this particular question that I'm going to give you. The question is: are changes needed? Are changes needed to the four pension plans that were the subject of this work? Another way of asking that question is: are the plans sustainable as is?

That's a question that's being asked in the public debate and discourse, and this is the answer I'll give you to the question. The evidence is that the contributors, who are the employers and the employees, are signalling that contribution rates are reaching a maximum acceptable level. So in terms of, "Is there something that needs to be dealt with and why is this an issue today and why wasn't it an issue yesterday?" the overwhelming evidence is that the people who contribute to the plans are signalling – that's the employers and the employees – that the contribution rates are reaching the maximum acceptable level. What do I mean by acceptable? In terms of individuals it would be, I think, viewed as affordable.

If that's the situation and assuming no willingness to increase contributions, there is no alternative but to reduce the benefits that the plans have. It's a simple mathematical equation. It's just founded in logic. There's not really any other place to go. If you reach the maximum in terms of the contributions that are affordable and assuming that you don't want to take on additional investment risk, then the only thing that can make this balance out over time is a change in the promise; in other words, a change in the benefits. The trick here is to have the participants agree on a promise that's acceptable to them all, a promise that they can live with, and – and I stress this – at a probability of being achieved that's acceptable, an acceptable probability, given a particular contribution rate and given an investment return.

The next question. Do the proposed changes that are being talked about by the department and the minister at this time make the plans more sustainable? I can only answer that in one way: I cannot give you that answer. There is only one person that can give you that answer, and that's the Minister of Finance and his departmental officials. So to the question, "Do the proposed changes make the plans more sustainable?" my answer would be: ask the minister to explain for each plan the degree to which his proposals increase the probability of the promise being met.

11:05

Very simply, what I'm trying to convey to you – and this is what risk management is all about. Risk management is all about the contributors in the plan understanding what the risks are that they bear and what it is going to cost them to manage their risks, what is the probability that the promise that is embedded in the plan can be met given certain contribution rates and given a decision on an acceptable investment return.

What we're trying to do in our report is to say that these are the questions that need to be asked. People need to understand the risks that they hold. If there's one thing that I think needs to be fully understood, it is that many people assume that the promise is a one hundred per cent guarantee. It is not that. I think that a frank discussion as to the probabilities of the promise being met is what's needed. If you fully understand what the probabilities are, then risk management can be win-win. People can be making decisions at the right time if they understand the risks that they're subjected to. They can come to the table and make good decisions about whether they're happy with the new information. What I'm trying to say is that as the dynamics of the plan change, as the probabilities change, then people can say, "Yes, we can live with this," or "No, we can't live with this."

I've tried at the highest level to explain to you the purpose of the piece that we made public in February, why we talk about risk management and what the risk is. It's the risk of the promise not being met. Our contribution is a new view, a sort of additional view, recommendations to the department on systems designed to manage that risk proactively. By proactively I mean almost continuously.

I'll end with my definition of sustainability. Sustainability means that benefits, funding, and investment policies are balanced so that the promise can be met with a high degree of probability. Remember that the probability will never be one hundred per cent. As I see it, Bill 9 is the Minister of Finance's proposal going forward on the balancing. In my opinion, as you study Bill 9, I believe you should ensure that the bill clearly articulates the result that the government wants. When a desired result is clear, you can analyze over time whether that result is being achieved.

I'm going to hand it back to Jeff just for a few seconds for some final thoughts.

Mr. Sittler: As the committee decides how to proceed with Bill 9, we suggest that you take into consideration: what are the objectives of the plans from the point of view of the sponsors and the employees; how do the proposed changes to the pension plans support meeting those objectives; what are the costs of the plans relative to the benefits or the alternatives; how has the funding process functioned in the past relative to meeting plan objectives; how much is benefit security enhanced by the proposed changes; has any further work been done to help assess the impact of proposed changes on employee recruitment and retention; and what risks are most important to each stakeholder group to mitigate, and how can the proposed changes optimize allocation of risks amongst them?

With that, we'll turn it over for questions from the committee.

The Chair: Well, thank you very much.

I have quite a list. Ms Kubinec is first on the list.

Ms Kubinec: Thank you, Mr. Chair. And thank you for your presentation. My first question is: currently, the way it's set up, does the government guarantee the benefits of these plans, and will it guarantee the benefits of these plans if they become jointly sponsored?

Mr. Sittler: In the legislation there is no guarantee. I don't believe there's a proposal to do that under the proposed changes either.

Ms Kubinec: So although the Provincial Treasurer is the trustee, if I understand correctly, then right now the government is not guaranteeing the plans. Is that correct?

Mr. Sittler: There's no explicit guarantee in the statute. There may be other legal requirements of the government given its role.

Ms Kubinec: Okay. My second question would be: if we do go to the jointly sponsored plan, who would be responsible then for guaranteeing it? Would it be the joint sponsors, for guaranteeing the plan?

Mr. Saher: I'll go first. I don't think that there's ever a guarantee in this world. The real issue is to design a plan and monitor that plan in a way that you maximize the chances of the promises inherent in the plan being paid, and by promises I mean the benefits that are promised. I don't believe that this is an area in which there is any guarantee. I mean, if a plan fails, the way I look at it is that any government of the day can decide at that point in time how it will act. Just to reinforce what my colleague has said, I don't believe that anywhere written in legislation explicitly is the notion that the benefit payments are guaranteed by the government of the day.

Ms Kubinec: Thank you. That's all.

The Chair: Thank you.

Ms Kennedy-Glans.

Ms Kennedy-Glans: Thank you. And thank you, gentlemen, for such a plain language explanation of a very complex issue. I think it's well appreciated. I read your report with great interest, and there's lots there, good guidance. The two strands that I want to pull through a little bit more are intergenerational fairness and the value of pensions, especially defined benefit versus defined contribution, in employment recruitment and retention. I think that we often conclude that the latter, defined contribution plans, are something that are not as attractive. Even companies like TransCanada have shifted back to a defined benefit plan from defined contribution, so I think we lose sight of that as something that's got a huge value for employees.

My constituents, especially younger constituents who are members of these unions that are affected by the proposed changes in Bill 9, are asking a lot about those two issues on intergenerational fairness. They're asking me as their MLA: where is this conversation being hosted? I look at your report, and I see that you tag that it's not particularly being hosted by government. My question to you is: how can we ensure that those two issues and others – but I want to focus on those two – are actually discussions that in plain language can be had in this province among union members and taxpayers? They're very big policy questions, and I understand your point about not opining on policy but on process.

Mr. Saher: Maybe I'll start, and then I'll ask my colleagues to weigh in. From the point of view of intergenerational, you know, I think the issue here is that people could look at the situation today and say: look, a large unfunded liability has built up, and in a fair world it wouldn't have been allowed to build up. Those that are benefiting today from these pension plans might in some way have had to pay more along the way, or there might have been a realization earlier that the benefits that were put on the table are not sustainable.

I think that I can only look at this going forward in the sense that we should all aspire to intergenerational equity and fairness, and the only way you get there is by – I mean, we're calling it risk management, but by any other name it's setting out the result you want clearly; measuring whether or not you're achieving that result regularly, continuously; and if the evidence is that the result you want is not being achieved, acting on it, calling people together and saying: "Look, the probabilities of the promise being achieved have moved from X percentage to Y percentage. You know, can we live with this?"

So, yeah, I do understand the intergenerational thing because people will be saying now, new employees will be saying: "Why do we have to pay in our current contributions? Why are we paying for the past?" I suppose the answer to that is: that's how defined benefit plans are constructed. You come into the plan. You pay a contribution rate that is designed to keep that plan healthy. But if the plan has been allowed to become unhealthy, then arguably that is a large burden that current employees have to shoulder in a plan that is jointly sponsored.

11:15

With respect to defined contribution, yes, these are options that other plan sponsors have taken. They've moved from defined benefit to defined contribution. My colleague explained in our introductory comments why moving to defined contribution, were it on the table as an idea, is not one that's being pursued. Essentially, the way I look at defined contribution, it's simply transferring risk to another party in its simplest element. Private-sector corporations have determined that their choice is to transfer

the risk of their employees having a pension retirement income at a level that they want – that risk is moved over to them wholly.
Jeff.

Mr. Sittler: Sure. Maybe just to supplement with a couple of things. I did appreciate your question earlier, when the department was here, about something seeming to be missing in the process, and I think we agree that something is missing. Where we settled on that with our recommendations is that what's missing is transparency over what the risks are in these plans and how they're being managed. I think our thesis and our recommendations are that if there was better quality information out there for all of these stakeholders to understand the risks they're truly bearing and what can be done to manage them – well, I mean, nobody likes change, I think, generally as a rule – at least there'd be a better understanding of why we need to change.

The other thing I would maybe just add in sort of assessing: well, you know, there's defined contribution, there's defined benefit, and now we have these hybrid plans in between, target benefit plans. If I was a younger person joining the public service now or even in the private sector, I would really focus on a statement we made on page 41 of our report. It's the last paragraph there that says:

> The quality of a plan's funding policy and the rigour of its implementation through asset liability management, the system by which contribution rates and investment strategies are set consistently with the objective of funding desired benefit levels with a defined degree of certainly, is a key determinant of plan sustainability.

I really think that's the criteria that I would encourage somebody to focus on in assessing the value of their plan and not the title. What this really means is that you could have a target benefit plan or one of these hybrid benefit plans that actually provides higher benefit security than some of these traditional defined benefit plans that we have here and others have. So focus on measuring what's important to you, which I think is security, and less so on the form of how you get that assurance or that security.

Mr. Saher: I would like, Mr. Chairman, with your permission, just to further supplement. I was able to catch part of the Treasury Board and Finance presentation, and the member asked about communication. I thought my colleague was going to tack that onto when he said that he appreciated one of the questions. Undoubtedly, this is complex, but just because it's complex doesn't mean that it should be something reserved for experts. After all, this is so profound to the life of Albertans: that public-sector employees feel comfortable with what they're earning today, that that makes sense, and what they understand their deferred compensation, if I can call it that, is going to be. They really do need to understand this.

I think that, to be honest, people just assume: well, you know, I'm a member of this plan, the contribution gets taken away, and everything is going to be fine. Well, everything is not going to be fine. I think part of the challenge is that, I believe, the government has to engage in very specific communication in language that can be understood. I know it can be done. There's nothing that cannot be explained if you take time to try to explain it. I have no evidence that the government is trying to hide anything. I just believe that the government perhaps has not realized that to get its message across as to what it's trying to do requires a superlative communication exercise. I'll just leave it at that. In my estimation, the communication at the moment is not where it could be.

The Chair: Thank you.
Mr. Lemke.

Mr. Lemke: Thank you, Chair. A version of my question has already been asked and satisfactorily answered.

The Chair: You're okay?

Mr. Lemke: Yes. Thank you.

The Chair: Okay. We'll move to Mr. Dorward.

Mr. Dorward: Thank you, Chair. Thank you, auditors, for attending. Mr. Sittler, you said in your presentation that something had to be fixed, and in my way of thinking, when something needs to be fixed, something is not right and broken, and we've heard discussion regarding that today. Is the bull's eye strictly on the unfunded liability? If we did not have an unfunded liability, would we be seeing a Bill 9? Would we be at the table? Is that as simply as you could state if for Albertans, that this is a problem, that there is an unfunded liability that has grown?

Mr. Sittler: The way I would explain it is this. Even if we had no unfunded liability today, we could still be here talking about making changes because what the department, I think, is trying to do is avoid future further unfunded liabilities. The proposed changes don't actually deal with the past unfunded liability. I think that having that significant unfunded liability might have prompted the thinking of: how do we avoid further liabilities in the future? But if we'd had no liability, we could still have the same discussion today.

Mr. Dorward: Mr. Saher, you said that the pension situation had been allowed to get out of line, and please correct me if I'm misinterpreting the words that you said. Is that because in the past it might have been explained away, the growing of the unfunded liability, with such things as "Well, don't worry about it; we'll hire more employees in the future" or "Don't worry about it; there will be more investment income" or those kind of notions? Is that why perhaps nobody stepped in and said "This is something that needs to be looked at now"?

Mr. Saher: Yes. I would say that it's been easy just to increase contributions. People have accepted contribution increases being the solution to the viability of defined benefit plans. I mean, I'm used to listening to that, you know. You have a general explanation: well, yes, the investment returns are not keeping pace with what we had thought; we need to top up, if you will, so let's go to more contributions. So, yes, in answer to your question, I believe that we are sitting here today because of an unfunded liability that has grown, and there is evidence that it will continue to grow.

The missing bit – and I keep coming back to that – is that I haven't yet heard in clear language what is the probability that the changes that have been proposed will deal with this unfunded liability, and best estimates of what could happen in the future. I mean, although the assistant deputy minister said that there is a scheme to deal with the unfunded liability going up to 2026, I think is what he said, the point he was making is that that's a scheme that's been put in place and it's valid as of midnight tonight; tomorrow everything can change. It's possible today to model what the probabilities are of today's contribution rates and today's proposed changes actually resulting in what's needed in the future. I think that's the missing bit. What is the probability that these changes will in fact make a difference?

Mr. Dorward: Mr. Chair, am I okay to ask another question?

The Chair: Go ahead.

Mr. Dorward: Thank you.
Mr. Saher, in your work with the Auditors General across Canada, does this come up? I know that you're able to at least communicate with them if not meet with them. What is the general feeling with respect to this scenario that we're in across Canada?

11:25

Mr. Saher: I think it's of concern to all Auditors General. New Brunswick is often cited as being a jurisdiction that is actually ahead of others in terms of – I'm not saying that the situation in New Brunswick is parallel or the same as the situation here, but it is a jurisdiction that recognized that it had problems and moved ahead with pension reform. I know that the audit office there has been involved in commentary on that. So at the highest level I believe all jurisdictions have, in some way or other, similar issues that need to be considered, and I think it is a concern to all Auditors General.

Mr. Dorward: Thank you, Mr. Chair.

The Chair: Thank you, Mr. Dorward.
Mr. Eggen.

Mr. Eggen: Thank you. That was a great presentation, executed with great clarity. I think that perhaps your office's ears might have been burning during the Bill 9 debates in the spring Legislature. You were being quoted extensively and, you know, I think, erroneously for endorsing Bill 9, and it was a heated debate, and it ended with where we are here today. I guess my first question might be: what was the fundamental flaw that brought Bill 9 to where we are today, where this legislation was removed from the legislative agenda and brought to committee?

Mr. Saher: I've been at this long enough that I won't answer that question. I mean, I'm not going to comment on how exactly you guys got yourself into the situation you did as parliamentarians.

Mr. Eggen: But you weren't endorsing this Bill 9, were you?

Mr. Saher: No.

Mr. Eggen: Okay. Good. That's what I thought.

Mr. Saher: I'm agnostic on it. My colleagues are agnostic on Bill 9. I think what we're trying to do is to say that, you know, we anticipate something is going to happen one way or the other. Our interest is from today going forward in terms of systems and procedures to manage the pension world. We think that Albertans will be better served by – and I come back to it – this risk management. This is a clear articulation of what the plans are designed to do, a continuous measurement of: are they being successful? The probabilities that the participants agreed to – I don't know a particular date. Are the probabilities changing? What does that mean?
I mean, I think that it's really brilliant that this discussion is going on today. Whatever caused us to be here is excellent. This is the stuff that, yes, we certainly don't want to be having hearings on monthly or weekly, but this is a subject that has to be talked about continuously because we're in a changing world. The assumptions that are used to plan today can change overnight, but there are techniques, modelling techniques – and I understand them conceptually; I couldn't explain them to you – which have validity, are being used elsewhere in the world, that take all of the information you have today and a good view of the future and put it all together and say: "Look. With this plan you've got, with the likelihood of it moving from funded to unfunded in the future, this is the probably of that happening. Are you, the government, as an employer, and you, the employees, happy with that? What can we do to change that?" This is what we're interested in in trying to have changed the – but, you know, what we want to have changed is, in our view, very relevant to the decisions that are behind Bill 9.

Mr. Eggen: Yes. Absolutely. I shouldn't doubt that. You know, I think in the heat of battle another misrepresentation was that those of us who were seeking to perhaps help create this public discussion like we are having here today were somehow trying to defend the past and defend the status quo. In fact, we are looking for a practical solution that everyone can accept. If you can think of a suggestion that I can move forward on for how we can improve our public pensions, if any one sort of thing stands out either to you or Mr. Sittler, I would invite you to bring it forward or maybe pass it forward to us when you can.

Mr. Saher: Certainly. We'd be happy to do that.

Mr. Eggen: Thank you.

The Chair: Thank you.
Mr. Fox.

Mr. Fox: Thank you very much, Mr. Chair. I come from a risk management background. I come from the insurance industry, and I've always found it an interesting topic. To manage risk, one must identify the risks present and perceived in the future. One very big risk to the pension plans is not just the level to which the members can contribute but also what is done to grow the pension fund. In other words, what are the market risks, and how are they being identified, and how are they being mitigated?
One thing that I am curious about is the transparency of managing those risks, the communication of the risks that are perceived through market risk to those that are involved in the pension funds, so those that are investing, both the employer and the employee. I will note that there are some changes in these two bills that allow the funds to pick new managers other than AIMCo. So I'm wondering. Do you have any purview to audit how the funds are being invested, whether or not their policies and procedures are getting us the best bang for the buck on these pension plans? That can contribute to unfunded liabilities in the plan. If these plans do move away from AIMCo, will you make a recommendation for any provision so that you can oversee or look at their policies and processes in the investment and management of those funds?

Mr. Saher: Thank you for the question. I'll start, and then I'll ask my colleagues to supplement. As I understand things, the pension boards at the moment do have the responsibility to set the investment policy. I mean, I think that, you know, at the simplest level it boils down to asset mix: of the invested assets how much will be in fixed income, how much will be in equities, and how much will be in alternative types of investments? That's the prerogative of the boards to do that.
Our job as auditors has been to look in and see that the investment managers are in fact adhering to those instructions faithfully. You know, the systems that are used to report on adherence and to report on the income generated from that asset

mix: that's our world. We've never been involved and I don't think it's right for an auditor to be involved in putting himself or herself in the role of deciding what is the best asset mix.

Mr. Fox: For an answer on the best asset mix I was wondering about your looking at the policies and procedures implemented by the fund managers and the boards.

Mr. Saher: Yes, certainly, that is a space for us as auditors. We are involved in that, and we do report back to the boards currently that their investment managers – and in Alberta it is primarily AIMCo – that AIMCo's systems and processes allow it to respond to the instructions in terms of asset mix and to follow through on that.

I think you asked: if things changed in the future, how would that change our . . .

Mr. Fox: Your ability to oversee their policies and procedures.

Mr. Saher: I don't think it would change. It really doesn't matter whether it's AIMCo or someone else. Our first port of call is always: how does the organization that has issued the instruction satisfy itself that its instructions as to asset mix, for example, or any other instructions as to how assets are to be invested – how are they assured from the agent doing that on their behalf that their wishes are being met? We're always looking at the quality of that system.

Brad, have you anything that you can add to that?

Mr. Ireland: I'll just say right now that we do audit all of the plans' financial statements. We are the auditor of AIMCo. If the plans did change investment managers in the future, our audit wouldn't really change unless a decision was made that we not carry on as the auditor of these pensions plans as we currently are. From our point of view, unless that changes in terms of the relationship, you know, we would apply the same audit approach that we're doing right now.

