

Labour Coalition on Pensions

Response

Government of Alberta “Charting a New Course: A Vision for Public Sector Pension Plans”

December 2013

This paper is a response to Alberta Government proposals to unilaterally implement major, detrimental changes to the Local Authorities Pension Plan (LAPP) as outlined in “*Charting a New Course: A Vision for Public Sector Pension Plans.*”

The Labour Coalition on Pensions represents more than 200,000 working and retired Albertans through the following member organizations:

Alberta Union of Provincial Employees
Canadian Union of Public Employees
United Nurses of Alberta
Health Sciences Association of Alberta
Civil Service Union
Non Academic Staff Association
Alberta Federation of Labour
International Brotherhood of Electrical Workers
Alberta Fire Fighters Association
Edmonton Fire Fighters Association
Alberta Colleges Institutes Faculties Association
Calgary Board of Education Staff Association
Unifor
Amalgamated Transit Union
Operating Engineers Local
City of Alberta Management Association

Introduction:

On September 16, 2013, the Redford government announced their intention to implement major changes to the Local Authorities Pension Plan (LAPP). The LAPP provides promised pension benefits for more than 140,000 Alberta public sector workers. These unilateral changes shift cost and risk from employers to Plan members, thus expressly advantaging government and employers at the expense of the future retirement security of Alberta public sector workers

The Coalition rejects the government’s proposals as set out in *Charting a New Course: A Vision for Public Sector Pension Plans*. The Labour Coalition on Pensions has a different vision for the LAPP. This response from the Coalition explains why government proposals are wrong. But it also proposes reasonable alternatives to maintain the long-term stability, viability, and financial sustainability of the LAPP.

This response is the initial position of the Coalition, but we are asking for a chance to sit down and discuss this and other ways in which we can strengthen the LAPP collaboratively and proactively.

As a defined-benefit pension plan, the LAPP has been good for both for our members and for the province as a whole. We are concerned about the absence of labour market analysis and fairness in the government's approach. **Independent analysis demonstrates that the LAPP is entirely sustainable without major cuts in benefits.** If the government is prepared to work with Plan members and their representatives, we have no doubt that the LAPP can continue to succeed as a leading pension arrangement in Alberta and in Canada. Now is not the time to abandon an efficient model that has a proven 50-year history of providing secure, predictable and adequate benefits to Alberta public sector retirees, and has played a major role in building a strong and fair economy for Albertans.

The larger pension crisis is that most Albertans don't have any workplace pension. For this reason, the foundation of retirement income security for all Albertans is the Canada Pension Plan (CPP). Changes to Alberta public service pensions must proceed in lock step with an expansion to the CPP. Eight provinces, countless stakeholders and financial experts understand that expanding the CPP offers people without pensions a hand up so they can enjoy a decent retirement. Expanding CPP would not only benefit all Albertans, it is a cost-effective solution for the challenges facing the LAPP. The Coalition believes the effective solution to our pension crisis is to preserve the aspects of our retirement system that are working, like the LAPP, while expanding the CPP to bring much-needed retirement security for the many Albertans without any pension plans.

Given these benefits, the Labour Coalition on Pensions strongly urges the Redford government to support meaningful expansion of the CPP.

The Union Coalition Position

After extensive discussion and analysis, the union coalition has come to a number of conclusions about the government's plan for pensions. We have also developed an alternative vision for pensions that we believe better protects the interests of both pension plan members and the Alberta public. Below is a summary of these conclusions, which will be elaborated upon at greater length throughout this brief.

1. Government undermining of the LAPP benefits is misguided and destabilizing

- a. **The LAPP is sustainable.** The Plan is facing a modest but surmountable funding challenge that is already being addressed by Plan members and employers. Independent analysis confirms that the LAPP unfunded liability will be eliminated in all but the most pessimistic scenarios without increasing contribution rates.
- b. **The LAPP is affordable.** The costs of the LAPP are reasonable and are in line with other public sector plans. Plan members carry a significant cost of funding the LAPP.
- c. **The LAPP benefits members.** The LAPP provides members with an adequate, secure and predictable retirement income after a career of work.
- d. **The LAPP benefits the province and the economy.** Defined-benefit pensions like the LAPP reduce pressure on government social programs for seniors and provide important sources of investment capital that help our economy to grow.

2. Government undermining of the LAPP Will Have Negative Consequences

- a. **Pension benefits will be lower.** Funding levels will be capped and indexation guarantees will be removed.
- b. **Workers will have to work longer.** Early retirement provisions are being completely removed from the Plan for future service. Many public-sector employees do physical work their entire working lives. An end to early retirement provisions will increase disability claims due to the physical nature of this work.
- c. **Pension benefits will be less secure, and workers will assume an inappropriate amount of risk in retirement.** Pension benefit levels will not be guaranteed in the new LAPP and could fluctuate with Plan funding levels.
- d. **The government's proposed plan cannot still be called a defined-benefit plan.** The Plan benefit levels cannot be guaranteed, given that contribution rates are capped.