Mr. Fox: Thank you.

The Chair: Are you done? Thank you.

Mrs. Sarich.

Mrs. Sarich: Thank you very much, Mr. Chair. You had raised the question, "Are the pension plans sustainable?" and then also had suggested that there's evidence to signal that they're reaching a maximum acceptable level. On page 29 of your February 2014 report bullet 3 says, "The department has performed some costing and stress testing for their proposed changes; however, a comparative analysis of each option and stress testing of all combined changes has not been completed."

We had the department here in advance of your presentation today, and they did suggest some of the testing, the stress testing. I'm just wondering if you could provide a bit more insight into this particular issue and also the other findings in this particular area as it relates to where we are today. You know, the department had touched on some of these findings that you're pointing out, but I'm just wondering. I'm looking at this as an opportunity to provide you with this time to maybe expand on some of these things that are here and the interrelationship of what we may have heard earlier.

11:35

Mr. Saher: If I can pick up on the stress testing first – and I'm going to ask Jeff to perhaps elaborate a little bit on what that is – I do want to bring to this committee's attention that at the Public Accounts Committee meeting recently, when Treasury Board and Finance appeared, the question was asked: will the department make public the results of its costing and stress testing for the proposed changes? The department replied in the affirmative. I don't know whether that information has been received by the Public Accounts Committee, but if it has, I think it should be received also by this committee because I think that that is, in a sense, at the heart of our recommendation. I mean, this language of costing and stress testing is another way of talking about communicating the probabilities of a particular result being achieved.

Mrs. Sarich: That's correct.

Mr. Saher: I do want to stress that I think that there is information which the department has committed to make public, and I think it's important that that be made public as soon as possible.

I want to talk about page 31 of our report, human resource risks. We say here: "The department has not assessed the impact of the proposed plan changes on employee recruitment and retention." That was a comment that we believed was correct when we completed this work in July 2013. This morning I was here when Assistant Deputy Minister Prefontaine talked about: not directly in his scope. I think it's an important issue. I believe that that is something that even if it's not directly the responsibility of Treasury Board and Finance, it certainly is a responsibility of the government. I think that that's something that should be pursued at this time in terms of looking at the bill and satisfying yourself that sufficient work and evidence have been generated to answer the question: what effect, if any, do the proposed changes have on human resource matters?

I'll leave it at that in response to your question, but I'm going to ask Jeff to talk just a little bit more about this stress testing issue.

Mr. Sittler: Sure. Maybe I'll just point out – you can either look at page 30 or the other place where this shows up, page 23 – that in the report we've broken the pension deal or pension equation into several components: cost and funding and then underneath that several different dependencies. You know, if you think of each of those dependencies as being a variable in an equation that bears on whether the pension plan is going to be sustainable or not, then you can use those variables to do modelling of what the future could potentially look like.

The department talked about that in terms of: do you use deterministic models, or do you use stochastic models? If you do use stochastic models, then you can do something called stress testing, which means that for a particular defined scenario for which you would consider a stress or a risk happening, you would run that through the model and see how the plan behaves given the impact of that stress on the variables. Usually there's a lot of focus on investment returns. One example would be, you know, that if we were going to look out, let's say, over the next 20 years, we could run a scenario that says: well, what would happen if we have another market downturn equivalent to 2008, or what would happen if we actually had two downturns equivalent to 2008 in that 20-year period? How would the plans stand up to that?

In evaluating the department's proposals, if we compare how the plans would have stood up to those stress scenarios under the status quo to what they're proposing to do, you should see an improvement over the status quo. At the time that we were doing our audit work, that kind of modelling was still in progress, and we didn't have an opportunity to audit it. The department has obviously done some work since we finished.

The last thing I'll say is that even though most of the focus is usually on the investment side of the equation, you could also do stress testing on the liability side. One of the things that the department highlighted this morning was the importance of plan maturity, and that means the ratio of active members to retired members. If that ratio were to change significantly in the next 10 years versus staying static, how would that impact the plans' ability to stay sustainable over the next 20 years? Those are the kinds of scenarios you can define and then test to see whether your changes are actually, you know, going to improve the odds of sustainability.

Mrs. Sarich: Just as a follow-up to that, they did point out that the ratio had changed. Going back to the evidence signalling reaching the maximum acceptable levels, would you agree that that's another level of evidence pointing out that there is something more happening here in the mix about the sustainability of pensions, so prompting change?

Mr. Sittler: Okay. You know, I don't think there's any dispute, and you can objectively say that contribution rates have risen fairly significantly over the last 10 to 15 years. I'm not comfortable saying that I would agree that at this particular level that's the time when you have to make changes. That really comes down to the stakeholders' tolerance for whether they want to pay more or not. I know that some of the plan boards in their submissions to the department had done surveys of their members on that, so there was some support for that assertion. Whether the surveys were statistically valid or not, that's another question, but, yeah, there was some support for that assertion.

Mrs. Sarich: Thank you very much.

The Chair: Thank you very much.
Any other questions? Oh, you're getting off easy, Mr. Saher.

Mr. Saher: Oh, well, thank you.
I'd just like to make the point that if any member of this committee felt that it would be useful to talk to us directly about this report outside of the committee, we'd be more than happy to make the time available to do that.

The Chair: Thank you very much.
On behalf of this committee I would like to thank you and your colleagues for being here and presenting and answering questions this morning. The *Hansard* transcript of the full day's proceedings will be available later this week, and the audio of the meeting is also available via the Legislative Assembly site. Thank you very much for being here.
We will be adjourning at this time to the committee room foyer for our break, and the meeting will go back on the record promptly at 12:45.

[The committee adjourned from 11:45 a.m. to 12:45 p.m.]

The Chair: Well, good afternoon, ladies and gentlemen. We are continuing our presentations relating to the committee's review of Bill 9, Public Sector Pension Plans Amendment Act, 2014, and Bill 10, Employment Pension (Private Sector) Plans Amendment Act, 2014. I am pleased to welcome our guests participating in this next panel, which is intended to provide comprehensive background information on pension plans and on Bill 9 to assist the committee as it commences its review.
We have two presenters joining us via video conference. Welcome, gentlemen. Can you hear me?

Mr. Leech: I can.

The Chair: Now we will go around the table and introduce ourselves for the record, and then I will have the members teleconferencing and the presenters participating via video conferencing introduce themselves for the record.
I am Moe Amery, MLA for Calgary-East and chair of this committee.

Mr. Fox: I'm Rod Fox, MLA for Lacombe-Ponoka and deputy chair of this committee.

Mr. Quadri: Sohail Quadri, MLA, Edmonton-Mill Woods.

Ms Kubinec: Maureen Kubinec, MLA, Barrhead-Morinville-Westlock.

Ms Kennedy-Glans: Donna Kennedy-Glans, MLA, Calgary-Varsity.

Mr. McDonald: Everett McDonald, MLA, Grande Prairie-Smoky.

Ms Pastoor: Bridget Pastoor, MLA, Lethbridge-East.

Mr. Rogers: George Rogers, MLA, Leduc-Beaumont.

Mr. Groch: Emilian Groch, CEO of Alberta teachers' retirement fund.

Mr. Gold: Murray Gold. I'm managing partner at Koskie Minsky LLP law firm.

Mr. George: Hi. I'm Brendan George, partner at George & Bell Consulting.

Mrs. Sarich: Good afternoon and welcome. Janice Sarich, MLA, Edmonton-Decore.

Mr. Luan: Good afternoon. Jason Luan, MLA, Calgary-Hawkwood.

Ms Sorensen: Rhonda Sorensen, manager of corporate communications and broadcast services.

Dr. Massolin: Good afternoon. Philip Massolin, manager of research services.

Mr. Tyrell: Good afternoon. Chris Tyrell, one of the committee clerks here at the Legislative Assembly.

Mrs. Sawchuk: Karen Sawchuk, committee clerk.

The Chair: Thank you.
Members on the phone? Who do we have on the phone? Nobody.
Okay. Guests joining us via video conferencing, would you please introduce yourselves?

Mr. Hamilton: I'm Malcolm Hamilton. I'm with the C.D. Howe Institute and for about 30 years was a consulting actuary with Mercer.

The Chair: Thank you, sir.

Mr. Leech: I'm Jim Leech, the retired president, chief executive officer of Ontario Teachers' Pension Plan.

The Chair: Thank you, Mr. Leech.

Gentlemen, you'll each have 20 minutes to make your presentations. We will go in the order listed on our agenda, starting with Mr. George. Welcome, sir. You may begin your presentation.

George & Bell Consulting, Koskie Minsky LLP, Ontario Teachers' Pension Plan, C.D. Howe Institute, Emilian Groch

Mr. George: Thank you for having me here today. I do intend to spend less than the 20 minutes. Happy to take questions at any time or after the presentation. Everyone in the room, I think, is just getting a copy of the presentation right now. We do have it up on the screen, so maybe what I'll do is just walk you through, starting with the first page.

I've tried to keep it simple. Really, what I'll try to address today are three key questions in my mind, the first one being: what is the current financial position or financial health of the Alberta public-sector pension plans? The second one: what are the long-term costs of the Alberta public-sector pension plans? Then the third one: what are the risks within the plans, and who bears those risks? I'll be happy to take questions on any other issues, but these are the three things I wanted to cover today.

Okay. The three questions I think we've answered in three reports that were provided to the committee ahead of time, and these reports were prepared by myself and my firm over the last six months at the request of the Alberta Federation of Labour. I guess the first obvious question that I would have reading that statement is: well, are these biased reports or written by the fed or, you know, how does this work? I was obviously paid by them, but in my mind these are not biased reports in any way. I have professional standards to live by, and these reports were peer reviewed by an independent actuary, so my view is that they're not the work of the Alberta Federation of Labour, but I thought they were useful for today's discussion.

The reports cover LAPP, local authorities pension plan, and the PSPP, public service pension plan. We didn't review the management employees pension plan or the special forces plan. A big part of the reason is that the two biggest plans were and are LAPP and PSPP. They have the biggest unfunded liabilities, the biggest impact in terms of contributions and members, so the focus of our reports was those two plans.

I'll talk about two key metrics. You would have heard some of this terminology used already, and you will hear a lot more of it, I'm sure, in the coming week. The unfortunate thing with pension plans is that they're technical, and people like myself make them worse and more technical. You know, I will try to make sure I explain myself. The funding ratio, which you will hear used a lot, really gives you a sense of how well funded all these plans are at any given point in time. You take the assets, and you divide by the liabilities. The liabilities are: what have we promised to members, both active and retired members, already? That really deals with the past. What have we promised, and do we have enough money today to cover those promises?

A funding ratio of 100 per cent basically says that you're in perfect balance. These plans are never at 100. You move past 100 on the way up or on the way down; you very seldom sit at 100. In an ideal world your assets at any point are equal to your liabilities for what you promised. We'll see some of the current funding ratios and what I think will be the future funding ratios of these plans.

The total contribution rate, which I think is the key number and the key metric for most people, is where a lot of attention has been placed. Really, this is what the employers and the members pay at the moment. In my presentation I've not split the total number between members and employers. To a large extent the split is even but is not the same for all plans. I focus on the total contribution rate. How much money needs to be put into these plans at any given point in time? That, really, is split into two pieces. One is the current cost of the benefit. Every year active members earn new pensions by working. You will hear people talk about normal costs or current service costs. Again, unfortunately, there's a lot of terminology that means the same thing. Really, it's the cost of the current benefit for the next year. That's normally expressed as a percentage of active members' salaries.

Then there's another piece which is often used called the unfunded liability, which is really: if our current assets don't cover our past liabilities, how do we get that funding ratio back to 100 per cent? Generally, how you get that funding ratio back to 100 per cent is that you put extra money in right now to get you there over, typically in these plans, a 15-year period. When I talk about the unfunded liability or the cost of the unfunded liability, it's that piece. That really is another piece of the contribution rate, the second piece of the contribution rate, that is needed to get you back to let's call it the balance, which is assets equal to liabilities.

The current financial position, which was my first question: for that you refer to the actuarial reports that are done by the public-sector board actuaries. The last official results that are available publicly were from December 31, 2012. Obviously, they're now almost 18 months out of date. There are two things, two big things, I think, that would have changed since then, and many small things. Obviously, membership data, et cetera, changes every day, but the two big things that were to change in the last 18 months would be that the Canadian Institute of Actuaries has released new mortality tables earlier this year. Really, the new mortality tables say that we're all living longer, which for everyone in the room is fantastic news. The actuaries are saying that we'll all live about three years longer, females obviously longer than males. Again, if you're female, that's great news, but if you're male, you will still live longer. Don't worry.

12:55

Really, what they've said is that the tables that actuaries have been using for probably the last 15, 20 years are out of date, so they've released new tables. It's great news for us as individuals, less great news for pension plans. If everyone lives longer, pension plans cost more money. What I've tried to do in the table below is reflect that new mortality table. Basically, people living longer means pensions will be more expensive.

The second thing that's happened, which is actually somewhat of an offset to the first, is that the investment returns have been good for the last two years and in particular for the last year, being the year 2013. For example, LAPP would have earned a return in 2013 of about 11 per cent, the public service plan about 14 per cent. The returns are generally pretty close. The target return in those plans is closer to 6 per cent, so any time you earn more than 6 per cent, you're going in the right direction. Any time you're earning less, you're going in the wrong direction in terms of that balance of assets versus liabilities. So what I've done in the table here is that I've reflected both the new mortality table and the stronger investment performance.

At this point I'd say for sure that they are estimates because I don't have the new data as of December 31, 2013. The official results will come out later this year, but we wanted to do an estimate for the moment. You'll see those two key metrics, being funding ratio and contribution rate. In December 31, 2012, LAPP was 81 per cent. I think that net-net it's gone up a little bit. Again, you want to move back to that 100 per cent level, so I think it's pretty close to where it was before but a little better at 82 per cent. The total contribution rate required 18 months ago was about 24.2 per cent. I think that it's probably gone up a little bit, which is really a net impact of these new mortality rates plus the slightly better investment performance. Net-net it's still a slight increase in contributions.

PSPP, similar picture: slightly improved funding ratio, about 2 per cent better, from 76 to 78 per cent. Total contribution rate also a little bit higher, from 26.4 to 27.2 per cent. The funded ratios look like they're getting a little better, not hugely different. The contributions look like they're getting a little higher, largely reflecting the fact that we're all expected to live longer.

The next question that I said I would address is: what is the longer term picture? I'll show you four charts here. We'll deal with LAPP first and then PSPP. I won't spend too much time on these charts, but I'm happy to take any questions.

What we did was run a 25-year projection. Twenty-five years seems like a long time, but in a pension plan's life it's, frankly, a drop in the bucket. These plans should be around forever, so 25 years is not a long time horizon. The idea behind this 25-year projection is to say: "Well, the contributions are around 25 per cent of payroll today, member plus employer. The funded ratios are let's call it around 80 per cent. What is likely to happen in the future?" Well, no one knows what's going to happen in the future, so this is obviously a bit of a forecast, a bit of a guessing game. But you have to do something on a best-efforts basis as to what these plans are likely to look like in future.

What I'd like you to focus on is maybe that middle grey line, which I have taken as the base-case projection that we did. The base-case projection is, in my mind, not rosy, not conservative; it's somewhere middle of the road. Basically, what I've said is that the LAPP and PSPP actuaries make assumptions to fund these plans, and what I've assumed is that for the next 25 years their assumptions really work out. People die when they're supposed to die, they live when they're supposed to live, and the investment returns are around 5.75 per cent per year. What you see there is a steady climb in that funded ratio. You start in the low 80s, and in about 10 years' time you get pretty close to 100 per cent, and then it's fairly level from then on.

In my mind, that's quite a likely picture, in some ways quite an obvious picture, the reason being that the members and employers today are putting in extra money to make sure you get back to the 100 per cent. But that extra money doesn't carry on forever. You're putting in an extra contribution over a 15-year period to get you back. It's self-designed to get you back to this 100 per cent funding ratio. But when you get there, that extra money you're putting in drops off. So, really, the idea is that if things work out the way the actuary is expecting them to work out, you will get back to 100 per cent at some point, I'm projecting in about 10 years' time.

The next chart basically says: well, what contributions would be needed to get you there? Again, I'd say: forget about the blue line, which is the optimistic scenario. You can look at either the red or the grey, the grey being the base case and the red being a more pessimistic scenario. The focus here was that we chose a 25 per cent contribution rate. There's no magic in that. This was really a discussion between the Alberta Federation of Labour and myself as to: "Well, at what point do these plans cost you more than 25 per cent of salary in total? At what point do they cost you less?"

Really, what you see, the next view, you know, about the next six or seven years, is that contribution rates go up above the 25 but then eventually do come down. The long-term trend is somewhere around 20. So even though the current contribution rate is 25, what I'm saying is that in most scenarios that's likely to continue for the next, you know, even 10 years. It's likely to be around that level. But at some point this extra money that's being put in will stop, and you'll see those charts come down, and you'll settle out around 20 per cent. In that case, it'll be about 10 per cent for members, 10 per cent for employers.

The charts for the public service plan are similar, so I won't belabour those. Again, you see in the middle a grey line, the base case, and you slowly move up. In about 10 years' time you get to about that 100 per cent level. Obviously, if things work out better, being the blue line, you'll get above a hundred per cent, and if things work out worse, the red line, you won't get to a hundred. The main difference in the red and the blue lines would be the future rates of return. The key risk, I would say, the key metric in these plans is: what return can you earn on the funds? If you can earn between a 5 and a half and 6 per cent return, you follow the grey line. If you earn better than that, you follow the blue. If you earn less, something like a 5 per cent return, you follow the red.

Contribution rates on PSPP: again, we've drawn that solid line at 25 per cent. In the near term they look like they remain above 25, but in about 10 years' time I would think they'd settle out, again just below 20 per cent of payroll. The reason for that is that once you've paid off the current unfunded liabilities and if you get back to that 100 per cent level, you can bring the contribution rate down to what I'd say is the true cost of the benefit, which is somewhere between 17 and 20 per cent of salary in total; again, 10 per cent member, 10 per cent employer.

Just a couple of slides. Of the main risks in the plans – and I've mentioned this already – the key risk, to me, is investment return on the funds. These are big funds. There's a lot of leverage on the investment return, meaning that a good year or a bad year has a big impact. I wouldn't be worried too much about one good year or one bad year. Everyone focuses on 2008 and how horrible it was. We've now recovered from 2008. It took six years to recover, but the stock markets recovered, and the plans' investment returns have been strong. The thing that I'd say would worry me more is: over the long term can these plans earn a reasonable rate of return?

Reasonable in the context of these plans would be something between 5 and a half and 6 per cent. AIMCo themselves have done some projections. Again, projections you can, you know, take with a grain of salt. But for AIMCo, who manages the money, their own projection for the next 10 years is a 5.7 per cent rate of return on their balance fund. I'd say that that's in the ballpark in terms of what you need to keep these plans healthy and get them back to that 100 per cent funded position.