The government's reforms may lead participating members and employers to question the value of the LAPP. This introduces uncertainty and unnecessary volatility into the Plan. This may create recruitment and/or retention problems in the public sector, given that the LAPP is a key component of total compensation for public-sector employees.

3. Government must implement joint governance of the LAPP now

- a. **The government has proposed that joint governance be addressed within an undefined framework at some point in the future.** The Labour Coalition urges that joint governance be addressed first. 'Sustainability' issues are the mandate of a properly constituted board, jointly sponsored by employers and employees. Deferring joint governance reform and instead, dictating changes to pension plan provisions is an inappropriate intrusion into pension bargaining.

4. The Union Coalition solution strengthens the LAPP and provides long-term stability

The Union Coalition has produced an alternative solution costed by a third-party actuary. The alternative features the following elements:

- a. **A real and meaningful joint governance framework.**
- b. **A different and less damaging, yet still significant, package of benefit adjustments.**
- c. **The continuation of the defined-benefit nature of the Plan.**

1. Government undermining of LAPP benefits is misguided and destabilizing

The LAPP is Sustainable

The government's concerns about the sustainability of the LAPP are overstated and misplaced. The Plan is sustainable in its current form.

All investors and all pension plans were hit hard by the 2008 financial crisis. After 2008, the LAPP's funding ratio (the ratio of assets to liabilities) had dropped to 75%. However, since that time, the health of the plan has been steadily improving. Last year, the plan earned a \$2.2-billion return on its investments — almost an 11% return for the year. By the end of 2012, the LAPP was 81% funded.

An independent actuary retained by the Coalition confirms that the LAPP is sustainable. (A copy of their report is included in our submission to the government.) At current costs and contribution rates, the LAPP will be fully funded in a reasonable timeframe. **The government can meet its goal of keeping contribution rates below 25% of payroll and eliminate the unfunded liability by simply keeping the Plan as it is.** In our view, this confirms the government's proposed changes are drastic, ill-conceived and unwarranted.

Provincial legislation requires that unfunded liabilities to pension plans be amortized over a given period of time. Amortization allows the Plan to recover in a timely, but affordable way. LAPP has been doing just that with average funding level improvements of more than 2% per year since the financial crisis. The current schedule of special amortization payments for the LAPP will end in 2026. These special payments are being paid for equally by Plan members and employers — each side is contributing about 3.7% of payroll for these payments in 2014. The special payments are temporary and are scheduled to decrease in the coming years. In many other pension plans, the employer alone makes these special payments. LAPP members are therefore carrying a significant share of the temporary burden of returning the Plan to full funding. Plan members and employers have already demonstrated that these additional payments are affordable.

The government's communications this fall have focused on the \$5-billion unfunded liability in the LAPP. While this is indeed the size of the projected deficiency, it must be put into perspective. The LAPP is a massive plan, with \$23 billion in assets and nearly 150,000 active members. It currently has 81% of the assets it needs to pay its long-term obligations. It has a reasonable and affordable way to fill the remaining gap over the next 13 years. Plan members are already playing a major role in filling that gap.

The key driver in determining the size of the Plan's liabilities is the "discount rate." This is the percentage the actuaries assume the Plan's investments will grow over the coming years. Lower discount rates mean higher liabilities, as the Plan would need more money to pay pensions if market returns will not be as good. The LAPP is currently using a 5.75% discount rate, a conservative assumption that effectively makes the Plan's funding "safer." Other pension plans, including some plans in Alberta, use higher, more aggressive rate of return assumptions. The Public Service Pension Plan (PSPP), for example, uses a 6.35% discount rate. If the LAPP used these higher rates, its funding ratio would significantly improve to 87% and the total required contribution rate would drop by approximately 5% of

payroll. LAPP has built a degree of conservatism and caution into its assumptions. It is still relatively well funded, which also speaks to the overall sustainability of the Plan.

The LAPP is facing a temporary challenge. **It is misleading to use a 'moment in time' analysis as grounds for permanent and drastic cuts.** We see no evidence that the LAPP in its current form is unsustainable or unaffordable. The LAPP Board of Trustees has told the Minister the Plan is not in a crisis. The Minister himself has said the Plan is not in a crisis. The LAPP Board says the plan is sustainable as a defined benefit plan. A report by an independent actuary commissioned by the Coalition shows the Plan to be sustainable. Pension plans across the country are continuing to recover from 2008 and funding levels are improving across the country. This is not the time to walk away from the LAPP.

Even though the LAPP is sustainable in its current form, the Union Coalition is prepared to enter into properly constituted negotiations to strengthen the plan and address the concerns raised by government and employers. With this in mind, the Coalition is proposing a different package of adjustments that, if implemented, could significantly lower the cost of the Plan going forward, while at the same time maintaining benefit levels and protections for retirees. These adjustments, combined with adopting some of the best practices on plan governance from across the country (which are discussed in further detail later) will strengthen the Plan and ensure sustainability for generations to come.

The LAPP is Affordable

Currently, the LAPP has two main categories of costs: the ongoing cost of the Plan, and the cost of amortizing the existing Plan deficit. Both members and employers are contributing to each of these cost categories.

Members pay about 8%, and employers pay about 9% for the ongoing cost of the Plan. So the ongoing “cost” of the Plan is about 17% of payroll. These contribution rates are on par with rates in other large pension plans.

The amortization payments for the past deficit are being shared equally between employees and employers. Each side is temporarily paying about 3.7% of payroll for these payments in 2014.

Looking at these two costs together, it is clear that LAPP members are paying a significant portion of the cost of the Plan. This is not the case in many public sector plans, where employers are often obligated to pay — and are paying — much more than Plan members.

The bulk of the “cost” of the pension benefits that will eventually be paid, however, will be paid by returns on investments that accumulate over the years. It is typically estimated that plan returns pay 70-80% of the eventual pension benefits. The remaining modest costs are the costs being shared by members and employers.

The power of compounding investment returns is the main reason defined-benefit pension plans like the LAPP are so efficient. However, there are other efficiencies at work in a large plan like this. These plans spread risk and pool resources in the interests of workers. The effect of lower fees, addressed further in

the next section, is just one example of how defined-benefit plans provide the best retirement security for every dollar contributed.

The LAPP is affordable in its current form. The ongoing cost of the Plan — about 17% of payroll — is affordable and is around the bare minimum needed to provide a decent retirement income. Our actuaries estimate that the government's proposals would permanently cut the cost of the plan by between 2.5-4.5% of payroll. That means the amount of money going into the plan to fund new service would decline by up to a third. The value of the benefits earned by plan members would, as a matter of course, decline proportionately. These numbers are in line with estimates provided by the government.

LAPP members are already securing a decent and secure retirement for an affordable price. The government's cost-slashing proposal will erode benefits and inappropriately transfer risk to members.

The LAPP Benefits Plan Members

The LAPP allows members to contribute to a pension plan throughout their working lives that will provide a modest and secure income upon retirement.

Workers without defined-benefit pension plans individually bear the risk and cost of funding their retirement. All the available evidence suggests that this individualized approach to retirement security is not working for Canadians. Only one-quarter of Canadian tax-filers contribute to their RRSPs each year.¹ Personal savings rates are at all-time lows and household debt is at an all-time high. Study after study confirms that Canadians, particularly those without good defined-benefit plans, are not saving enough for retirement. Former Assistant Chief Statistician at Statistics Canada, Michael Wolfson, has shown that half of middle-income Canadian baby boomers will experience a sharp drop in living standards when they retire.² Economists at CIBC made similar findings, and also noted that this problem will only get worse with each coming generation.³ They found that nearly 60% of Canadians born in the late 1980s will fall short of decent retirement income savings targets. A retirement income crisis is developing for those without good defined-benefit pension plans like the LAPP.

LAPP members — particularly long-service members — will generally meet the goal of basic income adequacy and security in retirement. **The average pension currently being paid from the Plan is a modest \$14,500.** Longer service workers would accumulate larger pension entitlements. A 35-year career of work and pension contributions would leave workers close to the 70% of pre-retirement income that most financial planners set as a goal, when the LAPP is combined with the worker's CPP entitlement.

These workers also benefit from the other main advantage of a defined-benefit pension plan. They know what their monthly income will be, because it is a promise backed up by a legislated obligation to keep the plan well funded. This appropriately minimizes financial risk for retirees, who often have little or no ability to earn more income. Yet, they have fixed, and often mounting costs of living. It gives LAPP

¹ Statistics Canada, "Registered retirement savings plan contributions, 2011," *The Daily*, February 11, 2013.

² Michael C. Wolfson, "Projecting the Adequacy of Canadians' Retirement Incomes," IRPP Study No. 17, April 2011.

³ CIBC, "Canadians' Retirement Future: Mind the Gap," *In Focus*, February 20, 2013.

retirees security, knowing their next pension cheque will arrive on time and in a predictable and secure amount.

Because LAPP members pool their investment costs, they only pay around 0.3% of their assets in fees for management, governance and professional investment services. They benefit from a diverse portfolio of equities, bonds, real estate, infrastructure and private equity. Compare this to the cost of an individualized approach (Canadians pay the highest mutual fund fees in the world in their RRSP investments), which often costs 2.5% in fees for a much less sophisticated portfolio of investments. This differential creates a massive advantage for participants in large defined-benefit plans like the LAPP. With less money flowing to money managers, more pension contributions stay in the plan. Complex and sophisticated portfolios become very affordable. Over the decades, these savings deliver a significantly better retirement than what an individual is able to purchase, all other things being equal. A recent Conference Board of Canada study found that 40% of the advantage defined-benefit plans have over RRSPs came from the effect of these lower fees.⁴

The LAPP, however, is only partially indexed. Retirees see their pensions rise by only 60% of inflation each year. This means that the “real value” of a retiree’s pension declines by 40% of the rate of inflation every year. LAPP members are therefore carrying a significant burden of the “inflation risk” within the Plan. Over a long period of retirement, especially if inflation is high, this effect can dramatically reduce a retiree’s purchasing power.