1:05

The current risk sharing, though, is equal or symmetric. This is the way the plans are designed. If things go well, then everyone benefits, everyone being the employers and the employees. Your contribution rates can go down on both sides. If things go badly, like they have, you could say, in the last 10 years, all the contribution rates go up, on both sides, the members and the employers. You could say that there is an equal or fair sharing of risk. The one thing with Bill 9 that stuck out in my head is that if Bill 9 goes ahead, you are changing that equal or symmetric risk sharing, the reason being that there's a contribution rate cap proposed, and the benefits will no longer be guaranteed, so there will be conditional or targeted indexing, based on whether the plan is well funded or not.

What happens is that in the good times the rewards are shared equally. In the good times everyone does well, and contribution rates go down for members and employers. In the bad times, though, the members bear the risk or the brunt of bad things happening, the reason being that with a contribution cap you won't increase contributions. Instead, you'll decrease benefits. There is that, I'd say, unequal sharing of risk in Bill 9, which to me is a key factor and a key change from the current way the plans work, where there's an equal sharing of risk between employers and members.

My conclusions on the three questions that I started with are that the public-sector plans are in better shape and healthier now than they were a year ago and two years ago. They're by no means fully funded, but they're going in the right direction. The future health of the plans no one knows. You can ask anyone you like to predict that, and no one actually knows, and no one should admit to knowing that. But it is heavily dependent on future investment returns, in my mind. That's the key metric or key factor, that you need a good long-term investment return on these funds.

The future contribution rates, though: they're currently around 25 per cent of salary. They can go in both directions. There's no guarantee that they will increase; there's no guarantee they'll decrease. If anything, I think the trend should be down because, as I said earlier, a big part of the current contribution rate, about one-third of it, is to pay for a historic unfunded liability, which eventually will be gone. By definition it has to be gone because you're paying it off by putting in extra money now. The long-term costs of both the LAPP and PSPP, which we worked on, are around 20 per cent of salary.

The last couple of points I wanted to make: what is a fair contribution, or what is a sustainable level of contribution? I don't think anyone can answer that except the plan stakeholders, being the plan members and the employers. They may have different opinions on what's fair or what's sustainable, but I think that in the end, if you want a higher benefit, you've got to accept a higher contribution rate. If you want a lower contribution rate, you've got to cut the benefit. It's as simple as that. But if you want higher benefits and you're prepared to pay for it, then you just pay higher contributions.

The last point. As I said, with Bill 9, one of the key concerns for me is that it does transfer risk from employers to employees. Maybe that is conscious, but it is a key change from what happens now, where employees and employers really move up and down together.

Thank you for your time. I would be happy to take questions either now or at any point.

The Chair: Well, thank you very much, Mr. George. We will wait until we hear from the other panelists, and then we'll open the floor for questions.

Mr. Gold, please.

Mr. Gold: Thank you, Mr. Chair. Thank you, committee members. It's a great pleasure and honour to be here. I know that pensions aren't everybody's first passion. They happen to be mine. I'm slowly converting my 16-year-old daughter, but it's a struggle, I can tell you. Let me try some of the tricks that I've developed with my adolescent daughter to see if I can engage people.

Really, the issue in Bill 9 today is the level of government intervention, interference in pension plan governance. That's really what distinguishes Bill 9 as a piece of legislation from other pension legislation in other jurisdictions concerning public plans. It's highly interventionist, and we'll go through some of the ways in which it really does interfere with the normal course of relations between the parties to those plans. Then I'll turn briefly to Bill 10, which I think is also part of your mandate, because Bill 10 does something that we've not seen done elsewhere save and except in New Brunswick, which, you can appreciate, is a very different case.

What Bill 10 does is that it says to people who have worked for 10 or 20 or 30 or 40 years for an employer, made contributions to a pension plan, built up a pension entitlement, relied on that pension entitlement, maybe even retired under that pension entitlement, that those pensions can be amended so that they are no longer defined benefit commitments, that they are target commitments, which means that they can be reduced.

So you have people who are working for five and 10 and 15 years with a promise that they will get a pension, that if there's a funding shortfall, the employer will pay up – and the employer knows that; that's an eyes-open deal – and then after the passage of 15 or 20 or 25 years, maybe even after the person has retired, Bill 10 would allow that employer to rip up that promise and say: "You know what? Sorry. We're not going to keep it. Your pensions may be reduced." For many of us in the industry it's a morally appalling proposition. Let me just put that as plainly as I can. I'll come back to it towards the end.

The place to start, of course, is: what's the purpose of the pension plan? Why are we even here? Why do we have these things? We have these things because at some point people stop working. They can't work anymore. It's time for them to retire, to make room for younger workers. And what do they look forward to? They look forward to something simple, something that is a decent income, something that's predictable, something that's secure. Not so controversial? That's what we want, and that's what these plans have done.

It's important to those people. It's important to those people while they work, it's important to those people once they retire, and it's important to their communities because when they have those pensions, they spend their money. They go out to small business. They go out to big business. They go out to the farm. They spend their money because they know where the next pension cheque is coming from. They have pension confidence. It's a great thing for them. It's a great thing for their families. It's a great thing for their communities.

When Paul Martin was speaking the other day about why they reformed CPP in the 1990s, not so many years ago, the one thing that he kept coming back to was pension confidence. The government was concerned that pension confidence was being undermined and that that was having a detrimental effect on the economy. Well, these plans are bulwarks in the world of pension confidence. They are important, broadly speaking, to the economy of this province and the country.

The real problem we have in pensions is that we don't have enough pension coverage. Pension coverage is going down, and good pension coverage is going down quickly. This is the real problem, and this problem is not being addressed in either Bill 9 or Bill 10. Maybe it'll be addressed through an expanded CPP, maybe not – we'll see how all that unfolds – but it's not being addressed here. This is the wrong problem. It's the not the problem that we need to face. I will try to persuade you that it's the wrong solution to the wrong problem.

Now, we have evolved in Canada a world leadership in pension governance and pension reform. We have pension plans like the Canada Pension Plan Investment Board. We have in neighbouring British Columbia the British Columbia Investment Management Corporation, the British Columbia municipal employees pension plan, teachers' plans and so on and so forth, and the Ontario Teachers' Pension Plan. These are all examples of one plan type. It's called the jointly sponsored plan, and it is what this legislation generally aspires to reach to. The problem with this legislation is that it's not taking us in the same direction as legislation in these other jurisdictions.

A jointly sponsored plan works this way. It's straightforward. Before we had jointly sponsored plans, we had employer-sponsored plans, which meant that the employer was responsible for the full cost. If there was a deficiency, the employer paid more, and if there was a surplus, generally the employer took it, all on the employer side of the balance sheet. Jointly sponsored plans through that proposition said: "Everything is shared. We're going to share the cost from year to year. We're going to share a deficiency if it arises. We're going to share a surplus if it comes up."

All of a sudden government's risk, government's costs fell by half. That was a great thing for government. It was also a great thing for employees and for members because they stepped up and took responsibility. They took funding responsibility, and they took governance responsibility. They've become invested in their plans. They respect their plans, and they respect them when they give them bad news. These plans have been amongst the most successful plans in the country and indeed the world. They are leaders, and they are all jointly sponsored plans.

Now, when we introduced jointly sponsored plans, starting in the '90s, we didn't change the underlying benefit. The underlying benefit promise remained the same, a defined benefit promise of decent, secure, and predictable incomes. No one ripped up the promise. No one said: going forward, it's going to be a different type of benefit. All they said was that we're going to share the cost and the risk of this benefit differently. That's the model that we have today, a defined benefit with shared costs. Recently we've taken some of those benefits, some of them, like indexation – Ontario Teachers' did this – and made it a target benefit, but the core benefit is still a defined benefit, fully funded. Okay?

1:15

There are a number of success factors that I would argue underlie the jointly sponsored model in this country – and I've listed them on page 4 of this presentation – but there are two that I'd like to spend a little bit of time on. The first one, at the top of page 5, is that the stakeholders are free to make their deals. They're free to govern this plan themselves, right? This isn't easy, and it often involves difficult choices. It involves the assumption of responsibility and taking consequences for your decisions, but this has worked. This is key to the model.

Generally, what happens is that there is a bargain, right? Employees and employers sit down, and they bargain. They bargain about the overall wage, the overall wage package, and then they bargain about how to split it up, how much they're going to take today and how much they're going to defer till tomorrow. The wage that they take today, they go out and they spend. The wage that they take tomorrow, well, is a contribution to a pension plan. That split can vary. It can change. It can evolve. Sometimes you'll pay less to the pension, sometimes more. Everybody would love to pay less. If you ask people in a survey, "Would you like to pay less?" the answer is yes. Of course, they would. But if you ask them, "Would you be prepared to pay less and get less?" the answer is generally no. It's very important what you ask.

We have a wage package that the parties bargain, stakeholders bargain. In this case trade unions and employers bargain. They bargain hard about the package. They bargain about how to divide it up between current and future income. This is crucial to the deal because we know that if there is a deficiency, as there has been in these plans for some time, more of the package is going to go into the pension; less of it is going to go into wages. The economists will tell us that the package is the package. You know, the package isn't going to change because pension costs go up. All that's going to happen is that a bigger chunk of the package is going to go into the pension fund, right? The package is determined by labour market conditions. The division of the package is determined by bargaining.

This is where Bill 9 intervenes in the bargaining process, and Bill 9 says: "Actually, we're not going to let you divide the package the way you think is best for your members and your employees. We're going to tell you that there's a cap. We are going to tell you that under no circumstances can you pay more than X into the pension fund. Not only are we going to tell you that, but we're going to reserve the right to change this cap any time we want and for any reason that we want." That's how the cap under Bill 9 would work. It would be a regulatory thing. The government, without returning to the Legislature, could say that the cap is this. The next week they could say that it's that. They could raise it. They could lower it. Here we have a long-term pension promise that requires steady-state funding or steady funding, reliable funding, and we have legislation that allows the government to change that contribution rate at any time without coming back to the Legislature for any reason.

Of course, this is and will be seen as political. It will be seen as political meddling in a pension arrangement, and it will destabilize it because people will look at it and say: "Well, I don't know if we can make this promise to you. I don't know if we can keep this pension promise. I don't know what it's going to be tomorrow. Who knows?" We could have a contribution cap that is radically different than it is now. It introduces a huge level of uncertainty, and it's not necessary, right? The basic premise of the model is that the parties who are responsible for this plan, who will take responsibility for it, who will live with its consequences will make this decision about what part of the wage package goes to the pension and what part goes to current income. There is no need for government to intervene via a contribution cap. We do not see this.

Plans have survived for a long time without legislated contribution caps, which is not to say that people will contribute an infinite amount or an unlimited amount to their pension plans. Stakeholders, left to themselves, will reach a conclusion at some point that that's it; they don't want to pay anymore. That's happened in plans, and they're able to do that. When they do that, they sit down, and they write into their deal: we don't want to pay more than this. If contributions go up beyond that point, they make adjustments. But that's something stakeholders do. They do it because they're responsible, and their members know they're responsible, and their members accept that responsibility. They don't do it willy-nilly. It's not political. It's driven by their interests, and that, too, can work. But this form of cap is a very dangerous, in my view, and destabilizing element of the pension proposals in Bill 9.

Now, the other key success factor that I think underlies the jointly sponsored model in Canada, that's spoken to a bit on page 6, is that stakeholders make their governance arrangements. They sort out who's going to do what in terms of governance – who's going to make what decisions, what the processes are going to be, what the voting rules are going to be, what the notification requirements are going to be – and they live within those rules. If those rules aren't working for them, they sit down, and they change them. It's their deal. They're responsible for it. They bear the consequences of it. They change it if necessary. That means autonomy. That means respect for the parties.

I'll come in a minute to Bill 10.

What Bill 9 does is that it inserts government constantly through the process. The government is there as regulator when the potential transition from the current plans to jointly sponsored plans take place – I'll take you through the provisions in a moment – and it's there again after the jointly sponsored plan has been established, with a constant, hovering, kind of nanny-state presence that constantly overbears the plan. This kind of legislation we do not see in the jointly sponsored space, and it is not needed because the jointly sponsored plans work well without it. It's profoundly disrespectful of the parties. It's essentially saying: we don't trust you. It's essentially saying: "We can do it; we know it better than you do. Even though it's your business and your plan and your members and your employees, we know better than you what to do." Faced with that, people don't like to be told what to do. Those kinds of structures don't work very well. People don't enjoy working under those structures, and they won't choose to work under those structures.

Now, this is what Bill 9 does in highlight, so from page 6 forward. The first thing I've noted is contribution caps. This is a government-imposed cap. This is a cap that can vary up, or it can vary down. It's a political cap. This is not the kind of thing that we need to see. We need to see stakeholders sitting down, bargaining out a wage package, bargaining out its division. If they feel that their contribution rates are too high and that they need more for current consumption as opposed to future consumption, that's their business. They'll do that, and they have done that.

We know from experience that when governments intervene in one piece of a wage package, there will be consequences somewhere else, right? We know from wage and price control days that if you say that, you know, wages can't go up, what people will do is that they'll just create new titles. It's not the same wage for the same job. All of a sudden it's a new job with a new title and a new salary. There are always ways to get around things, and if we have such a crude thing as a contribution cap imposed by government, that people won't respect and don't respect, they'll find ways to get around it, and probably those ways won't be very productive for anybody. They probably won't be very tax effective. They probably won't be very accountable. They probably will not be very desirable, but people will feel that they're necessary, and they'll do them. Contribution caps aren't necessary. They are, I think, profoundly disrespectful of the parties. They interfere in a way that's not necessary, and they're going to have adverse consequences.

But Bill 9 goes further than that. Section 13(1) is the contribution rate cap section, but section 13(2) permits the government to prescribe any other constraints or conditions in relation to any plan. Any other constraints or any other conditions. I mean, I don't know what's not included in that phrase, but what it tells you, what it tells the reader, what it tells these plans and their stakeholders is that government is always there. Always there. This is not just their deal. They're not adults. They're not capable of looking after their own affairs. Government is always there, always prepared to intervene. It's quite unprecedented. It's a huge, broad, and deep regulation-making power that we just don't see and don't need in the pension context.

1:25

Another unique feature of Bill 9 is in regard to validations. Validations, which are dealt with in section 15 of Bill 9, say this: "Listen, we may have misapplied the law. We may have deprived you of rights under the laws that we passed. We may have denied you a pension entitlement to which you were entitled under our legislation, but – you know what? – you have no remedy because we're above the law, and we're just going to change it. So sorry."

This, too, is a little bit unprecedented, you know. Generally speaking, if pension plans are not administered in accordance with their terms, if people's rights are violated, they have remedies, and they go to court, or they go to a tribunal, and they get those fixed, and governments say: "We are subject to the law, and if we didn't comply with the law, we are accountable. We are just like everybody else." But the validation section doesn't do that. It goes back in time, and it retroactively changes the rules so that what was done is by definition right, and that's troubling but in some ways of a piece with Bill 9.

The third thing that Bill 9 does that is problematic to many is in respect of how it governs a potential transition from the existing plan to a jointly sponsored plan. This is ultimately the objective, yet it's not really encouraged under this legislation because the government continues to be able to regulate the transition process. It tells you who the parties will be at the table. It tells you what those parties have to do in order to reach a joint sponsorship agreement. It allows government to continue to prescribe conditions and constraints throughout the transition process

Then, on page 9, even after the transition process, even after you have a jointly sponsored plan, section 19(9) of Bill 9 still allows the Lieutenant Governor in Council, the cabinet again, without returning to the Legislature, to make regulations with what it calls "enduring effect" . . .

The Chair: Mr. Gold, you have three minutes left.

Mr. Gold: Yeah. Okay.

. . . meaning regulations that go on forever respecting virtually every element of the joint sponsorship deal that these parties may enter into. Virtually every element. So the government never leaves. It's always there. It's always hovering. It's very much a nanny state kind of approach to this problem.

Finally, a minute on Bill 10. I've already suggested the main defect. It is really destabilizing to a pension system to see legislation that says that rights that have accrued under government legislation, under the terms of contracts between employees and employers, that have accrued over many, many years can simply be taken away and that the government would authorize that to happen. It's truly destabilizing when one thinks that we live in a system where laws are relied upon and governments are relied upon and promises are kept.

Let me stop there. Thank you so much for your attention.

The Chair: Thank you very much, Mr. Gold.

We'll turn it over to Mr. Leech, who is joining us via video conference. Mr. Leech, please.

Mr. Leech: Well, thank you, and good afternoon. I'm sorry I couldn't be in Edmonton, but I'm in rainy downtown Kingston.

The Chair: You're missing the good weather here.

Mr. Leech: I thought what I'd do is to give you my perspective – and really that's a perspective of somebody who has been operating one of the largest pension plans in Canada and the world, for that matter – and talk in generalities and try to deal with the principles that I see in this bill.

First of all, I think I start from a position that says that the most important thing for employees and employers is that any plan must be sustainable, and that really means predictable. People have to have confidence that there's a level of income that they're going to get in the future. It means it has to be secure, and it also means that it has to be affordable, and you kind of need all of those characteristics. It's very important for members as they need to know what level of lifestyle they can count on, plus or minus some small deviation.

The plan really must be able to absorb variances, not large swings but variances. You also need the flexibility to absorb changes in future environments, things such as financial market ups and downs, demographics, et cetera. You don't want a plan that is overly reliant on unsecured promises. I don't care who they're from. Rather, the employees know that they have the funds set aside and appropriately invested to secure their future. You don't want a plan where people are taking too much risk, so for the sake of: "Gee, I'm going to get that extra return so that we can keep the plan whole. We're just going to take on more risk." Finally, we need contribution rates that are affordable for both the sponsor and the member and young employees as well as old employees.

When many of the plans, the general, stereotypical defined benefit plans, were set up in the '50, '60s, '70s, I asked myself the question: were they sustainable then? Did people think they were sustainable? Well, yes, they did. The designers certainly thought so given the assumptions. They were, you know, appropriate assumptions based on what they knew at the time. However, as the environment changed, largely through longevity – people stopped smoking, people started to exercise, people started to eat better and therefore live longer, and medical science has come to the aid of many diseases, et cetera – and rates of return in marketplaces changed, many of these plans responded to these changes by basically taking on more risk, moving out of government bonds into corporate bonds and moving into equities and more recently into private equity, infrastructure, et cetera, and by taking on more leverage, so adding risk into the plan. But there must be and should be a prudent limit to the amount of risk that one would have in a pension plan.

Let me now talk about some of the characteristics that I see in this legislation. I'm going to talk about joint sponsorship, I'll talk about risk management, and then I'll give you my basic views on the reform package as I see it.

Joint sponsorship is the construct that the Ontario Teachers' Pension Plan has worked on since the very early 1990s. It's not a panacea. It doesn't solve all problems, but it goes a long way to ensuring responsible management and sustainability as I had defined it before. There are different ways that it can be effected, and what I thought I'd do is tell you how it was effected and how it's governed at the Ontario Teachers' Pension Plan.

How Teachers' is set up is that they very clearly from the outset said and set out: what are the responsibilities of the plan, and what are the responsibilities of the sponsors? Again, they're joint sponsors, the members and the employer. What they said is that the plan would be responsible for the administration of the pensions. That's dealing with members on a day-to-day basis, paying pension amounts, collecting contributions, et cetera. That was their first job. Their second job was to invest the funds of the plan in an appropriate manner, and the third is to report on the funded status, including making recommendations to the sponsors if there's a deficit or a surplus. That's very key. They tasked the plan with reporting on the funded status.