The LAPP is a good pension, but it is far from “gold-plated.” It is a decent pension that allows retirees, particularly long-service retirees, to have a modest retirement income that is secure, adequate and predictable. These defined-benefit pension plans have been an integral part of a decent middle-class life for generations. The Alberta government’s attack on the LAPP, if successful, will make retirement riskier and costlier for workers. It will make a decent middle-class life much harder for them to sustain.

The LAPP Benefits the Province and the Economy

A good defined-benefit pension plan like the LAPP not only benefits its members — it helps to build a better and fairer economy for all Albertans. Government proposals are only focused on inputs — Plan costs. If the government wants a meaningful review of the LAPP, it must also examine the Plan’s outputs (pension benefits) and their broader effects.

Last year the LAPP made about \$735 million in pension payments to the Plan’s 50,000 retirees. This money is spent in Alberta businesses and communities. **These pensions help keep retirees out of poverty and help Alberta’s economy to grow.**

LAPP’s modest pensions (currently an average of \$14,500) allow retirees to live in dignified self-sufficiently. This lowers fiscal pressure on federal old age pensions for low-income Canadian seniors, and for similar provincial and municipal support programs. A recent study revealed that defined-benefit pensions reduce federal government means-tested Guaranteed Income Supplement costs by \$2-3 billion

⁴ Conference Board of Canada, “Economic Impact of British Columbia’s Public Sector Pension Plans,” October 2013.

per year.⁵ The province would spend much more than \$450 million on means-tested programs like the Alberta Seniors Benefit were it not for good defined-benefit plans like the LAPP. Higher incomes in retirement not only mean lower costs for government programs, they also mean retirees support the revenue side of government ledgers too. Retirees with defined-benefit pensions pay \$7-9 billion in federal and provincial taxes from their retirement incomes.

The LAPP contributes significantly to the economy of the province. The pension contributions made to the LAPP are invested by the plan's investment professionals at the Alberta Investment Management Corporation. This expanded level of investment increases the overall productive capacity and potential of Alberta's economy. A recent Conference Board of Canada study in British Columbia found that public sector pension plans alone will increase Canada's GDP by \$7 billion by 2035. These plans increased provincial employment in B.C. by nearly 8,000 jobs.⁶ Positive effects were also found in retail sales, housing starts, and corporate profits. The effects in Alberta would be largely similar.

It is misguided to view the LAPP solely through the lens of its costs. Pension contributions provide crucial investment capital to help the economy grow. Retirees spend their pension incomes which provide increased revenue for businesses and governments. Pension benefits also help seniors live independently, lowering fiscal pressure on social and income support programs. In our view, these important outcomes are well worth the affordable costs of the LAPP — shared by both workers and employers.

Conclusion

The government has presented the LAPP as an unsustainable problem that needs immediate drastic action. We strongly reject this analysis. The LAPP is a sustainable and affordable plan that has significant benefits not only to Plan members, but to the province as a whole. It would be misguided to dismantle the defined-benefit nature of the LAPP which has done much to build a strong, stable and fair economy for Alberta.

⁵ "Defined Benefit Pension Plans: Strengthening the Canadian Economy" Study conducted by The Boston Consulting Group (BCG) and commissioned by Healthcare of Ontario Pension Plan (HOOPP), Ontario Municipal Employees Retirement System (OMERS), OPSEU Pension Trust (OPTrust) and Ontario Teachers' Pension Plan (OTPP), 2013.

⁶ Conference Board of Canada, "Economic Impact of British Columbia's Public Sector Pension Plans," October 2013.

2. Government undermining of LAPP will have negative consequences

The proposals put forward by the Minister of Finance on Sept. 16, 2013 would, if implemented, result in a significant transfer of risk within the LAPP. Essentially, LAPP employers and the Government of Alberta would largely divest themselves of risk stemming from the performance and adverse experience of the Plan. These proposals are:

1. Elimination of the “85 factor,” (for service after 2015). This factor allows Plan participants to retire on an unreduced pension when their years of service and age add up to 85. For service after Dec. 31, 2015, the normal retirement age would be 65 years, and the pensions of those retiring before age 65 would be reduced by an early retirement penalty.
2. Increase the early retirement penalty from 3% per year to full actuarial cost.
3. Cost of Living Increases (COLA) for service after 2015 reduced from 60% of CPI to a target of 50%, conditional on Plan finances. The exact nature of the conditions hasn't been specified.
4. A cap on total contributions to the Plan, established by Government regulation, and capable of being modified unilaterally by government by means of an Order in Council.
5. Increase in the portion of the cost-share of the Plan carried by employees. Currently, employers pay slightly more than members. The government wants 50-50 cost sharing in the Plan going forward.
6. Immediate vesting: Benefits are vested immediately on entry into the Plan, rather than after two years, as at present.
7. Removal of 35-year service cap. Currently, Plan members stop making contributions and stop accruing benefits at age 65. The government proposals would remove this cap.

The latter two proposals are positive for Plan participants. Neither, however, will have a significant effect on the majority of LAPP members, or on the cost of the Plan itself. On the other hand, the reduction in benefits and the contribution cap markedly diminish the value of the LAPP. They fundamentally alter the nature of the Plan. The government's proposals significantly reduce Plan contributions and shift risks to Plan members.

The implications of these adjustments will now be explained in more detail.

ELIMINATING THE EARLY RETIREMENT BENEFIT

Government LAPP proposals approach early retirement without any reference to the useful labour force adjustments that early retirement provisions permit. Historically, early retirement benefits have saved employers money by moving older, more expensive workers into retirement, sometimes saving on severance costs as well. These benefits need to be considered, and weighed against the pension costs of early retirement. Cuts to the LAPP, like the elimination of early retirement provisions like the 85 factor, will be offset by other factors, such as the

likelihood that employers will be on the hook for increased long-term disability costs as more long-service workers in physically demanding jobs find that they simply can no longer do the work as they move into their 60s.

While the move to full actuarial cost for early retirement raises serious concerns, when taken in combination with the elimination of the 85 factor, it will have a serious negative impact on public sector workers in the LAPP.

Getting rid of the 85 factor, and substituting the normal retirement age of 65, will magnify the impact of a higher early retirement penalty. The government has tried to portray the 85 factor as a subsidy favoring those who retire early over those who work until normal retirement age. This pejorative framing of the issue provides a built-in rationale for eliminating this benefit. A more objective perspective sees the 85 factor as an option built into the LAPP. Plan members may or may not choose to exercise this option. It has real value to many LAPP participants, particularly for those who have had long careers in physically demanding jobs and experience difficulty working up to age of 65 or longer.

When illustrating the impact of eliminating the 85 factor, the Alberta Treasury Board and Finance website is careful to use examples that minimize the effects of this benefit change. All of the seven examples provided, feature hypothetical employees retiring on or before 2020. Which means this only shows the effects on Plan participants who have five or fewer years under the new benefit regime. This allows the government to downplay the effects of the proposed changes. **Newer or younger workers working most of their careers under the government’s proposed plan will see much larger impacts.**

What would be the effect on a more typical LAPP member? According to LAPP administration, the average active participant in the LAPP, as of Dec. 31, 2012, was 45.2 years of age, with 8.7 years of accrued pensionable service. Such an individual would, if they worked full time, reach her 85 factor in the middle of 2028 (at age 60.75 years), and under the current Plan design could retire with an unreduced pension based on 24.25 years of pensionable service.

Under the proposed revisions to the LAPP, however, this member would be retiring 4.25 years early, and that portion of her service after 2015 (about 12.5 years) would be subject to an early retirement penalty of 25.5% (4.25 years x 6%/yr). What would this mean in terms of their actual total pension?

Sample Pension Calculation

<i>Let’s assume that at the point of this member’s retirement, her highest five year’s average salary is \$65,000/yr and the average Year’s Maximum Pensionable Earnings for the same period is \$60,000/yr.</i>	
<i>Under the current LAPP design, the pension would be:</i>	<i>Under the proposed LAPP design, the pension would be:</i>
<i>1.4% x \$60,000/yr x 24.25 yrs pensionable service</i> <i>= \$20, 370</i>	<i>a) For Service before 2016:</i> <i>1.4/% x \$60,000/yr x 11.7yrs pensionable service</i>

	=	\$9,828
+	+	
<i>2% x (\$65,000 - \$60,000)/yr x 24.25 yrs pensionable service =</i>	<i>2% x (\$65,000 - \$60,000)/yr x 11.7yrs pensionable service =</i>	\$2,425 \$1,170
	<i>Total Pension for Pre-2016 Service =</i>	<u>\$10,998</u>
	<i>b) For service after 2016:</i>	
	<i>1.4% x \$60,000/yr x 12.55yrs =</i>	\$10,542
	+	
	<i>2% x (\$65,000 - \$60,000)/yr x 12.55 yrs =</i>	\$1,255
	<i>Total Pension for Post-2016 Service =</i>	<u>\$11,797</u>
	<i>Reduction for Early Retirement: 6% x 4.25 yrs = 25.5%</i>	
	<i>Final Reduced Pension for Post 2016 Service \$11,797 x 74.5% =</i>	\$8,789
Total Pension Current Benefit Structure	Total Pension Under Proposed Benefit Structure =	\$22,795/yr \$19,787

The Government's proposed benefit changes mean that an average LAPP member as of Dec. 31, 2012, working full time at the salary assumed above, who wants to retire when she reaches her 85 factor, would lose about \$3,000 (13%) of pension benefit each year of her retirement. Members earning higher salaries will lose even more.

The government says their proposed cuts to early retirement only apply to future service. This means that the full effect of the cuts will hit new hires and younger workers the hardest, as they have the most service to accrue under the reformed Plan.