On the other hand, the sponsors also had three responsibilities. The first was to set contribution rates, the second was to set benefit levels, and the third was to take action necessary to deal with either a deficit or a surplus. So you basically had this dynamic tension set up between the two groups, and it's a very constructive tension. The plan, with regard to its funded status, is the one which says, "This is what the funded status is," and the sponsors then have to respond to it. By the same token, the sponsors set contributions and benefits, which actually drive what the plan can do and not do with regard to its investments. So, again, a dynamic tension, in my view, is very healthy.

1:35

The next thing we did: in looking at how the plan itself would be governed, the constructors of the Ontario Teachers' Pension Plan opted for a professional board. On the other hand, you could have a representative board, or it's often referred to as a lay board, so the board is made up of, you know, people who are representing the employer and people who are the members themselves. The teachers' plan was set up with a professional board, and it's set up with four members who are chosen by the employer, four members who are chosen by the teachers' unions, and then the ninth was jointly chosen by those two sponsors to be the chair.

When they originally sat down to work this out, as I said, they said that it would be a professional board. What the government had said was: okay; you cannot have any elected officials, you cannot have any bureaucrats, and you can't have any – pardon the expression – bagmen. I'm not sure they exactly wrote it that way, but that's what they meant. On the teachers' side they said that it's very important that you have one – but only one – person who is a member of the union, who is a teacher or was a teacher, and the balance has to be people who come from the financial community, the accounting community, actuarial, HR, economics, et cetera.

As I said, some other jointly sponsored plans have gone another route, and they would have a lay board, which would have people who are actually union members and people who are members of management of the employer. I don't believe that works as well because I believe that lines get very fuzzy at that point, and the temptation to fudge the governance is quite high.

The key elements, though, of that plan, then, are that you have a professional board – it is highly professional, you know, a high level of talent – to deal with the issues of administering the plan and investing the money. You have a separation of responsibility, so you don't have the person who's trying to balance the books of the province also determining what the discount rate will be and therefore fudging. That's how most of the U.S. states have gotten themselves into great difficulty. The state treasurer would say, when faced with a deficit in his pension plan: oh, well, let's just simply raise the discount rate by 25 basis points, and we do away with the $10 billion deficit. Hence, you've got these unrealistic valuations going on in the United States at the present time.

Then, I think the final part that's really key in the model is that everything to do with pensions is totally, one hundred per cent removed from the collective bargaining process, and that is key. In my view, pensions do not belong in the collective bargaining process, which usually has a short-term time horizon about it. You know, the clock is striking down. It's three minutes to midnight. You're trying to get a deal. Somebody comes up with some hare-brained idea about changing the pension plan. Nobody gets the opportunity to test it and see what that means as it plays out over 40, 50, 60, 70 years. That's where so many corporations and so many of these plans have gotten themselves into trouble, because the parties agreed to something, and they had no idea what they were agreeing to or the impact it would have.

Things in your case that I think you have to take into consideration: what's the interface with AIMCo? In the model for Ontario Teachers' the investing is being done by the plan itself. In this case, as I understand it, it still looks to be outsourcing the investments to AIMCo. I think that that's something you have to bring into the equation because it really means that, potentially, the assets are being managed by one group and the liabilities managed by another. I can tell you from my experience at Teachers' that it's much more effective if the same organization is managing both the liabilities and the assets because you can design investment programs for your specific liability mix which may be more doable.

Let me talk about risk management. I'm a big proponent of these plans having a very strong funding management policy. That's a policy that, in effect, puts these plans on autopilot. It sets out: what happens if? If we have bad markets and we start to get into a deficit, what exactly is going to happen? The parties agree to it well in advance. This is probably, in my view, the most important part in the New Brunswick restructuring, where they have put such firm funding policies around it that the employees have a high level of confidence that what they are expecting, they will be getting.

Now, a guarantee is only as good as the guarantor, and employees really deserve to know that the money is there versus an unsecured promise by anybody, including the government. It's key that the fund be sufficient and that the risk management around that fund be sufficient so employees know that they can count on it. Those risk management tools need to be rigorous. They can't be played with. I like the stochastic modelling that New Brunswick does, where it runs out a gazillion scenarios, and it works out what the probability is that benefits will be assured. That's better than just picking an assumption that says: "Okay. We're going to earn 4 per cent forever and ever. Amen." These things are so path dependent. If you've used an assumption of 4 per cent going forward and in the first year you only got 2 per cent, then you have to earn more than 4 per cent for the balance. That's why I believe in the stochastic modelling. As I said, it puts these plans on autopilot.

I think that the funding management policy should also set out how the discount rate is established. I strongly believe in the market model, which says that you tie it to long-term government bonds because that's the risk-free rate. Then the funding management policy would also have bands in it. So you say: okay; if we are 97 per cent funded under this assumption, maybe we don't have to take action. But perhaps at a lower discount rate you will have to start taking action. There are many such funding management policies out there. I suggest that you look at it – and look very hard at the one in New Brunswick and those that are used in the Netherlands – so that all parties understand where this thing goes.

Finally, let me talk about the reform package generally as I see it. I would put this on a scale of a light-to-medium reform package. It is far from heavy, but it's not ultra light. It's a light to medium. If I use the spectrum of light, being only dealing with making the cost-of-living contingent going forward, heavy is where you start redefining the core benefit. They did that in New Brunswick. They changed it from your best five to the career average, et cetera. Also, in New Brunswick they introduced some retroactivity with regard in particular to COLA benefits, where it impacts retirees also. That I put at the heavy end. You're light to medium. It's not overly intrusive, in my view. Personally, I believe that there are three parties to the contract. There are the employers, obviously, and the members. I also think that the retirees, who are an increasingly larger group, are also party to the contract, and there should be some appropriate level of risk sharing amongst all three parties, in my view. You've chosen, in effect, to exclude retirees, as I read it. That gives you less flexibility. However, as time goes by and the changes kind of grow in, they will start to affect an increasingly larger proportion of the retirees going forward.

1:45

COLA is the most obvious benefit to make contingent. Caps are kind of, in my view, a fail safe to protect everyone, to protect the employee and the employer. Early retirement subsidy: I mean, this is an area that I think will come under increasing scrutiny. It no longer really makes sense as people don't retire. I mean, what I see happening is that people take advantage of being subsidized to take an early retirement, and they just go get another job and keep working. In effect, you've got the longer term employees, who stay there and work till they're 64, 65, 66, indeed subsidizing their colleagues, their younger colleagues, to leave at age 55 to go out and get another job. To me, it just doesn't make sense.

I think one analysis that you kind of really need to do is to take a look at what is the cost of the core benefit versus the cost of the add-ons: COLA, early retirement subsidies, et cetera. With some of the plans that I studied in this past year, if I recall the numbers correctly, 53 per cent of the entire liability of the pension plan was the core benefit – you know, 2 per cent times your best salary times the number of years worked – and 47 per cent of the entire liability was made up of what I call the add-ons, or the fringes, things like early retirement subsidies and cost-of-living increases. In some they were in spousal benefits as well. I think that's something that people need to keep their eyes on.

With that, I'll conclude. Thank you.

The Chair: Well, thank you very much, Mr. Leech.

Our next presenter is also participating via video conference. Mr. Hamilton, please go ahead.

Mr. Hamilton: Good afternoon, everyone. During the 1990s I was the actuary for a number of Ontario public-sector plans, including the teachers' plan and also the colleges of applied arts and technologies and the electricity, Ontario Hydro and Ontario Power Generation, plans. This was a very pleasant time to be an actuary. You would, particularly, every year turn up at the annual presentation of the valuation results, and you always had the same story. The pension fund did brilliantly again, far exceeded everybody's expectations. Yes, there were some annoying things with salaries and longevity, but all of it was overwhelmed by a 20-year bull market. The surplus was even bigger than the last time you turned up, and everyone could either cut back on contributions or improve benefits or both. As you would leave the room, you could hear the cheers resounding down the corridor as organizations prepared for yet another round of pension plan improvements and contribution holidays.

In the late '90s that was the norm for pension plans. They were well funded. They typically had surpluses. Everyone fought about the surpluses. Nobody knew what to do about them. Even DC plans: employees by and large wanted DC plans so they, too, could benefit from the excellent performance available in the stock market. We all looked like heroes. We all thought we were smart.

Then we hit the 2000s, and it was basically as if the retirement system stepped on a banana peel. In essence, what we saw in the 2000s was something we had never seen before, and that is: what happens when a mature retirement system, a well-funded, mature retirement system, collides with a very difficult economic environment? Now, I don't know whether the people in the room are sort of familiar with the concept of plans maturing. Pension plans, notwithstanding the fact that they may go on forever, age in some very obvious ways. If I use the Ontario teachers' plan as my example, in 1990 you had a pension fund with $20 billion. Jim can jump in and correct me, but I think now it's like $140 billion, $150 billion. In 1990 the contribution rate was 16 per cent, and contributions were well in excess of pension payments. Today the contribution rate is up to about 24 per cent, so that's about 50 per cent higher than it used to be, and the benefits are now much bigger than the contributions notwithstanding the significant increase in contributions. The percentage of the pension fund that's held for members who are retired or nearing retirement is, maybe, 60 per cent today. It was quite a bit smaller then.

The pension fund back then was about 3 times the annual payroll of the teaching profession. I think that now it's probably 10 to 12 times the annual payroll of the teaching profession. This isn't anything going wrong. This isn't huge changes in benefits. This is the gradual maturation over 25 years of the Ontario Teachers' Pension Plan, and it has happened to our entire retirement system.

If I look at Canada's retirement system – DB plans, DC plans, Canada pension plan all rolled into one – we had about $500 billion in 1990, and at the end of 2012, so 22 years later, that $500 billion was up to about $2.5 trillion, and I suspect it's getting close to $3 trillion today. So the good news is that these mature pension plans are well funded; they have lots of money. The bad news is that they need to earn some kind of decent return on all of this money. They can no longer do it with safe investments.

If I go back to 1990, we didn't have much money, but we were guaranteed 4 or 5 per cent real returns on government bonds. Today we've got all sorts of money, and we are guaranteed 1 per cent real returns on government bonds. We've got this big pile of money, but we can't get any kind of safe returns. So now you have to start taking fairly significant investment risks to get the returns you need on the money you've accumulated, yet you've got so much money that it becomes difficult with an aging population with mature pension plans to take all of this risk. That is the problem that we have today.

The last 10 to 15 years is about seeing for the first time what happens when a retirement system that is really a pretty good retirement system has to deal with that kind of adversity. The bottom line is that it didn't cope as well as everyone was hoping it would. What we found was that in the case of DB plans, the benefit became unsustainably, unaffordably expensive. What we found with DC plans was that the benefit became disappointingly inadequate. You can't design around both of those problems, you know. Your DB plan is very good at delivering adequate benefits that are sometimes unaffordable, and your DC plan is very good at delivering affordable benefits that are sometimes inadequate. I don't think there's a design out there that is always going to deliver adequate benefits at an affordable price. If that design is out there, I haven't seen it anywhere. If we did know how to do that, you wouldn't see these pension problems, not just in Alberta, not just in Canada, not just in North America but pretty much right around the developed world.

To some extent what we're going through now is a process of adjusting our expectations from the unrealistic expectations fed by a 20-year bull market in the '80s and '90s to the more tempered, more realistic, less pleasant expectations about what we can achieve in a world where interest rates are low, populations are aging, and plans are mature and have to take a fair bit of risk.

1:55

If you look at how that's being dealt with in the private sector and the public sector, you see two solitudes. The private sector has basically decided that the defined benefit plan, the traditional, fully guaranteed, as distinct from the jointly sponsored or target benefit plans – the traditional defined benefit plan, the private sector has more or less concluded, is not viable. When the plans get mature, when we hit bumps in the road economically, the plan costs cannot be sustained. The private sector is continuing to move away from defined benefit, but it's got a formidable challenge ahead of it because it hasn't yet been able to find a defined contribution plan that is going to deliver in difficult times the kinds of benefits that members would like to receive. So the private sector, I think, will probably spend the next 10 to 20 years trying to make defined contribution plan designs work better.

When we get to the public sector, we see something very different. The difference I attribute to a serious flaw in public-sector accounting for the costs of pensions. I know that that's not the subject that you're all here today to listen to, so I considerately sent along two commentaries I've recently written for the C.D. Howe Institute, and I'll invite you to look at those if you want to see what the issue is.

In essence, the issue is that private-sector accounting standards in Canada and pretty much right around the developed world say that if you're a plan sponsor and you guarantee benefits to employees, you're effectively guaranteeing them a return on their retirement savings, and you will account for that by recognizing that today, with interest rates very low, to guarantee high returns on people's retirement savings, to guarantee good pensions is basically to provide a very expensive guarantee.

The public-sector accounting standards have gone down a very different road. Not just in Canada but pretty much, again, right around the developed world the public-sector accounting standards say that guarantees are free, that if someone guarantees you a 4 per cent real return on your retirement savings for the remainder of your life, that has no cost to taxpayers whatsoever notwithstanding the fact that the market rate of return for guaranteed investments isn't CPI plus 4 but CPI plus 1.

Basically, public-sector accounting standards look at a guarantee that a public-sector plan like the federal government's plan, that's fully guaranteed, is worth about 20 per cent of pay, and the public-sector accounting standards say that that doesn't cost anything. That creates at the federal level a complete misunderstanding about what the cost of their pension plan is. Now, in the provinces where we typically see the jointly sponsored model, the problem is half the federal problem. So the problem isn't a 20 per cent of pay problem; it's a 10 per cent of pay problem. But it's still a big problem.

Here's what I think happens as we go forward. I'm not going to make any predictions about the timing of this. I'm just going to speak about the direction in which I think public-sector and private-sector plans are going to be moving. In the public sector I think ultimately we will get a proper accounting for pension costs, and when we do, it will become clear that if you want somebody to guarantee you pensions or to guarantee you returns on your retirement savings in a low-interest environment, that is prohibitively expensive to the point of being unattractive.

When that happens, we will see the very natural change that we have so far seen in Holland, that I think we've seen in New Brunswick, but I'm less clear on that, that we've seen to some extent in the Ontario teachers' and the hospitals of Ontario pension plans and, I think, in the B.C. pension plans, which is saying that if we're going to price this properly, if guarantees are expensive, if members are ill advised to actually pay for the high cost of guarantees, the obvious fix here is to take the risk and move it to the recipients; i.e., go from the traditional defined benefit to jointly sponsored, where the risk is shared with active members. But I think, frankly, that's only a halfway house. I think the real destination here is the target benefit plan, where the risk goes entirely to members by having benefits that are contingent on how well the pension fund performs.

At that point in time, if we converted all of Canada's public-sector plans to target benefit plans from defined benefit, then the public-sector accounting standard that we have today actually puts the right price on the pension. It attaches no value to guarantees. If you get rid of the guarantees, at last the pension has been properly priced, and the pricing is very transparent to taxpayers, who will basically be told: this plan has a 10 or 12 per cent of pay cost. To taxpayers that's the amount that you put into the plan, and that's all there is to the cost. Ultimately, the members will get that together with whatever returns it produces. That will become their pensions.

I think that will work for taxpayers as well as DC plans, and it will work for members better than DC plans because it is, in essence, a collective institution. We don't really have to change the very excellent delivery vehicles we have in Alberta or anywhere else. The governance will all of a sudden make sense, where members can decide for themselves whether they want to subsidize early retirement, but it's their money that they'll be using for the subsidies, and they can decide whether they want to subsidize the highly paid people and people who get big salary increases late in their careers, which is what current DB plans do. They can decide how much risk they want to take, with them taking the risk, whereas today too often we have a lot of very bitter bargaining because the perception that the members have – and I think that in the public sector it is the correct perception – is: the bigger the benefits we get and the more risk we take, the better it is because the taxpayer is bearing a lot of that cost for free and bearing a lot of that risk for free.

I think better accounting will take us to target benefit. It's not the only road that goes to target benefit. As I said, the Ontario Teachers', hospitals of Ontario, the DC plans, many of the jointly sponsored plans get to target benefit or close to target benefit by a different path and by a different form of reasoning. But in a world with old populations, large amounts of assets needing to take significant amounts of risk, ultimately the members for whom the money is invested need to bear a lot of that risk. You know, that can be managed professionally. It can be managed responsibly. It needs to be communicated very clearly. But if you look at the leading pension systems around the world and you say, "What's the common denominator in the direction in which they're headed?" that's it.

Bottom line: I think that in the world we're in today, we're not going to go back to the '80s and '90s. You know, plans that become mature, systems that become mature don't ever again become immature. That's a one-way trip. These plans will stay mature. The risks will stay large. The only thing that would make things a lot easier is if we had high real interest rates, but I don't know anybody who is expecting us to see the kinds of interest rates that we took for granted in the 1980s and the 1990s maybe in the remainder of our lifetimes. I wouldn't wait around for high interest rates to save the day. I'd recognize the problem for what it is, I'd recognize the permanence of the problem, I'd learn the lessons that others have learned, and I would move in the direction of getting as close to target benefit as you can.

I'll stop there. Thank you.

The Chair: Well, thank you very much, Mr. Hamilton.

Our final presenter on this panel is Mr. Groch. You may begin.

Mr. Groch: Thank you very much, Mr. Chair. Good afternoon, Chair and committee members. Thank you very much for asking me to present to you on the key issues that are facing defined benefit pension plans. Just for transparency, I'm the CEO of the Alberta teachers' retirement fund. It is a fund that administers the pension plan for the teachers of Alberta. It is not a plan that is subject to Bill 9. We are a separate Crown corporation, and we've been so since 1939. We are a jointly sponsored plan, so some of the comments that you've been hearing this afternoon are very much what our model is like.

2:05

Previously, I was the head pension regulator for the province of Alberta. I've been in my current job for 20 years, and before that I was the head regulator for about 10 years. I'm also the chair of the board of trustees of the Calgary firefighters supplementary pension plan. I'm also a director of the Pension Investment Association of Canada. I'm also on the National Policy Committee of the Association of Canadian Pension Management.

So pension, pension, pension, pension: that's been my life, and that's why I've been asked to come here. I've been asked to come here to present to you based on my experience in pensions. I'm not here today in any other capacity other than Emilian Groch. I'm not here as ATRF's CEO or on behalf of ATRF or on behalf of any of the other entities that I work with or am involved with.

I believe the presentation, my slide deck, has been passed out to everybody. I wanted to just touch base on some fairly key issues that I see from the point of view of the challenge. The challenge is very simple, and that's securing the pension promises that are being made under the pension plans. The key issues that I'm going to speak about are governance, funding, the regulatory enforcement framework, and the design of plans within a compensation structure.

Securing pensions is obviously the critical element, and that's making sure we have enough money to pay the pensions, money that actually exists and doesn't exist in a promised form. That all involves dealing with risks and managing those risks from a holistic enterprise risk management perspective and entire organizational structure. Assets, liabilities, investments, administration, governance: all of that needs to be dealt with. It can't be dealt with in separate pockets. One of the issues that the Auditor General's report had dealt with is that holistic view of risk. Where is all of that being combined and looked at together?

It's also about implementing cost-effective solutions. Everyone is lined up to get our money. The pension plan has money. The lawyers, the actuaries, the investment managers: everyone wants a slice of it. Then they're all going to do wonderful things for you. Everybody wants to work for you, and the issue becomes cost-effective solutions.

All of that is around the most important issue from my perspective, and that's the governance. I want to just spend a couple of minutes off the start here talking about why the right governance matters. What we want in the end is to make sure we meet the pension promise, and that means that from the point of view of plan administration and investment returns we get superior long-term value for the plan members and the plan sponsors. This means that you need knowledgeable, capable, and motivated governance trustees that can add value in a constructive way with management and be proactive on issues.

I've provided you, on slide 5, with just an extract from a book that Keith Ambachtsheer put out within the last eight years. It was called *Pension Revolution*. I do really want to read what I've put down here. These are the four pension-fund, high-performance challenges.

The first one is that the context in which the pension fund operates must be clearly understood by all stakeholders. Everyone needs to understand the pension deal. The governance board has to have necessary authority and collective competencies to understand their role and to provide management with encouragement and resources to become a high-performing organization because you can't have anything less than a high-performing organization. The board must clearly delegate accountability for the development and implementation of a strategic plan to a high-performance chief executive, and proper resourcing of the organization in terms of both people and information technology is a critical success factor. Finally, risk must be defined, measured, and managed in an operationally relevant manner. That's just a very high-level commentary about the four challenges.

Pension plan governance is critical. The members of the board of trustees are critical. They approve the strategies. They monitor the financial performance. They maximize human performance and resources and oversee risk management. It's all about setting the direction, setting the boundaries, and helping management transform ideas into action.

It's the critical issue because you have to get the structure right. That means you need to understand what environment the plan is operating under, who the stakeholders are, what their issues are, the key risks in the pension deal, and that each plan situation is going to be unique. There are a lot of commonalities between plans, but every plan situation is unique. There are differences. The structure has to work effectively. If it's not set right and it's not working right, you have to fix it. That is the starting point. Ladies and gentlemen, the key issue, I think, in all of the pension plan designs that I have seen and worked in is: what is the governance? The clarity around it and the effectiveness of that governance are absolutely essential starting points.

The people that you put on these boards, the experts or the lay people, who will become semiexperts, working well together inside that board from the point of view of getting the job done – that's great, but it's the tone of those individuals at the top that is critical. It's acting in the best interests of the plan members. The sole purpose that they are there for is to secure the pension promise. It's making sure that board members are going to ask those challenging questions of management, that they're going to have mutual respect for each other and for the people they work with, and that they take their stewardship role very seriously. They have to have a deliberate process that's going to engage the board members, the stakeholders, the management, the plan members, and, of course, the regulators. So that's it on governance at this point in time.

Plan funding. The plan has to have a robust, detailed funding policy. It's really easy, conceptually. You want to have enough money to make sure that your liabilities are going to be covered, you want to manage the volatility of contributions from year to year, and you want to make sure that there's a level of equity between generations within the defined benefit pension plan. It's easier said than done, as we've been talking about today.

The challenges of pension plans, we've talked about: extremely low-interest-rate environment, negative market extremes in 2002 from the tech bubble bust to the '08 prices, longer longevity, and the fourth one that I throw in here is that environments for pension plans lack to some extent an ongoing structure for total compensation discussions to ensure that the pension deal keeps pace with factors that will affect plan costs. For example, if investment return patterns change for the long term or longevity changes for the long term, those structures to allow the plan sponsors to sit down and talk about those things that are changing and what they need to do about that don't exist in many situations.

So what are plans doing? They're all affected. They're increasing contribution rates. They're looking at long-term sustainability. But a little aside here is that some are also taking the opportunity to say: "You know what? We set the benefit structure under this plan 40 years ago. Well, at that time work patterns, longevity, and life expectancies were very different, so maybe we need to look at something more than something just on the side. Maybe there's a more fundamental shift." You don't make major changes in defined benefit pension plans every five years, 10 years. You set it; it's there for 40 or 50 years, potentially. So a lot of plans now have been looking at what they need to do. They actually go in, and they take a look at a more fundamental redesign, rethink about what we need to have. For example, is age 65 still the right retirement age? In 1970 it might have been. In 2014, well, that's a question.

The sources of funding pension plans, of course, are employee and employer contributions, but they don't largely fund the benefit. In the long term investments really fund 70 to 80 per cent, and this chart shows that it's about 75 per cent in our teachers' pension plan. But there are reduced return expectations for the future. There are only two sources for funding a plan, and that's contributions and returns. If returns are going to be less, then contributions naturally will have to go up.

Plan governors require some levers to deal with funding issues. Most plan governors have the option of increasing contribution rates when there are deficiencies or they have to because of the fact that the legislation requires amortization of deficiencies over a 15-year period to bring the plan back up to a 100 per cent funded status. Most plans just have that one lever, and that kind of ties their hands.

You can adjust investment policies, but do you really want to take on more risk? If you take on more risk, it's got to give the right level of return that's commensurate with that risk, and it has to be prudent. So that's not really a great opportunity set. Changing the benefit design: pension plans have been doing that or moving to risk-sharing arrangements where the asymmetric risk sharing that we have with pensioners in a lot of defined benefit pension plans can be addressed. So that's funding.

2:15

The third piece is that you require a regulatory enforcement framework. Every pension plan that I know of has a regulator of some sort that sits over them from the point of view of minimum standard regulation, but that regulatory framework has to be flexible and adaptable. There obviously has to be an independent, capable, and adequately resourced regulator, and they have to apply that oversight on the regulatory side in an effective manner. That kind of framework does exist in Alberta. We've had pension legislation with minimum standards on funding and investment rules and minimum benefit provisions and disclosures since 1966. I administered that legislation from 1976 to 1994, and we have that now. There is an office in the government and in all provincial governments that regulates all the pension plans. It has minimum funding standards, minimum investment rules, and adequately performs that job. So that already exists.

The final point I wanted to talk about was that you need to deal with pension benefits within a total compensation structure. Employers obviously have to set their competitive total compensation structure that they need to attract, retain, and reward their employees, and they need to get the best possible employees they can get. This includes the employer sitting down and setting a total compensation cost for salaries, for incentive pay, for benefits, for leave, and for pensions. The employer needs to know how much we're going to spend. Employees as cosponsors in pension plans also have to set their risk, how much risk they want to be able to take and to understand what that is, and they have a cost cap as well.

In my view, a setting of pension benefits, the design of the pension plan benefits, needs to be set in the context of the desired retirement income targets that the affected employee group should have, the risk appetite of the plan's sponsors, and if it's jointly sponsored, like most public-sector pension plans are, then obviously that should be set by the employer and the employees together.

You need to understand the pension deal – what the risks are, and who's sharing those risks – and there has to be an understanding that there's a reality, as Murray mentioned, on cost cap. Contributions are not infinite. Both the employer and the employee know that at some level they are not going to contribute any more. And, of course, in all of this there is this minimum regulatory funding standard that has to be in play, which already exists right now in the private sector in Alberta.

So my summary is essentially one of saying that you need to focus on securing the pension promise. That's the only issue. It's the overriding message that always has to come in on everything you do. You have to get the governance right. You have to start there. It has to happen. You have to have a robust funding policy, risks need to be understood, and the plan's sponsors need to set the benefits within the governance, funding, and regulatory structures that that plan is going to be operating under. In the end, there should be an independent regulatory oversight function that's run by an independent regulator.

Thank you for your attention, and I'd be glad to answer questions later on.

The Chair: Well, thank you very much, Mr. George, Mr. Gold, Mr. Leech, Mr. Hamilton, and Mr. Groch for your presentations and for being here this afternoon.

Now we would like to open the floor for questions. I have a list of six names so far, and we'll start with Mr. Luan.

Mr. Luan: Thank you, Mr. Chair. My question is going to Mr. George. I understand that your report has been sponsored by the unions, and you acknowledge that. You presented those different projections here?

Mr. George: Yes.

Mr. Luan: I just want to verify a few things. If I follow you correctly, your targeted rate of return is 6 per cent for the so-called baseline.

Mr. George: Yeah. The baseline, for example, in the local authorities plan is 5.75. I did not set that rate of return. That's the rate of return that the local authorities plan actually uses themselves.

Mr. Luan: That's also the government of Alberta's number. They use 5.75, right?

Mr. George: I'm not sure what the government of Alberta's is, to be honest.

Mr. Luan: Yeah. It is.

Mr. George: The 5.75: I just set it for the baseline to be the same as the plan actuary independently uses. I didn't try to tinker with that.

Mr. Luan: Thank you for that.

Following on that, can I clarify further?

The Chair: Sure.

Mr. Luan: With your projection, it looks like that within 12 to 15 years we will have totally paid off the unfunded liability. How far off is your projection on that part compared to the government's report?

Mr. George: To be honest, I'm not sure what the government said, you know, about when the plans will get to a hundred per cent funded. I just ran my projections independently, and these are the results I came to. I mean, if you think about it, the obvious answer would be that the plan should be back to fully funded in 15 years because that's how long you can spread deficits. The reason my projections say that you'll get there quicker is that some of these deficits are from 10 years ago, so they've got a shorter period left to pay than 15 years. The average is about 10. That is really what I'm saying.

Mr. Luan: Okay. The last associated question – I'll finish mine – is directed to you, but I'm very happy to hear the rest of our panel members' comments. In listening to all your interpretations, the current problem or challenge we're faced with, if I can summarize it – correct me if I'm wrong – is based on two factors. One is that life expectancy went significantly higher. The other is that demographics have drastically changed because of the aging population. The life expectancy part is harder to predict. However, we do have some reasonable ground to follow that trend. The aging population is a predicted one.

Here's my question. With all the experts in this field throughout the half century of science and social science, how come nobody saw this coming? Like, why are we where we are now? We're in a broken-promise kind of a crisis and trying to figure out how to get out of it. I'm very appreciative. I think I can remember the second-last presenter's view, saying that we enjoyed 20 years of good times and that we had some rosy predictions at the time. Nobody predicted this kind of thing happening. Now we're becoming more realistic. I'm hearing that one of your panel member's recommendations is that this undefined pension plan is no longer a viable reality, that a sort of defined contribution is the solution at the end of the day. That comes back to my question to a room full of experts and to scientists around the world: how come this wasn't predicted before?

Mr. George: I'll take a stab at it, and I'm sure others will join in. I think it's a fair point. Your original two points that you said were, you know, the aging population and people living longer. I'd say that to a certain extent those were predicted. There is a third one – and Malcolm will jump in because I think he made this point – and the third point is that what was not predicted very well was that for the 2000s, from the end of the '90s to today, investment returns haven't been what was expected. When you say, "Why are the plans 80 per cent funded instead of 100 per cent funded?" a key factor, to me, is not the demographics; it's more the investment return. You had a bad year in the early 2000s, with tech going down, and another bad year in 2008. I mean, in the big scheme of things, that investment return is the number one factor, and if you look forward, the key success of these plans is going to be driven by: can you get that 5.5 to 6 per cent investment return? If you can, I think they'll get back to fully funded. If you cannot, then you have to keep putting in more money.

You know, the demographics, I think, were reasonably well predicted. The investment returns were not. The problem is that no one predicts investment returns well. Even today, sitting here, no one will give you a good prediction, and if they do, they'll be wrong. So that's the key risk.

2:25

Mr. Luan: Thank you.

The Chair: If any of the other panelists would like to respond to this or any questions, you're welcome to do so.

Mr. Hamilton: I'd make a couple of comments on two important things. Longevity, for me, is a distant third. The maturation of plans was a predictable thing, but people just didn't appreciate 20 years ago that when a DB plan was mature, you had to treat it much differently than when it was young. That was simply not appreciated. People just thought that the plan will be around forever; hence, nothing changes with the passage of time. It turns out that that was something we should have known about better, but we didn't.

The number one change for me is the drop in interest rates. Now, I'll tell you why. If you look at the last decade, maybe life expectancy at 65 improved two years versus maybe we were expecting it to improve one year. In a bad decade for longevity we've added a year to life expectancy, and the impact that has on pension costs is about 3 per cent, which isn't a huge impact over a decade. Now, if you look at the interest rate decline over the same decade, it was about 300 basis points, which basically doubled the cost of a pension discounted at market interest rates. To me, the interest rate movement has a far, far bigger impact than anything we've seen from longevity, and the plan maturity is something that we should have seen but didn't.

It's not just us, though. You look at old age security, where three years ago apparently all of a sudden everybody was surprised to find that the cost was going to triple between 2010 and 2030. If you go back, the very first old age security report, in 1988, said that the cost would more than triple between 2010 and 2030. Literally, that was a known thing for more than two decades, yet when the seventh subsequent report said more or less the same thing, all of a sudden everybody was surprised by it, and nobody should have been.

The Chair: Thank you, Mr. Hamilton.
Mr. Gold.

Mr. Gold: Thank you. I, too, represent employees and trade unions all across the country, including here in Alberta, on these issues. We always hear about this, and then you have to sort of figure out two things. First of all, these are real problems from one point of view, and from another point of view they're great things. We're living longer. That's a great thing. From a pension point of view, it's a cost. Predictable, not predictable, known, not known: we have to deal with this, right? Then the question becomes: what's the best way? What's the best mechanism? Is it DC? If it's DC, that means that the individual deals with it. That means that someone who lives a long time is probably going to run out of money. Someone who doesn't live so long is probably going to leave an inheritance.

If it's defined benefit, it's all in one pool. Everybody gets paid for their whole life, the ones who don't live as long and the ones who do live longer. It's sort of an insurance concept. The problems are constant. Then the real question is: which design does the best job? I would suggest that the pooling that you have in either a target or a defined benefit plan allows us to use those resources most efficiently to deliver pensions to people for as long as they live and for different durations.

The Chair: Thank you, Mr. Gold.
We'll go to Mr. Leech.

Mr. Leech: I was just going to say, on that earlier comment, that we can spend a lot of time pointing fingers. Who's to blame? Why didn't we know this? Why didn't we know that? When I say "we," I talk about the actuaries and the accountants, of which I am not one.

I looked at actuarial reports for Teachers' going back into the 1970s, well before Malcolm was the actuary. They were dead right, probably by accident, on the rate of return. They were dead right, probably by accident, on how long people would work. They were 60 per cent out on how long they thought people were going to live in retirement. They predicted they'd live for 20 years on pension, and they're living for 32 years. They were using the best information available to them at that time, but it turned out that medical science, people stopping smoking, people eating better, and people exercising made that assumption totally erroneous. That's why it's so important to build flexibility into these plans to absorb these types of changes going forward.

On the concept of DB versus DC, I mean, maybe it's simplistic, but if you think of it as DB, the entire risk is borne by the sponsor. DC: the entire risk is borne by the employee, the member. It seems to me that we can be imaginative enough to try to find some place in the middle, some sort of hybrid such as target benefit or shared risk, et cetera. It's not perfect, but it is the hybrid that will get us closest to a sustainable plan than either of the two other extremes.

The Chair: Thank you, sir.

Mr. Groch: Just to the question. In my view, the number one issue that has caused the problem in all the plans that I've seen is, essentially, the artificially suppressed interest rate environment. Why didn't we see it? Because we can't control what central banks will do and what some governments are doing around the world from the point of view of ensuring that if you can get a loan, you're getting it free. In the meantime savers and pension plans are getting it in the ear.

The Chair: Thank you, gentlemen.
Ms Pastoor.

Ms Pastoor: Thank you, Mr. Chair. I'm not sure that I'm going to be able to explain myself as clearly as I would like because it's a question that's a bit out there. We talk about the new mortality tables, and I guess my question is: who is really living longer? When you look at those numbers, there's only one-third of Canadians that actually are in a pension plan; two-thirds of us are not. So has that division, the mortality numbers, have they broken them out to the general population and those that are actually going to be affected by pension plans? The health determinants are probably not as good for those in lower incomes. It certainly pretty much maintains that their lifestyles and their quality of life are probably not as good as those in the upper brackets.

So I guess that would be my question if that makes sense. There are two-thirds. They are a totally different demographic than those that actually are privileged to be in the one-third of the population of Canada that actually has pension plans. There was a question in there, right? I hope so.

Mr. Leech: Maybe I could start off on that, Mr. Chair?

The Chair: Okay, Mr. Leech.

Mr. Leech: Malcolm and the actuaries can talk about the general table being used. But with many of the large pension plans such as for Ontario teachers, the population and the data we have is of a sufficient size that is statistically significant. So for Ontario teachers, for example, longevity tables that we use are a result of studying the longevity of teachers in the province of Ontario and nobody else. In fact, we have been doing that for almost 20 years and have updated our longevity tables almost every year. Those updates certainly in the past decade have probably meant that the liability has gone up somewhere around $10 billion to $12 billion just on those longevity changes in the last decade. It seems to me what's happened now is that the rest of the world is kind of catching up. The actuaries are changing those tables.

One other factor. We've done a lot of studying on why the teachers in Ontario live so long. I can actually tell you that there's only one other group that lives longer, and that's teachers in British Columbia, so I'm not sure what that says. But for the teachers in Ontario it really is, you know, lack of smoking. They were one of the first groups as a cohort to stop smoking. They eat better, and they started exercising sooner.

2:35

But there's another factor that is coming up, and I don't have a study to necessarily prove it, but a great contributor to the demise of people kind of over the age of 75 is financial anxiety. By having a sustainable defined benefit pension plan, you reduce that anxiety, and people live longer. So it's a bit of a self-fulfilling prophecy.

The Chair: Thank you, sir.

Ms Pastoor: Thank you. If I just might interject, I'd like to jump onto what would clearly follow from that, which I'm sure the answers would come from. Do all the pension plans – I'm not sure; somebody said that there were 700 or something. Do all the pension plans, I guess some of the ones that we're talking about here in Alberta, actually follow what the Ontario teachers do and use their own membership as a factor in terms of mortality?

Mr. George: Yes. My understanding, for sure, in Alberta is that – and actually I think these studies are under way right now for both the public service plan and the local authorities – they're not as big as Ontario teachers' but big enough to study their own. What you'll find, basically, is that public servants and health care workers don't have the same mortality rates. There will be different tables, quite likely, used for a public service plan, for example, versus local authorities.

Mr. Groch: Just to clarify on the first part of the question, the two-thirds, I can tell you that the data that's been used by the Canadian Institute of Actuaries to establish the new mortality tables were based on 100 per cent of the people working in this country because it's based on the Canada pension plan and the Quebec pension plan data. Of course, that covers the two-thirds, at least those, plus the other third that's in pension plans. All those are being covered.

On the second point, absolutely. We have been doing our own mortality table structuring under the teachers' pension plan in Alberta for quite some time because we have a large population that we can do that from.

The Chair: Thank you.
Mrs. Sarich.

Mrs. Sarich: Thank you very much, Mr. Chair, and I'd like to thank all the presenters this afternoon for their information, which is of value to the committee. I'd like to begin by saying to Mr. Groch: thank you for framing the challenge, which is securing the pension promise. Actually, this morning the Auditor General also raised that question, indicating that there is compounding evidence to signal that we're reaching the maximum acceptable level, so there are challenges with that, raising the other question of: something needs to be done. That's why we're here taking a deeper look at where we're at.