Younger workers will see steep reductions in pension benefits if they choose to, or if they have to, retire before 65. If a new worker retires at the average retirement age of current LAPP members, they will see a cut of 20% in their annual pension benefit. A worker retiring at 60 would see a 30% reduction in their annual pension benefit, and a worker retiring at 55 would see a 60% reduction. These are massive cuts when compared to the benefits paid under the current Plan — benefits that workers have earned and paid for through their service and pension contributions.

Increasing Early Retirement Penalty

The details of this element of the government proposal are unclear. Historically, the Canada Pension Plan has reduced pension entitlements by 0.5% for each month of retirement before age 65. This 6% per

year penalty for early retirement has been widely accepted as actuarially appropriate. The proposal from the Alberta Treasury Board and Finance, however, does not specify a penalty, saying just that “pension will be actuarially reduced to reflect the true cost of paying the pension longer.” The “Example” included in the Sept. 16 handout uses a 6% per year early retirement penalty, as do all the examples provided on the Alberta Treasury Board and Finance (ATBF) “Public Sector Pension Plan Reform” web page. In the “Frequently Asked Questions” section of the same web page however, ATBF suggests that the reduction rate (penalty) will vary according to the age of the retiree.

MOVING TO CONDITIONAL 50% COLA

A cost-of-living increase or allowance (COLA) is necessary to ensure that pensions keep up with inflation. If they don’t, the “real value” of the pension declines each year as the price of goods and services increases.

The government’s COLA proposal is vaguely worded. It is not clear what exactly would trigger removing COLA in any given year. It is clear, however, that if the Plan’s investments performed poorly for five years, and annual inflation averaged 2.5% during that same period, a LAPP pensioner would see a compounded reduction of more than 12.5% in the real value of her post-2015 pension benefit. Under the present provision for 60% COLA, that reduction would be just 4.5%. If inflation is high, or if a member has a long retirement, the cumulative effects of insufficient COLAs can amount to a significant cut to the real value of a pension. These effects are often felt most towards the end of a pensioner’s life, an often costly and vulnerable time.

Even if the Plan does meet its financial goals, the reduction in COLA from 60% of inflation to 50% means the pensioner’s income will be lower in real terms than a pension earned under the current Plan design.

THE CAP ON CONTRIBUTIONS

The flow of contributions into a plan largely determines how adequate and secure the pension benefits within that plan can be. In a typical defined-benefit plan like the LAPP, the pension benefits are promised. Therefore, they must be backed up by the possibility that contributions could rise to compensate for adverse plan experience. Currently, members and employers are making “special payments” to balance the plan’s unfunded liability.

The government, however, has proposed a contribution rate cap — a hard ceiling for overall contribution rates. Permanent, government-controlled contribution rate caps are fundamentally at odds with the concept of a defined-benefit plan.

The Government’s proposed cap on contribution rates potentially represents the biggest change to the LAPP. It’s unfortunate, then, that the proposal is the least specified part of Finance’s proposals. It’s not clear what form the cap would take, or at what level it would be set. The Minister has indicated that this crucial plan element would be established by regulation, which means it could be changed by an Order in Council at the Government’s whim.

In trying to assess the impact of the cap, we can, however, make some reasonable assumptions and reach some tentative conclusions. Past discussions of acceptable contribution limits for employers within the LAPP have suggested that a total contribution rate (member and employer) of 25% of payroll may be a cap that the government is considering. This provides a reasonable starting point for an evaluation of the Government's proposal.

As of January 1, 2014, combined employer and employee contributions to the LAPP will be 24.16% of payroll. Our actuaries estimate that the government's cuts will reduce the cost of the LAPP by 2.5-4.5% - estimates that are in line with those already provided by the Alberta government. Unfortunately, we are aware of proposed changes to mortality tables and assumptions that are likely to be adopted by the LAPP within the next two years. These new assumptions will raise the cost of the Plan by something approaching 4% of payroll. The net result is that the LAPP will be hard up against a contributions cap of 25% at or about the time the new "reforms" take effect. Any adverse experience in Plan demographics or investment returns will therefore require further reductions in benefits, possibly even core benefits.

There is also the possibility government will set the cap lower, which could mean even more immediate and severe benefit cuts. As the cap will be ever-amendable by government, the Minister of Finance will retain effective control over the level and security of the benefits the LAPP is able to provide. LAPP members will be vulnerable to short-term political inclinations. Yet, what has made the LAPP a success is its long-term arrangement, with a disciplined savings structure operating over a long period of time to gradually accumulate the necessary resources to provide decent retirements. This basic strength is will be fundamentally compromised by the government proposals. They introduce uncertainty over future contribution levels and eliminate the possibility of increasing Plan contributions in the face of adverse experience or fluctuations in the rate of return on the Plan's assets.

The government proposal is internally contradictory in serious and problematic ways. **The government claims that earned or accrued benefits will be protected under this new model, but the restrictive funding mechanisms they propose raise serious questions about this claim.** The government continues to call their proposed LAPP a "defined-benefit" plan, despite it having none of the basic features of the secure, defined-benefit model: the possibility that contributions can increase and benefits that cannot be reduced.

Finally, it should be noted that, by removing from the sponsors the ability to control their own contribution rates, the proposed contribution cap makes the Government's offer of joint governance essentially meaningless.