Mr. Chair, I have questions for two different presenters, so I just wanted to let you know.

The Chair: Go ahead.

Mrs. Sarich: Starting with Mr. George: you did some work with for the Alberta Federation of Labour coalition on pensions, and I read your report with interest. I'm focusing on pages 9 and 10 of that report, section 5, commentary on results. That's on page 9, and you begin with the LAPP. Page 10 is PSPP. What you outline here are some scenarios. In each it's very consistent. It's a base case scenario, optimistic scenario, and pessimistic scenario for the LAPP and the PSPP. You put some points. In fact, there are 10 possible outcomes for each of those particular areas, four for the base case scenarios and three each for the optimistic and pessimistic scenarios.

I would like you, to the best of your ability, to answer this. You didn't indicate the probability of each outcome, so I'd like to know why. If you could try or attempt today, if you would want to cite some examples here, for example, on your optimistic scenario for LAPP, the first bullet, even on the PSPP, the optimistic scenario, what would be the probability of reaching the first bullet or any of those bullets or even the pessimistic scenario so that we can get a flavour for that? Depending on how you answer, I might even offer you the opportunity to elaborate through a written response to my question on that.

Mr. George: Sure. Thanks very much. We consciously did do the modelling, I'd say, in a fairly straightforward, simple fashion. I left out the full stochastic kind of model, which would give you the probabilities. But I think I can address your first question, which is the base case, which I see as the middle of the road. In my mind, it would be 50-50. So half of the time you'll be better than that and half of the time worse. The optimistic and pessimistic do not reflect the very best and the very worst. Exactly where they fit in the probabilities is hard to say for sure. But I would see them as: 25 per cent of the time you might be better than the optimistic, and 25 per cent of the time worse than the pessimistic. The range of results is higher at the top end in the optimistic and lower at the bottom end in the pessimistic. The middle of the road I see as a 50-50 likelihood.

Mrs. Sarich: Okay. You have indicated in your response that you do have those details of the probabilities for each of these scenarios – base case, optimistic, and pessimistic – for the two areas. Is that correct?

Mr. George: Yes. Actually, in that report we didn't actually run the probabilities, but we could produce them.

Mrs. Sarich: All right. Through to the chair, then, I'm asking for those details for the LAPP and the PSPP on the probabilities for those three areas outlined in the original report for the committee.

Mr. George: Sure.

Mrs. Sarich: Thank you.

Moving on to Mr. Leech. You had made a statement that the pension and liabilities should be with one unit, and when you looked at Alberta, you had noted that that wasn't the case. I was wondering. I'd like to give you the opportunity just to explore that. What was your observation? Any other presenter may provide an observation around that. I think you had signalled to the AIMCo example. Please correct me if I heard wrong. It was quite a lot of detail this afternoon.

Mr. Leech: And I'll ask you to correct me if I've got it wrong. As I understand it, the plans would by and large continue to use AIMCo as their investment management arm. AIMCo's objective would be to maximize the return on the investment. Well, sometimes maximizing the return on the investment is not the appropriate objective function. You have an asset that you're trying to offset against a liability, and there are many financial instruments that one would choose to purchase or to invest in because they clearly – I'm trying to stay away from jargon here – offset what the liability is. Your liability is a stream of pension payments going into the future with a cost-of-living increase on top of them. The ideal investment to offset that is a government, i.e., low-risk, real-rate, bond. It's a bond where, in fact, its interest rate increases as inflation increases, so it's a perfect offset.

The problem is, as Malcolm articulated, that today real-rate bonds are only yielding about 1 per cent, so there isn't enough return to indeed meet those obligations going forward, but at some time there might be as rates go up or as they get closer. If you're managing both the assets and the liabilities, one would look to invest in real-rate bonds as an offset. That is not something that you would necessarily do if your total objective function was simply to maximize the return on the assets. I don't know if I've explained that well enough. It's why it's very difficult to compare the returns of various pension plans.

Ontario teachers will say – and I'm just picking hypothetical numbers – that they earn 10 per cent this year, and another pension plan may say that they earn 12 per cent. Looking at that, you'd say: oh, gee, that other pension plan is doing way better than teachers. Well, that may not be so because Teachers' may be purposely getting a lower rate of return, but they're offsetting the liability. In a way what you have to do is look at the funding status, whether it's improved or worsened. That should be the true measure.

2:45

From my perspective, the organizations that I ran had control over both of those matters and could make decisions on both of them simultaneously, and I think that maximizes the likelihood of the plan being sustainable. So it's something that you've got to figure out, whether you're going to bring AIMCo into a discussion about what your liabilities are so that they can tailor-make an investment plan for you or whether you're just asking them to give a big rate of return. Maybe, simplistically, it could be set as to which body is actually going to choose the asset mix, which body is going to say: we want to have, you know, 40 per cent invested in equities, 40 per cent invested in bonds, 20 per cent invested in real estate and other types of investments. Who is going to make that decision? Is it AIMCo, or is it your pension plan?

The Chair: Mr. George, briefly.

Mr. George: Yes. Thank you. Just briefly to add to Mr. Leech's comment, I think, as Mr. Gold said earlier, that in a true jointly sponsored pension plan that's exactly what happens. The board of trustees sets that investment policy and asset mix looking at the liability. So, you know, if you want that to work, I think it works in a true jointly sponsored pension plan.

The Chair: Thank you.

Mrs. Sarich: Thank you.

I'm going to close with this one.

The Chair: Make it brief, please, Mrs. Sarich.

Mrs. Sarich: I'd like to redirect back to Mr. Groch. Believe it or not, I've been asked this question repeatedly by teachers. You had made an opening statement from your perspective. Because the government is looking at two distinct bills, 9 and 10, could you state it one more time: does Bill 9 or Bill 10 have any impact on the teachers' pension at all, in any way?

Mr. Groch: No. Bill 9 does not, in no case whatsoever. Bill 10: not with what's in the content of Bill 10, no.

Mrs. Sarich: Thank you.

The Chair: Thank you very much.

Mr. Eggen.

Mr. Eggen: Thank you very much. I was intrigued by Mr. Gold's comments characterizing how you negotiate your total financial package between the employer and the employees through whatever means. Part of that package is the pension, so this presumption that the government can interfere with that somehow in Bill 9 by setting caps on the pension – I don't know. It seems to me – you can help me with this – a way for the government to be intervening in a collective agreement and trying to engineer that somehow and engineer how the two parties come to a conclusion about that. I'm curious to know: why do you think that the government seems so unwilling to bargain a contribution cap with public-sector unions and otherwise just impose it, like they were suggesting they were going to do with Bill 9 until we finally got it off the legislative table? What do you think was going on there?

Mr. Gold: Well, it's an interesting question, and I can only speculate about it. When you look at Bill 9, what's interesting across the board is the level of continued government involvement with the plan. There's government involvement now. Under Bill 9 regulations can be made about a wide variety of things on an ongoing basis, not just the cap. During a transition process to a jointly sponsored plan there's another wide-ranging regulatory interventionist authority, and even after a plan is fully transitioned to a jointly sponsored plan, if that were to happen, there is ongoing regulatory authority to regulate over virtually any aspect of the governance deal.

So the contribution cap is sort of one element of a very interventionist package that is very much at odds, for example, with the way Ontario Teachers' works. You do not see government with an ongoing legislative, regulatory mandate. With the B.C. plans you don't see the government always hovering there with a regulation-making power, able to second-guess or overturn a piece of the stakeholders' governance authority. You know, I think it's part and parcel of the general approach to the plans, which is quite controlling.

Mr. Eggen: Yeah. I'm feeling like having people come from different provinces here to give us different perspectives is refreshing. It's like there is this culture of imposition on the right to collectively bargain these important issues. I mean, it becomes a very essential part of the security of that contract for workers. It seems that, like, in Alberta – we just heard the Auditor General this morning saying that, you know, he thought that the rates might be too high, right? Again, too high for what, and why? Why should he tell us that? Like, there's this whole movement towards intervening in basic rights to bargain these things, and I just find it really disturbing.

My second question is in regard to Mr. Groch's six-point plan, which I find to be very refreshing and, you know, easy to understand. I'm just wondering: do you sort of look at this as an application of a model for a defined benefit approach? Like, we seem to be seeing an assault on defined benefits coming from the video screen here, from this government, different quarters. Can we use this six-point plan to help to refresh and strengthen our defined benefit position here in the province, in your view?

Mr. Groch: I stand by my summary comments if that's what you're referring to on the six points.

Mr. Eggen: Yes.

Mr. Groch: I think that those are the key issues: focusing in on the pension promise and dealing with those things, the governance and funding policy and the framework. Those are the essential elements for success, I believe.

Mr. Eggen: So we can certainly apply them successfully to strengthen our defined benefit approach if we choose. There seems to be this move to walk away from defined benefits, but certainly we can use this to strengthen our defined benefit position, too, yeah?

Mr. Groch: Absolutely. I would have to quote what other panelists have said. The defined benefit model is not broken. It should not be replaced by DC. There's got to be a different answer than just going to DC. There are better approaches for employees and for retirement income security for Albertans and Canadians than just going to DC, and that answer is in the defined benefit realm of design.

Mr. Eggen: Absolutely. Thank you.

The Chair: Thank you, Mr. Eggen.
Ms Donna Kennedy-Glans.

Ms Kennedy-Glans: Thank you, Mr. Chair. I'm going to repeat what I said this morning because the author of the book that I quoted from is actually at our table here. My question will originally be directed to Mr. Leech, but I would invite anybody to comment. I would recommend that anybody who wants to understand pensions read this book. I've found it to be one of the most helpful resources we have available. What we're talking about are changes to governance and changes to plan design, and sometimes we're going down into the weeds, which is understandable.

I've got constituents, lots of them, who are union members, and I've got lots of constituents who don't have any pension at all. They all want to participate in this conversation at different entry points, and we don't seem to have any process in this process of looking at this bill to actually have clear communications with my constituents or with other people who have an oar in this water. In your book, Mr. Leech, you recommended that there's a critical need for clear communication, and you recommended hiring pension experts to explain to reluctant plan members and labour leaders and, I would suggest, taxpayers what is going on.

It feels to me like we're doing two things at the same time. We are fixing the plane in the air, looking at governance and looking at the plan design. I guess, Mr. Leech, two questions: what would you recommend we do to try to bridge that how gap, the process gap? The second is: does it make sense for us to be doing governance changes and plan design changes at the same time? How do we navigate through that?

2:55

Mr. Leech: Wow. You know, just drawing on my experience and what I saw in other jurisdictions, any amount of change takes time. We put that challenge out in the book, that says, you know, that it takes leadership. It takes leadership at the government level, the corporate level, and at the union level. If everybody is just running for their corners and saying, "I want to keep the status quo," et cetera, I mean, it isn't going to work. People have to come, probably at their own pace, probably being dragged kicking and screaming a little bit to a place where they say and agree that there needs to be change.

I remember talking to the head of the nurses' union in New Brunswick – I think we talk about it in the book – where, you know, she was a palliative care nurse for 25 years, and she used the expression that when it came down to it, she had to put her palliative care glasses on to resolve the issue. When we asked her what that meant, she said: "Well, in palliative care you stop kidding each other. It's a time when you're coming to peace, and you've got to deal with the issues." I think that's the issue. Part of the problem is that some of the constituents that you're dealing with are still in denial, probably. Somehow, I think it is incumbent on everybody to get the facts out in front of everybody. Many of the changes in other jurisdictions have taken several years, but it is needed.

You've got some models out there to look to, to follow. One of the tactics that was used in Rhode Island was that they produced a three- or four-page document called Truth in Numbers. You know, the Treasurer there spent a lot of time doing town hall meetings across the state. Now, it's a small state, and there are not that many people, so it's not nearly as big an undertaking as you would have.

You have to judge from your own constituency how far along people are. There are hundreds and hundreds of myths out there, you know, that defined benefit plans are horribly expensive and broken, et cetera. Well, that's not necessarily true. They are still the least expensive way for an employer to provide a reliable pension for workers. It's far less expensive than defined contribution because of attributes such as pooling, that Murray talked about. The difficulty is that the promise is not sustainable anymore. The promises that were made in the '70s aren't sustainable, and people have to come to that realization. To close your eyes and say, "Oh, we can earn our way out of this," I think is just not realistic. You've got to build – I'm not sure I'm helping you here. I am saying that it's difficult.

I was asked by an institution last year: how did you get changes at the Ontario Teachers' Pension Plan, where the cost of living is 100 per cent conditional? My answer was: I started 10 years ago. It doesn't happen necessarily overnight. Now it's 10 years later. There are many more models and examples of organizations that have successfully brought in reform, and the world didn't come to an end, and employees are protected, and employers are protected. It's working, but it's a process, and unfortunately the accountants, the economists, and the actuaries have made it complex.

The Chair: Thank you, Mr. Leech.
Mr. George and Mr. Gold, briefly, please.

Mr. George: Yeah. Thanks. Just briefly on this second question, about governance and benefit design being done together, I think that if you look across the country at plans that are well run, successful, well funded, et cetera, the governance issues were solved first, and then the rest of it came second, be it funding, investment policy, benefit design, et cetera.

The Chair: Mr. Gold.

Mr. Gold: Thank you. Two quick points. One is that not all plans are the same, as people have said. There's a huge difference between the States and Canada, very different histories of funding, very different assumptions that underlie the funding, so Canadian funds are generally in much better shape than south of the border. Even in Canada the Ontario plan just declared a $5 billion surplus. Some plans have deficiencies. It varies. Not every plan is in crisis. One has to be really careful, looking at each plan, to sort of sort out where you start. Some are in trouble, as they may have been in New Brunswick, and others really aren't. Most have, you know, some problems, and there are different ways, of course, of fixing them.

In terms of doing both, the question is: who does the benefits? Is this really a responsibility of the stakeholders, that essentially own this plan, or is it the responsibility of the state? It's certainly our position that it's the responsibility of the stakeholders once they are in a position to do that, which they're currently not quite.

The Chair: Thank you. Thank you, gentlemen.
Ms Kubinec.

Ms Kubinec: You know, I think both of my questions have been answered, but I'm going to just verify with Mr. George that you did not use the stochastic model when you were doing your actuarial variations. Is that correct?

Mr. George: Yes. I mean, we could have run a stochastic model. I didn't, to make it easier to understand, to be honest.

Ms Kubinec: Okay. Thank you.

The Chair: Thank you.
Mr. Fox.

Mr. Fox: Thank you, Mr. Chair. We're here studying Bill 9, so I'm curious: in your opinion are the changes in Bill 9 appropriate to securing the pension promise, providing the framework to get the plan governance right, setting a method for an appropriate funding policy? In the legislation is there an understanding of the key risks and who bears them? Last but not least, is it appropriate in ensuring effective regulatory oversight? To any one of the panelists.

Mr. Leech: I mean, I'll stick my oar in, and I think I've said in my presentation that you're certainly going in the right direction. The devil is in the details, when you get into the regulatory oversight, the funding management policies, and the risk management structures that you put in place. That's where I would spend my time, making sure they're very rigorous and can withstand body blows from changes in the economy, et cetera.

But on the scale of pension reform, where people are endeavouring to save the benefits of the defined benefit model, you know, I would place you at the light to medium. You certainly haven't gone overboard, so my sense is that you are certainly going down the right path. There is no one hundred per cent solution that works for everybody in all circumstances, but you're clearly moving to that hybrid model, which I think holds the promise for the future.

Mr. Gold: If I might.

The Chair: Yep. Go ahead.

Mr. Gold: Sorry, Mr. Chair. So this may be one question on which Mr. Leech and I disagree sharply. I've read and reread Bill 9 many times and compared it to the laws that we see in other jurisdictions governing jointly sponsored plans or public-sector plans. This is different, and it's different because it maintains the government as regulator always, always present, ever hovering over this plan. In these plans in their current condition, as government-sponsored plans, in a transition process the government is still there with regulation-making authority. Even once these plans become jointly sponsored plans, if that ever were to happen, the government still has the authority, by regulation and without returning to the Legislature, to override virtually any aspect of the governance arrangement.

This just sends the wrong signal. This is telling the parties that they're not in control, that the government is always watching, always second-guessing, can overturn any aspect at any time for any reason. It sends the signal to this pension sector that it's not autonomous, it's not independent. The people who work for it, their conditions can be changed at any time. This is not the right framework for successful pension plans. We do not see this in other jurisdictions. I believe this to be the wrong path.

The Chair: Mr. George.

Mr. George: Yeah. I'll just comment on maybe one or two of the questions focused on let's call it sustainability or contribution rates. At least based on the analysis we did, I think that without any changes – so forget about Bill 9. If the sponsors, being the members and the employers, are prepared to pay 25 per cent of salary, which no one knows – I'm not sure if anyone around the table here knows whether that's acceptable or not – but if they are in agreement, they'll pay 25 per cent of salary or maybe 26 and maybe 27 over the next 10 years. Then without any changes these plans would get to fully funded, and, you know, subject to another 2008 happening, which no one can predict, the plans will get to fully funded on the current schedule. So I don't see the Bill 9 changes being necessary to get back to your sort of secure, affordable pension plan.

3:05

The Chair: Thank you very much, gentlemen.

Mr. George, Mr. Gold, Mr. Leech, Mr. Hamilton, Mr. Groch, on behalf of the committee thank you all for being here and for presenting and answering the committee's questions. The *Hansard* transcript of the full day's proceedings will be available later this week via the Legislative Assembly of Alberta website. The audio of the meeting is also available via the Assembly site. If you wish to provide additional information for the committee, please forward it through the committee clerk. Thank you all very much for being here today.

Committee members, we'll take, I think, a 20-minute break, and we will be back here at 3:30 sharp, please.

[The committee adjourned from 3:06 p.m. to 3:30 p.m.]

The Chair: Good afternoon, ladies and gentlemen. I am pleased to welcome the presenters for our final panel of the day relating to the committee's review of Bill 9, Public Sector Pension Plans Amendment Act, 2014, and Bill 10, Employment Pension (Private Sector) Plans Amendment Act, 2014. This next panel is intended to provide comprehensive background information on pension plans and on Bill 10 to assist the committee in its review. Welcome, gentlemen.

Now we'd like to go around the table to introduce ourselves. I am Moe Amery, MLA for Calgary-East and chair of this committee.

Mr. Fox: Rod Fox, MLA for Lacombe-Ponoka, deputy chair of this committee.

Mr. Quadri: Sohail Quadri, Edmonton-Mill Woods.

Ms Kubinec: Maureen Kubinec, MLA, Barrhead-Morinville-Westlock.

Ms Kennedy-Glans: Hi. I'm Donna Kennedy-Glans, the MLA for Calgary-Varsity.

Mr. McDonald: Everett McDonald, Grande Prairie-Smoky MLA.

Ms Pastoor: Bridget Pastoor, Lethbridge-East MLA.

Mr. Rogers: George Rogers, Leduc-Beaumont.

Mr. Groch: The cat came back. It's Emilian Groch. I'm back again.

Mr. Wolpert: Michael Wolpert. I'm a partner at Lawson Lundell in Calgary.

Mr. Rivard: Phil Rivard. I'm an actuary with Segal in Edmonton.