CONCLUSION: THE LIKELY OUTCOMES OF THE GOVERNMENT'S PROPOSALS

The basic effect of the government's proposals on Plan members is that the pension benefits paid from the LAPP will be smaller and less secure. Members' pension benefits will be worth less. Members will

have to work longer, they will see their pensions decline further in real value each year in retirement and they will assume more risk in the Plan going forward.

The proposed changes will provide only transitory relief from the financial challenges facing the Plan. In particular, the contribution cap potentially limits the ability of the Plan to respond to any new challenges. In reality, the proposed “reforms” have a very real potential to make the LAPP’s financial position worse:

1. By eliminating early retirement benefits, the proposed changes would require younger Plan members to continue paying high contribution rates to pay for benefits that these younger members will never enjoy themselves.
2. Defined-benefit plans crucially depend on the confidence of employers and employees in the value of these plans. By advancing proposals that would sharply reduce the value of the LAPP, the Government will create incentives for both these groups to avoid entry to the Plan or, potentially, to exit the Plan.
3. By proposing benefit cuts, while leaving in place commuted value policies that reward those leaving the Plan early, the Government creates incentives for younger members of the Plan to leave the LAPP, taking their commuted value, and avoiding the cost of paying down the unfunded liabilities.
4. By limiting the ability of the sponsors to deal with adverse changes in the economic environment, the Government raises doubts as to the viability and sustainability of the Plan and its “defined” benefits.

In sum, the “reforms” proposed by the Government of Alberta provide perverse incentives for employees and employers to avoid participation in the LAPP. Far from being a useful recruitment and retention tool, the Pension Plan could become a deterrent to those thinking of employment in the public sector in Alberta. The Board of the LAPP views employer withdrawal as a significant risk to the Plan that must be addressed. When combined with the loss of Plan members through misguided government efforts to privatize social services, such as Alberta Health Laboratory Services, the future of the proposed Plan is increasingly risky.

Alberta Treasury Board and Finance has plainly said that the Plan faces serious challenges and has to be reformed to make it “sustainable.” **The proposed changes to the LAPP are misguided. They threaten to drive employees away from the Plan,** potentially accelerating the maturation of the Plan. The consequence could be that government turns the current challenges into existential threats — from policy proposal to self-fulfilling prophecy in one easy step.

3. Government must implement joint governance of the LAPP now

Pension plan governance describes who has the authority to make decisions about the plan: what contribution rates will be and what benefit levels will be.

Currently, the LAPP has a Board of Trustees that includes representatives of participating unions and employers, but the Board's power is limited. Decisions about major Plan changes that the Board recommends are ultimately controlled by the Minister of Finance — the sole legal trustee of the Plan.

LAPP differs significantly from most large public sector pension plans in Canada, where joint governance or Jointly Sponsored Pension Plan (JSPP) model is the norm. In a JSPP, workers, through their unions, and employers have equal representation on the decision-making boards of their pension plans. This makes sense. The sponsor parties pay for and benefit from the plan, and bear significant risk in the plan. Therefore, they should have the power to set the terms of that plan, as they see appropriate, through a balanced, democratic structure. In jointly-governed plans, the terms of the plan do not exist in government-controlled legislation (as is the case with the LAPP), but in a pension plan text, which is only amendable through the consent of a majority of the joint board.

Joint sponsorship and governance of the LAPP is a goal that all of our unions have been supporting for more than 20 years. If joint sponsorship were in place, the current debate about the future of LAPP would not be taking place. Government would not have the first and last say about changing Plan design and Plan benefits. That would rightly be the responsibility of the Plan sponsors — including Plan members represented by their unions and employers.

Canada's jointly sponsored plans are among the country's most successful pension plans. They have strong histories of investment returns, effective low-cost pension administration and funding levels. Though adversely affected by recent economic events, they remain relatively strong.

British Columbia's public-sector pension plans, for example, moved to joint sponsorship and survived the 2008 financial crisis with some minor increases in pension contributions and remain in good shape financially.

Joint sponsorship and joint governance have been mechanisms for governments to share the risks and costs of public sector pension arrangements with public sector employees. This sharing has worked in good times and bad. In recent years, public sector employees have stepped up and significantly increased their own contributions to many jointly sponsored pension plans.

At the same time, jointly sponsored and jointly administered plans have been an important attraction and retention tool in labour markets that are highly competitive. Employees considering broader public sector employment in health care, municipalities and education know about, value and trust the model of jointly sponsored arrangements to deliver decent though modest pensions upon which they can rely when they reach retirement age.