Mrs. Sarich: Good afternoon and welcome. Janice Sarich, MLA, Edmonton-Decore.

Mr. Rowe: Good afternoon. Bruce Rowe, Olds-Didsbury-Three Hills.

Ms Sorensen: Rhonda Sorensen, manager of corporate communications and broadcast services.

Mr. Eggen: Good afternoon. My name is David Eggen. I'm the MLA for Edmonton-Calder.

Dr. Massolin: Good afternoon. Philip Massolin, manager of research services.

Mrs. Sawchuk: Karen Sawchuk, committee clerk.

Mr. Tyrell: Chris Tyrell, committee clerk.

The Chair: Thank you very much, ladies and gentlemen.

Do we have anybody on the phone? No. Thank you.

Okay. Now we will hear from our panelists in the order listed on our agenda, beginning with Mr. Groch, who also participated on our last panel. You each have ten minutes, and then I will open the floor to questions from the committee.

Mr. Groch, the floor is yours.

Emilian Groch, Lawson Lundell LLP, Segal Consulting

Mr. Groch: Thank you very much. There's a revised presentation being handed out, just a few more slides from the slide deck that I'll be speaking to. Thank you very much, and thank you again for inviting me this afternoon, not only for the previous session but also to participate in the discussion on Bill 10.

It was spoken about at the last session briefly by Mr. Gold that the key issue for employees is really pension plan coverage. That is the issue. There is very low coverage of employees in the private sector in pension plans and even lower in Alberta than in the rest of Canada, so it's a fundamental problem. The percentage of private-sector Alberta employees covered by pension plans has been low and actually has decreased a bit further over the last decade. A key retirement income issue in Canada is that employees are not saving enough for retirement, particularly those in that middle-income group, $30,000 to $80,000 or whatever you want to define it as. That has been the focus of many, many studies over the last decade or so. So the key is the shortage of pension plan coverage in the employment sector, and we need to encourage and facilitate additional pension plan coverage.

We talked about that earlier on this afternoon, about the defined benefit plan world, right? That is a severe problem in that defined benefit plans in the private sector are disappearing to some extent. They are, without question, the most efficient and cost-effective plan mechanism for providing retirement income benefits. We spoke about that earlier on from the point of view of just the ability to pool the risks and also to generate very low costs from the point of view of provisions from the pensions.

Traditional private-sector pension plans that have been defined benefit have placed all of the funding risk with the employer. Typically, the employer created the plan, the employer dictated what the terms were going to be, and the employer then funded all the deficits and requirements. But most private-sector employers have now taken steps back to derisk. They can't handle the risks anymore going forward, and they have been derisking their exposures. Many of these defined benefit plans in the private sector have moved to defined contribution arrangements, transferring all the risks, which means the investment risk, the longevity risk, the conversion risk from the point of view of the income that you would get at retirement, and interest rates. All those risks would fall on the employee. Plan sponsors have said: "I don't want a pension plan anymore at all. We'll pay you a little bit extra. You take care of it yourself."

The problem is that it's been demonstrated in all jurisdictions that have DC arrangements, be it Australia or be it in the U.S. or in other countries that have DC arrangements, that if you don't mandatorily force people into the plan and actually make them contribute and give them options, they will take the road of least resistance, and that is to not make decisions, not enter the plan, and not save for retirement. So DC is not necessarily the right answer.

There's an alternative benefit design, and that's called target benefit or defined benefit with target benefit components. It's similar to a defined benefit plan. Benefits are not guaranteed, though; they are targeted. We talked about that earlier on in the session. There really is no guarantee, right? You could say that there's a legislated guarantee for a plan. Well, legislation could be changed. "There's a guarantee. My employer has a defined benefit plan. I am going to get that benefit." Yeah, if there is enough money. But if something dramatic happens that is not contemplated, there may well have to be benefit reductions.

A target benefit plan basically takes away that perceived guarantee and says: "We're going to target a level of benefit like 60 per cent cost-of-living adjustments for pensions. We're going to target that, and we're actually going to fund for that. But you know what? If we don't get there at a particular time because we have some problems that arise that we haven't properly funded for, we may not be able to provide that 60 per cent cost-of-living adjustment." What this does for the plan's sponsor, which is the employer, and in co-sponsored plans for the employee is that it caps the cost. It effectively says that there's a maximum cost, a maximum exposure that the employer and the employee are putting into this pension deal, and everybody understands that right from the front.

However, this plan requires really clear communication and understanding of risks. Everyone needs to understand that the benefits are being targeted, that they're not guaranteed, and there's a good, robust discussion around that and around the funding policy. There has to be around that a robust regulatory framework that is being managed and enforced by an independent, capable regulator from the point of view of ensuring that the funding and benefit structure that the plan's sponsors have put together for the plan will actually be fulfilled.

What target benefit plan designs do is that they preserve the defined benefit objective, but they limit the funding risk for the plan's sponsors. That means the employees and the employer. If the plan's sponsors want to change that funding risk because there's a shortage, then they can do so, but they'll do that when they decide they want to do that.

With respect to target benefit plan flexibility where plan sponsors have decided to replace a defined benefit plan, they've either changed it to a defined contribution plan or they've cancelled the plan altogether. If the parties agree, a defined benefit plan should be able to convert to a target benefit design. This isn't a mandatory feature of legislation, where legislation would say that employers have the absolute right to walk in and make a change and impose a target benefit plan design retroactively on plan members. However, plan sponsors, which means the employees and the employer, if they agree, should be permitted – legislation should be permissive to allow parties that agree under some sort of structure that they design and will administer to convert from a defined benefit arrangement to a target benefit plan arrangement.

So the regulatory framework needs to accommodate that. That's what, you know, the industry has been asking for, and I think that's what Bill 10 did in that one section that I'm focusing on. I believe that is the section that has caused the bill to come to committee for your discussion and consideration.

In summary, the key issue is increasing coverage of pension plans for employees. The problem is that we have very low coverage, and we're losing DB plans in the private sector. So what's the answer? Is the answer nothing or DC, or is there an answer that says that it should be something different like a target benefit design? Regulation should be permissive to the extent possible. That's what I believe should be done, and that's what I think Bill 10 attempts to do to some extent: provide a permissive clause to allow the plan sponsors to agree to a target benefit plan design, obviously prospectively but also potentially, to change certain provisions of the plan that are accrued on a defined benefit basis to a target benefit design.

Thank you, Mr. Chair.

3:40

The Chair: Thank you very much.

I will now turn it over to Mr. Wolpert. Please go ahead.

Mr. Wolpert: Thank you, Mr. Chair, and thank you to the committee for inviting me today. I bring a bit more of a technical standpoint, or perspective, today. I wasn't entirely sure where you want to go, so to the extent that there are more detailed questions where this committee would like additional analysis, I can certainly provide that should there be a need.

What I thought would be helpful to the committee is to provide a bit of background on how we actually got to Bill 10, where we're at today. Mr. Groch talked about concerns within the pension world, concerns about needing reforms to address the issue of retirement income. Alberta, like other provinces, decided to study the issue. There are a number of committees around the country that were sort of looking at this issue at the time. Alberta got together with British Columbia, and that was at the time in the spirit of some joint provincial efforts to increase labour mobility between the two provinces, and the Joint Expert Panel on Pension Standards was formed. Now, this panel was comprised of a cross-section of industry experts, I believe about six in total from Alberta and B.C.

The panel, known as JEPPS, released its report in November 2008. As part of the development of the report the panel conducted quite a number of consultations, invited submissions from the industry and industry stakeholders. In the report were identified, I think, roughly about 120 submissions they had received either in person or in writing. These came from advisers such as law firms, actuarial firms. They came from multi-employer pension plans, single-employer pension plan sponsors, organized labour, and individuals.

There were many recommendations that came out of the JEPPS report. There are a few I just want to touch on briefly. One was harmonized pension legislation between Alberta and British Columbia. A key recommendation was greater flexibility in terms of plan design and administration in order to allow plan sponsors to create plans that reflected a broad array of deals between employers and employees and their particular circumstances. As part of that the JEPPS report also recommended allowing for new plan designs, including target benefit plans, which Mr. Groch just talked about.

Lastly, in terms of the legislation the recommendation was that the legislation be principles based and rules only applied where absolutely required. This was intended in part to create greater flexibility, to allow plan sponsors to adapt their plans without being encumbered by a set of rigid rules. That was certainly something that plan sponsors had complained about: "We want to do more. We want to do this. We want to do other things that suit us, that suit our employees, but we can't."

Once this report had been released, the governments of Alberta and B.C. then focused their attention on actually drafting the legislation that was going to come out of these recommendations. Each government appointed six members to an advisory committee with respect to the drafting. The three panelists here today were on the Alberta side, and there were six in B.C. as well. They, again, came from a cross-section of pension industry backgrounds, from a joint-trustees perspective, single-employer perspective, legal, actuarial, and so on.

The result of the drafting process was Bill 10 in Alberta, which was released in November 2012, also called Bill 10, and Bill 38 in British Columbia, which was released in May 2012. These two pieces of legislation are relatively similar. There are a few differences to reflect some differences in policy and also to reflect some differences within provincial legislative structures that just didn't work for one reason or another. Both pieces of legislation included the broad ability to convert between different types of plan designs, including defined benefit, or DB; defined contribution, or DC; and target benefit, or TB.

Once the legislation was out, the government and the joint advisory group – this is the drafting committee, or JAG, as it was known then – turned its attention to drafting the regulations. For a variety of reasons the regulatory drafting process started to diverge a bit. Alberta went more or less off on its own, B.C. went off on its own, and the regulations, as I'm sure you're aware, have not yet been released in either province. I believe that B.C. is now targeting the end of the year for theirs.

In the course of preparing the regulations and also as a result of these two pieces of legislation being out and subject to review and scrutiny and so on, it was realized that there were a few issues that needed correcting, tweaking, whatever you want to call it. At the same time, there was a reform process, that Mr. Groch was talking about, that was continuing. Some new ideas were coming out about things like derisking and so on that were still under consideration. Ultimately, we ended up with a new Bill 10, the one we're talking about today, in Alberta, and also Bill 10 – a popular number for pension legislation, apparently – in British Columbia. There are quite a few similarities between the two pieces of legislation. Bill 10 in British Columbia, as I understand it, just received royal assent last Friday.

So what, in fact, is in our Bill 10? Well, there are about 37 amendments in there, and the vast majority are what I would call technical amendments. These are grammatical corrections, little tweaks, fixes to errors that had been in the legislation. Some, such as the deemed trust provision, were there, I believe, for harmonization purposes, to fit with B.C.'s legislation. A few amendments are what I would call enabling, and that would include section 20(2)(d), which I'll discuss in a little more detail in a moment. These new provisions, the brand new provisions: there really aren't that many. There's electronic communication – and there's some history behind that – allowing plan sponsors to communicate pension material electronically, which, in fact, probably the considerable majority of plan sponsors and plan administrators do in any event; annuity buyouts; and to some degree, section 20(2)(d).

Let's take a step back and look at what appears to be and what I think is the potentially controversial provision of Bill 10. As I mentioned, one of the key recommendations in JEPPS was flexibility in design to foster sustainability of pensions and to allow for each employer to make its own deal with its employees. Also, I touched on the fact that JEPPS had recommended allowing the establishment of target benefit plans with a unique set of funding, communication, and governance rules. Mr. Groch has talked about what a target benefit plan is. Briefly, they provide for fixed or capped contributions, typically a defined benefit type of formula, and flexibility to adjust the benefits and ensure that the plan is sustainable for all members, including the ability to adjust accrued benefits if need be. As such, Bill 10 and Bill 38 in British Columbia specifically allow for conversion to target benefit among other things but in accordance with prescribed rules, and these rules are not out yet.

Just coming back to where this might all go, in the course of developing its rules, the Alberta government released a consultation paper in early 2013 on the funding for multi-employer target benefit plans, but it made it clear in that paper that it was contemplating target benefit plans for single-employer plans as well with their own set of funding rules. To this extent, the concept of a single-employer, private-sector target benefit plan certainly isn't new, but it turned out that the old Bill 10, as I'm calling it, did not go quite far enough in allowing for the full creation of such plans. It did not allow for the retroactive conversion to target benefit, and you couldn't override the act with regulations; therefore, the amendment was required. Now, there's a similar amendment in B.C., but I should point out that in B.C. they have limited it to negotiated-cost, multi-employer plans. This is in that section 20(2)(d).

At this point I'm going to stop. I can't go much further because, again, the regulations aren't out. From my perspective, this is enabling legislation, and really that's where we stop.

Thank you.

3:50

The Chair: Thank you, sir.

We will now turn it over to Mr. Rivard.

Mr. Rivard: I also want to thank the committee for this opportunity to appear. I have 20 years of experience as a pension consulting actuary. I think you've already heard from a couple of actuaries today, so hopefully my presentation is just a little bit different. My primary focus has always been specified multi-employer pension plans, which is, I think, very different and not very well known in terms of what they are and how they exist. I'm going to talk more about those in a minute. Most of my clients that I work for are boards of trustees, so these are jointly sponsored arrangements where half the trustees are appointed by employers and half are appointed by employee representatives.

As an actuary my governing body is the Canadian Institute of Actuaries, or the CIA. The CIA oversees the education, accreditation, and professional guidance for all actuaries.

In terms of my professional history, I've been a member and vice-chair of the PPFRC. That's just a committee that oversees the development of all pension guidance for actuaries. I've also been a member and chair of the Practice Council for the CIA. That's the entity that approves and puts out all professional guidance for actuaries practising in all areas of the country, all practice areas. As the chair of the Practice Council I was also an ex-officio member of the CIA board of directors as well as an ex-officio member of the Actuarial Standards Board of Canada for that period of time. From time to time the CIA also creates task forces to look at different issues. There currently is a task force specifically set up to look at target benefit designs, and they will be providing a report, hopefully later this year. I'm also a member of that task force.

A little bit closer to home, there are a few advisory committees that work with and report to Alberta Finance. There's an actuarial advisory committee and a specified multi-employer advisory committee. I'm a member of both of those, and as Michael mentioned, I was also part of the joint advisory group who helped develop and provide assistance with the new rules.

In terms of now getting to the legislation, I agree with Michael. I see Bill 10 mostly as enabling legislation. My understanding of where some of the concerns or confusion lay is with section 20(2)(d), which deals with the conversion of accrued benefits from defined benefit to target benefit. I'm going to talk about this, first, strictly from the context of a specified multi-employer plan, and the acronym for that is SMEP.

What is a SMEP? It's a single pension plan to which numerous employers contribute. Generally, they exist on behalf of a specific industry or a trade in the province. Some of the larger SMEPs can have over a hundred employers contributing to it in any given month or at any point in time. These are actually very large pension plans. SMEPs are governed by boards of trustees. They are typically jointly sponsored. Not necessarily so, but the majority are. The involvement of any individual employer is essentially limited to contributing to the pension plan on behalf of its workers, and there are no governance responsibilities beyond that contribution.

These plans were created and they exist, really, for industries or trades to support more labour mobility, so individuals are allowed to follow the work as opposed to staying with a specific employer. An individual worker can work for employer A, employer B, or employer C in their given trade or industry, all the while continuing to contribute and earn benefits within a single pension plan. Typically with all these plans the contributions are per hour worked, so employers contribute a fixed dollar amount for its workers for every hour worked.

When you look at these and how they're set up, they're a single trust under legislation, and that trust holds all the money that's contributed to it, and all the money that's invested and all the investment income stays within that trust. The money within that trust can only be used to provide benefits for the beneficiaries of the trust: the workers and their beneficiaries. The money can never revert to the employers. Really, these are single-purpose entities strictly designed to provide for pension entitlements.

One of my roles as the actuary is to assess the financial position of these plans and then provide a recommendation. If I determine that the funding, which is the current assets plus the expected future contribution investment income, isn't sufficient to provide for the target benefits, then I have to report back to the board of trustees, and something has to change. Either funding contributions have to go up or the benefits have to be curtailed because they have to balance out. Now, with these arrangements the board of trustees themselves have no power to increase contributions. Typically, while you can try to affect increases down the road, if the decision is solely with the trustees, which it is nearly all the time, the only mechanism they have to bring things into balance is to adjust benefits.

While historically these plans have always been called and fell under the same legislation as typical single-employer defined benefit plans, they've always been very different. They have always been what we are now calling a target benefit plan today. I'm sure you've heard many people who spoke today say that the cost of pension arrangements has increased, and not all of the industries and not all of the trades were able to pass on those increases in terms of increased pension contributions. There have been situations where the benefits of the individuals participating in the plans have been reduced, but these plans continue to exist and continue to grow in terms of future growth.

For me, one of the important aspects of the new legislation is that once you formally recognize these entities as target benefit plans, I think it provides better transparency and better recognition on the part of the participants themselves of what it is that they're participating in and what risk they're exposed to. I think it's just better for all participants.

Now, in terms of that section, converting accrued benefits to target benefit provisions, these SMEPs I think are the natural reason the conversion is required. There always have been target benefit provisions, so the legislation, I think, should reflect and has to reflect the ability to convert the accrued benefits. But even within the structure that's laid out, nobody is being forced to convert. It's going to be up to the individual stakeholders of each pension plan to decide whether or not they want to continue to operate under the current regime or regulatory framework or if they want to convert to the new target benefit plan framework.

While I don't do a lot in the private sector anymore, I will touch upon it a little bit in terms of conversions. Conversions of defined benefit plans are not new ground. All jurisdictions in Canada have always permitted conversions from defined benefit to defined contribution, and when you look at it, defined contribution plans are riskier and expose individual participants to more risk than a target benefit plan would. So why has it been permitted in the past? Well, it's not that people can just convert at will. There have always been prescribed rules and conditions around conversions, and those rules and conditions were put in place to protect participants' rights and entitlements and to make sure that anybody involved in the conversion is properly treated. While the regulations for conversions from DB to target benefit are yet to be written, I firmly believe that they will be written appropriately and that there will be the proper safeguards in place to make sure that individual entitlements are properly protected.

Why is it important? I think target benefit plans provide a valuable role in terms of providing pension coverage. If the choice of an employer who no longer wants to support a defined benefit plan is to either wind up completely or convert to a defined contribution plan, I think a conversion to a target benefit plan provides advantages for participants, and that's why I would support having that type of ability in the legislation. The key is that all the participants involved understand what the pension deal is, what the risks are in the pension deal, and who's bearing the risk, and as long as everybody is understanding the risks and the roles, then I think there should be some flexibility in terms of how these arrangements are structured.

4:00

One of the key strengths of a target benefit plan is its adaptability. These things are just better equipped to adapt to evolving economic realities over time, and we've all seen that nobody can predict the future with any type of certainty. If you consider that if the current regulatory and economic environment had always existed over the last five decades, you would have seen very, very few private-sector pension plans ever come out. They just would have been too complex and too costly. It's only because things have changed over time that these things have actually come into place and evolved.

Even when the Canada pension plan was first put in place in 1966, the combined employer and employee contribution rate was 3.6 per cent of pay. Today it's just shy of 10 per cent of pay, and that's even though the benefits have been cut back a little bit. That's just an example of an entity that's been allowed to evolve over time to fit the needs of the stakeholders and of the industry. I think private-sector pension plans need to be allowed to evolve as well if they're going to stick around and remain and fill a role in terms of providing retirement income. Like I said, I think a target benefit plan is superior to no plan or just a DC plan in its place.

Just quickly, why are target benefit plans a little bit superior to defined contribution? Well, they do provide for a pooling of both longevity and investment risk. They should result in lower investment expenses over time and allow for a broader range of investment choices. They also allow for a lower level of participant involvement. One of the key problems of defined contribution plans is that individuals just don't pay enough attention to their own retirement needs.

I also did want to convey that there is a sense of urgency here. I mean, especially in terms of the multi-employer plans, there have been discussions about changing the regulatory framework going on 12, 13 years now, and there are three key issues in terms of the ongoing delays. One is that proper investment policy and proper funding policy for these plans are set by the boards of trustees. For them to make the right long-term decisions in terms of how those boards are going to deal with aging and maturing plans, all that is tied to the regulatory framework in which they have to operate. Even since 2006 there's been a temporary situation. It's been unclear or uncertain around the future, and with that uncertainty it makes it very, very difficult for these boards to discharge their responsibilities. These boards are trying to do the best for the plan beneficiaries, so a clear legislative outlook would be good for the plans.

Another key concern has to do with commuted value rules, and I'm going to try to avoid a very complicated explanation here. For the most part, individuals who participate in a pension plan will work at their careers, and when they get to their retirement, they'll take their pensions. Many individuals will cease participating in the plans before they're eligible to retire, so when that participation ceases, they have the option to elect portability of their entitlement. They can either choose to remain a member, and once they're old enough to retire, they can elect retirement at that time, or they can take a lump-sum transfer in lieu of their future retirement entitlement.

There are rules around how that lump-sum entitlement is calculated. It was set up with a single employer framework in mind, and it just is not appropriate at all for a multi-employer plan. What is happening is that the people who are leaving are being overpaid. If somebody – I'm going to step back for a minute. I was talking about that these are trusts, and they're set up for the benefit of only the individuals in the trust. One way you can view these multi-employer plans is that every member, every participant in the trust is entitled to a certain percentage of the entire fund. People who are terminating and taking lump sums are taking more than their fair share, and they're being overpaid. What does that mean? The members who are being left behind are left with less than their fair share.

One of the things that the new legislation would address would be that discrepancy. So there's an equity issue that needs to be addressed, and it's pretty significant. Now, the percentages vary depending on the pension plan itself and the ages, but there's a strong argument that people leaving are getting paid, in some cases, at least double the amount that they should be taking with them. It's a huge equity issue that we need to have addressed.

Lastly, the whole issue of uncertainty causes other problems. When there's uncertainty around a pension plan, it is much more difficult to negotiate increasing contribution rates to support the plans, whether it's just legislative uncertainty or if there are problems with the financial stability of the plan. It's no different than if you thought your local bank was in financial difficulty. You're not going to go put more money in the bank. The reaction is the reverse. So some of these pension plans, that provide a lot of value to workers and to the province, are at risk if they're not allowed to properly adjust to their circumstances and there's uncertainty. Then it becomes very difficult in terms of negotiating additional contribution rates to support those plans. So certainty is important for the plans.

Lastly, I just wanted to close with a thought. You probably haven't heard a lot about these plans because they're the minority in terms of the numbers in the province. I think there are 22 or 23 of them today. They are big in size. Today there are approximately 150,000 participants in Alberta registered SMEPs. If you look at the total assets, we're looking at somewhere around $8 billion today, so there's a substantial amount of retirement savings and income tied up in these arrangements. For the most part, the members in these plans are past and present construction workers in the province of Alberta.

I think one of the things I take away in terms of my work and what interests me is that long after these construction projects are done and gone and finished, there are going to be positive legacies left behind. You're going to have thousands of workers who are going to enjoy retirement income from these plans well into their retirement years. They're going to continue to be contributors to the province, to the economy because they're going to continue to have income and be spenders, and they're not going to be reliant on government sources of income because these plans were in place when they worked.

I think the plans are good for Alberta, I think they're good for the workers, and I think Bill 10 is necessary to go through to allow us to continue to support these plans and make sure that they continue to be around and evolve to fit their needs. I'd like to thank the committee for the opportunity to show that.

The Chair: Thank you very much.
Any questions?

Mr. Eggen: Thanks for your presentations on Bill 10. I think it's an area we need most illumination on as legislators. I think that one of you mentioned that one of the goals of this Bill 10 is to harmonize Alberta's and B.C.'s pension legislation – right? – but I don't think, necessarily, that B.C.'s legislation specifically allows the conversion of DB plans to target plans. I'm just curious to know if Bill 10 is doing this. But, then, you know, there's no harmonization going on, necessarily, for B.C. Am I right?

Mr. Wolpert: I can check.

Mr. Eggen: If you don't mind.

Mr. Wolpert: If you can give me time.

Mr. Eggen: Yeah. That seemed to be one of the reasons to do this, but then I don't think it really fits in with the actual B.C. legislation, right? That's my question. You can check later. It's okay. That's my only question.

The Chair: Mr. Wolpert, you'll get back to Mr. Eggen?

Mr. Wolpert: I can although I can just tell you right now. Section 92 of British Columbia's legislation has the same sort of enabling. The rules talk about converting, and they reference defined benefit, defined contribution, target benefit, and a provision prescribed to be a benefit formula provision. Then, as I mentioned during my session, their equivalent to 20(2)(d) is, in fact, different because it is limited to negotiated cost multi-employer plans. [Not recorded] conversion. That type of plan may reduce accrued benefits if the trade union whose membership includes or consists of members of the plan agrees to the reduction.

Mr. Eggen: Right. Okay.

The Chair: Do you have a supplemental?

Mr. Eggen: Yeah.

The Chair: Okay. Go ahead.

Mr. Eggen: This Bill 10 as well is talking about accrued benefits to be changed, but then for B.C. are they allowing that? I don't think so.

4:10

Mr. Wolpert: It's just not as broad as the rule here, as far as I can tell, but I can provide a more comprehensive answer.

Mr. Eggen: If you don't mind, that would be great.

Mr. Wolpert: Yeah. Certainly.

Mr. Eggen: Thank you very much.

Mr. Rivard: Just to add a little bit to what Michael said, I think what the B.C. legislation is saying is that it's restricting the conversions to the plans I was talking about, the multi-employer plans, which are collectively bargained, whereas Alberta potentially is more permissive and would extend to single-employer plans.

Mr. Eggen: All right. Thanks.

The Chair: Good. Thank you.
Ms Kennedy-Glans.

Ms Kennedy-Glans: Thank you. I think I sponsored the original bill, the old Bill 10, and at the time I was handed a whole bunch of information on the JEPPs review and read it with great interest. I was amazed at the time at how much work had gone into making sure that that harmonization process was discussed with stakeholders. Maybe for the benefit of this group, because we're looking at Bill 9 and Bill 10, it would be useful if any of you wish to speak to the consultation process that Alberta was involved in to get to the point where we put this new Bill 10 on the table.

Mr. Groch: I think the consultation process has been fairly exhaustive from the point of view of starting with the JEPPS process in 2008. With the industry, as Michael mentioned, there have been some evolutions. In 2008 it was JEPPS, but there are a lot of things that happened since then, and a lot of plans have been looking at sustainability. They've been diving deeper into the issue, and they've been looking at derisking. A number of issues have come up, for example, from the point of view of dealing with plans going forward. Greater flexibility was requested. The industry, certainly the Pension Investment Association of Canada and the Association of Canadian Pension Management, has been asking the regulators for additional flexibility within some structure to allow the parties to move forward, both from the point of view of accrued benefit conversion to target benefit but also from the point of view of funding rules; some greater flexibility on solvency funding, for example.

Those things have evolved, and there's been quite an extensive consultation. For Alberta, I've been involved in that consultation, and it's been fairly wide open. They've been very open to hearing our views, sharing their ideas, asking us questions, with us not telling them what to do, just giving them our opinions from the industry or from individual experts such as you have here today. It's been pretty widespread.

You know, on this issue, Mr. Chair, the federal government in April announced this target benefit plan consultation paper, a very detailed paper dealing with the kinds of issues that I think the Alberta regulations will be dealing with. I know that certainly within the Association of Canadian Pension Management and within the Pension Investment Association of Canada we are providing a whole bunch of input from those organizations as to the structure and those kinds of things to ensure that there isn't any mean-spirited allowance of regulations that's going to come into play.

A lot of governments are looking at this. The feds, in particular, are dealing with this at this point in time, so I would say that you can get additional deep-dive information on potential regulation types of issues by looking at the federal paper or even looking at what the Association of Canadian Pension Management is putting out with respect to target benefit plans.

The Chair: A supplemental?

Ms Kennedy-Glans: No.

The Chair: Thank you.
Mr. Rogers.

Mr. Rogers: Thank you, Mr. Chairman. Gentlemen, I listened intently to your presentations, and I don't have a specific question. I'm just wondering if you might comment. I jotted down some words, comments. I believe it was Mr. Rivard who said: target benefit plans provide a good option, and this option in the legislation is desirable; these plans can be more adaptive to economic realities. You also mentioned the piece about addressing the equity issue, with some people leaving with more than those left behind.

I realize we're looking at both bills 9 and 10, but putting aside the level of angst over Bill 9, it sounds to me from your comments that Bill 10 offers some great opportunities to do some good things, obviously with some guidance from this committee, based on some of the comments you made about the opportunities to essentially create a better pension environment for the people that Bill 10 would impact. Would you comment on that? Did I miss something?

Mr. Rivard: No. I agree completely. I mean, from my selfish perspective and that of the plans I work with, they would be much happier if Bill 9 never existed. Bill 10 does have a lot of positive aspects to it, and the confusion between the two bills, I think, has the potential to derail what Bill 10 was going to accomplish. Without speaking on the merits of Bill 9 at all, the confusion between the two, I think, has been unfortunate.

Mr. Rogers: Fair enough.
Any other comments? Mr. Wolpert.

Mr. Wolpert: Yes. I would certainly agree with Mr. Rivard. In terms of target benefit plans, I mean, it's very – you know, we talked about funding rules. I think there's perhaps a perception that because accrued benefits can be potentially reduced, it's likely to occur at will.

The intent of the funding rules is that they be set up in such a way that, certainly, the funding is more manageable and that it's known and that there will be enough stress testing and security in that funding that the likelihood of having to actually reduce benefits is going to be quite small. I mean, that's really the intent. It's not that, you know, suddenly your pension is slashed one day or something like that. It's quite different.

In contrast, if people are saying, "Why would somebody even opt for a plan that might lead to reduced benefits?" well, if their current defined benefit plan is on shaky ground, if the employer is on shaky ground, keep in mind that under federal bankruptcy rules the way it works is that if the plan is wound up and it's in a significant deficit, then benefits are going to be cut, potentially far more than they might have been under a target benefit scenario.

I was certainly involved in this area and working in this area during the financial crisis in 2008. The solvency funding rules at that time and the changes in financial markets created huge pressure on organizations, where they were in some cases faced with either funding their pension plans or ceasing operations. I mean, the magnitude of the dollars that had to go into these plans to keep them going was huge, and that's why you've seen some larger organizations, certainly, seek legislated relief for defined benefit plans and so on.

So there's more to it than just simply the potential to reduce accrued benefits. That's just part of the deal, but it's hopefully not a likely scenario.

Mr. Rogers: Thank you very much.

The Chair: Mrs. Sarich, then Ms Pastoor.

Mrs. Sarich: Thank you very much, Mr. Chair. I just would like to go back to some of the documents. Mr. Groch you were talking about the opportunity for consultation. This standing committee is being streamed live. You lifted a document that you made reference to. I'm wondering if you could just elaborate a little bit more on that consultation piece and if you could cite the sources that you were referring to and those opportunities – I believe you also had mentioned, if I heard correctly, the Association of Canadian Pension Management and a federal linkage there or what that activity is – just to provide a little bit more baseline information.

Mr. Groch: Sure. The federal government released in April this consultation paper called Pension Innovation for Canadians: The Target Benefit Plan, a consultation paper from the Department of Finance Canada. It delved into a whole bunch of questions, as much into the weeds as you want to get from the point of view of asking the industry questions about: how do we handle conversions? What happens if an employer decides that they're going to convert the plan and then they wind it up right away? Are they getting out of some obligation? What rules should we bring in? So that's this paper that the Association of Canadian Pension Management has put out, and it's on their website, a paper on target benefit plan design.

4:20

That association also is responding to this and is also putting out another paper to supplement those issues, those technical weed issues, from the point of view – I'll give you one example. Can employers wind up the plan quickly after they convert and get rid of their liabilities? Well, no. Even the Association of Canadian Pension Management right now is talking about, essentially, that the rules should say that you determine the shortfall that exists, and whatever funding obligations were there at the time that the benefits were converted prospectively to target benefit, those obligations remain for a minimum of five years. All right. In other words, you have to fund those up. You can't just convert the plan and suddenly say: "Well, there's not enough money. We're going to reduce benefits."

All those kinds of little, very technical issues are the ones that are being sort of mapped out and the ones that we, you know, would assume would be in the regulatory framework eventually in Alberta to support Bill 10's enabling clause.

Mrs. Sarich: Thank you.

The Chair: Thank you.
Ms Pastoor.

Ms Pastoor: Thank you, Mr. Chair. My questions are actually along the same lines as Mrs. Sarich's. How could the disgraceful debacle of Nortel have been averted? Then, if there's the power for companies to change the accrued benefits or wrap it up or whatever, how are the people who have paid into the pension – and I'm using Nortel because I think it's a pretty understood example – how are they protected? If you're going to change it so that companies can just say, "Okay; we're going to wrap it up," where's the protection?

Mr. Groch: The empowering clause allows the plans to be revised. So it depends on what the trust agreement and the plan documents state already, right? The legislation is not saying: irrespective of the trust agreement that's in place now, irrespective of the provisions that are in the plan text contractually now, someone can walk in unilaterally and do X. That's not what the legislation is saying. I'm looking at the legislation. I read it, and it says that a plan can make these changes. So if the plan sponsors, which are the employee group and the employer group, decide they want to amend their trust agreement, their plan text – okay? – in accordance with the provisions of that trust agreement and plan text as they sit now, which have all kinds of safeguards built into them already, then why shouldn't they be able to do that? That's really the issue at hand.

Ms Pastoor: Would one of those safeguards, then, be that that money that has been put into this plan actually has to be somewhere, that it actually has to exist?

Mr. Groch: Oh, certainly.

Ms Pastoor: In Nortel it did, and it just went poof and disappeared.

Mr. Groch: Yeah. I'm not sure about the Nortel situation, but I think Nortel got relief on funding to some extent. Phil might know.

Ms Pastoor: People lost everything.

Mr. Rivard: Not everything. I mean, I don't think what we're talking about in legislation today changes Nortel in any . . .

Ms Pastoor: Okay. That was my question, I guess. Is there any protection from a Nortel situation?

Mr. Rivard: No. I mean, Nortel as an entity was not fully funded on a wind-up basis. The entity unravelled very quickly. There wasn't enough money, and they weren't able to secure sufficient funding. So the plan design, that doesn't change that.

Mr. Wolpert: If I can just add to that, part of that issue comes out of the bankruptcy legislation, which is federal legislation. Currently unfunded liabilities are not given priority in terms of creditor status, and that's where things sit. That's a separate issue, then, from Bill 10.

Ms Pastoor: Is that issue being looked at at all at the federal level?

Mr. Wolpert: It has been. I mean, there have been some revisions over the years to sort of increase protection for certain degrees of contributions that have been owing. The notion or the concept of an unfunded liability taking priority comes up periodically, and it has maybe two or three times by way of private members' bills, as I understand it. Obviously, there's a huge issue in terms of financial markets if a pension plan can leap ahead of, say, a secured creditor. That would affect the ability to, you know, borrow money and so on. That's part of the issue there. But that's really where the federal rules and the paramountcy apply. It's the same with respect to orders under, say, the Companies' Creditors Arrangement Act in insolvency, and that issue was recently dealt with by the Supreme Court of Canada. So similar types of issues, but we're dealing with provincial versus federal laws here.

Ms Pastoor: Yeah. I understand. Okay. There's no protection, none whatsoever.

The Chair: Any other questions? Seeing none, thank you very much.

Mr. Rivard, Mr. Wolpert, Mr. Groch, thank you very, very much, and thank you for the presentations and for being with us today. The *Hansard* transcript of the full day's proceedings will be available later this week via the Legislative Assembly of Alberta website. The audio of the meeting is also available via the Assembly site. If you wish to provide additional information for the committee, please forward it through the committee clerk. Thank you again. It was a pleasure having you here.

We're not done. We have one item under Other Business, and I would call on Mr. Eggen to present his item.

Mr. Eggen: Thanks. Tomorrow at 10:15 we have the presidents of four different public service unions presenting. They've all agreed to shorten their time so that the president of CUPE, Marle Roberts, can make a brief presentation. So I'd just like to move that

> we include Marle Roberts, the president of CUPE Alberta, in the 10:15 spot, recognizing that each of the other presidents will shorten their presentations to accommodate for her.

The Chair: Okay. The clerk has indicated she has to advise us of something.

Mrs. Sawchuk: Thank you, Mr. Chair. I just wanted the committee to be aware that we did have CUPE down as an alternate for this panel, and we had in fact tried to get them scheduled in for Thursday. It was just that the scheduling wasn't working. So it isn't a new group. They were part of our expert and stakeholder panel list.

Ms Kennedy-Glans: I totally support this. I can't believe how well the organizers have done in terms of getting this many people at the table in this way. So kudos to you. Absolutely.

The Chair: Mrs. Sarich.

Mrs. Sarich: Thank you, Mr. Chair. I would support the addition as well.

Thank you.

The Chair: Great. Any other discussion on the motion presented by Mr. Eggen? All in favour? Opposed? Carried. They're on for tomorrow.

Mrs. Sarich has another item under other business.

Mrs. Sarich: Yes, Mr. Chair. Thank you very much. I would like to say that it's my understanding that at the outset, at the very beginning of the meeting, when I was not here to hear the words – I just wanted to affirm that there is an opportunity for other groups to present to our standing committee in September, I believe, or after the public hearings, at another time in September. Should that be the case – and we're going to reaffirm it this afternoon – it has come to my attention that Mr. John Tackaberry would like to make a presentation to this committee for the Building Trades of Alberta, and I would like the committee to think about that, to give that consideration.

The Chair: That's in September?

Mrs. Sarich: In September.

The Chair: For the fall. Okay. He can contact the clerk, and we will be happy to accommodate that.

Mrs. Sarich: Thank you.

The Chair: Mr. Eggen.

Mr. Eggen: Yes. I concur. I think that's an important addition. I was in contact with the Building Trades as well, and they would be delighted to help us in our endeavours here.

The Chair: I like this co-operation.

Mr. Eggen: Yeah. It's all just love and roses, right?

The Chair: The spirit of co-operation between two Edmonton MLAs: I like that.

All right. Any other items under other business?

The date of next meeting is tomorrow at 8:30 a.m.

If nothing else, I'd like a motion to adjourn.

Ms Kubinec: I so move.

The Chair: Thank you. Thank you very much.

[The committee adjourned at 4:30 p.m.]

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