The Labour Coalition's Governance Vision

The Union Coalition supports adopting a jointly-sponsored governance model for the LAPP. The following principles are essential to this new model:

- A jointly sponsored pension plan, as is true for other pension plans, should be administered by a fiduciary board.
- The sponsors of a jointly sponsored plan, the parties that pay for it and are exposed to the risks of deficiencies and possibility of surpluses. They are the ones that should be responsible for plan design, have the capacity to manage the benefits they provide, and assume the costs and risks associated with them. The Plan Sponsors require an institutional arrangement within which they can exercise their responsibilities.
- The fiduciary board that administers the jointly sponsored plan, and the Sponsor Institution that sets the Plan's benefits and manages its costs and risks, must be two different entities. Each have clearly delineated duties and responsibilities.
- Governance mechanisms, both in regard to the fiduciary board and the Sponsors' institution, must be transparent and accountable.

These governance principles are consistent with the governance principles articulated by the LAPP Board itself. The Labour Coalition believes that these principles are sound, and are reflected in the governance arrangements of other successful plans across Canada.

Since the beginning of the Alberta Government's pension consultation process in the Fall of 2012 the Labour Coalition has held that *Reformed governance in line with public sector pension plans across the country is an essential part of any sustainability plan for the LAPP*

The Government's Narrow Vision for Governance

The government's *Vision for Public Sector Pension Reform* addresses the future of LAPP governance — but imposes far reaching restrictions. Essential decision making powers of Plan sponsors have been pre-empted in the government's proposal⁷ including the following:

- The Government will set out the sponsoring organizations, e.g. employers and unions, in the enabling legislation and how many seats each will have

⁷ <http://www.finance.alberta.ca/publications/pensions/sustainability/Public-Sector-Pension-Reform-Vision.pdf>

- The managed framework includes a legislated maximum or “cap” on contribution rates.
- The funding and benefits policy established by the sponsors must set out the sharing of costs between employees and employers and how benefits will be reduced when this cap is reached.
- The cap for each plan will be set, following further consultation and analysis. Two possible ways of setting the maximum are either a total percentage of payroll, or a multiple of current service costs (to take into account the need to fund any shortfalls as well as current service).
- Transitional provisions will be put in place so that the current unfunded liabilities can continue to be paid under their current schedules.
- **The Government will be able to modify the caps in the future, perhaps for unforeseen reasons**
- Enabling legislation will be tabled in the Legislative Assembly in Spring 2014 For the Public Service Pension Plan (PSPP), the LAPP, and the Special Forces Pension Plan (SFPP), **the legislation will give Government the ability to put Plan design changes in place by regulation without a recommendation from the respective Boards.** This will enable the Plan design changes to be effective Jan. 1, 2016.
- The legislation will name the employee and employer sponsors of each plan and empower them to come to an agreement to make their respective plan jointly sponsored.
- The legislation, as proposed, will place additional constraints on the sponsors:
 - For a transitional period of at least five years, trustees of the jointly sponsored plans will not be allowed to choose a provider other than AIMCo for investment management and APS for administration
 - Until Jan. 1, 2021, benefit improvements will not be permitted.
 - The trustee boards will be fiduciary rather than representative, and will consist of “experts.” (It is unclear how “expert” will be defined and if this criterion will be used to effectively limit union member representation on these boards.)
 - The funding of the Plan will be split 50-50 between employees and employers.
 - There will be a contribution rate cap for each plan that can be changed from time to time.

Government control of contribution levels — through the contribution cap would become a permanent feature of the Plan. Future sponsors could be faced with no other option than introducing benefit cuts. And future governments could potentially impose more restrictive contribution caps.

The Labour Coalition strongly opposes the government’s proposals. They would unnecessarily constrain and distort the functioning of the joint-sponsorship model. Sponsors would not be able to act responsibly and accountably under these conditions. Joint sponsorship is not meaningful where Government, quite exceptionally, maintains control over contribution levels and also keeps the power to act unilaterally in regard to the Plan.

Steps toward a secure future for the LAPP as a defined-benefit plan must implement joint governance to the standard that exists across the country. **Workers who contribute to the plan from their paycheques every month deserve a greater say over pension decisions than set out in the government’s proposals.** Reformed governance must be an essential part of any sustainability plan for LAPP.

Further negotiations of changes to the LAPP must include a process which addresses the limitations of the consultation, the unrealistic timelines and effective representation of sponsor groups.

We propose a timeframe for review and implementation of responsible joint governance that includes:

- Government support for the recognition of separately established councils — a Plan member council (represented by their Unions) and an employer council
- Creation of a table for equal numbers of representatives from the employer and Plan member councils to meet with representatives of the LAPP Board and Government to address the following:
 - Support the ongoing work of the LAPP Board
 - Review and evaluate any proposals for changes to the LAPP that may be under consideration
 - Establish the basis for independent joint trusteeship of the LAPP

Suspension of any legislative/regulatory changes to the LAPP for up to 24 months (from Dec. 31, 2013) to ensure the successful outcome of the above noted steps.

The Labour Coalition is willing to work with all stakeholders and the LAPP Board to develop an effective framework for negotiations on the future of LAPP.

4. The Union Coalition solution strengthens the LAPP and provides long-term stability

The Labour Coalition rejects both the content of the government's proposals and the unilateral decision-making process the government has adopted so far. Retirement security is too important an issue to be dictated by government bureaucrats and politicians. Plan members are principal stakeholders and need to play an active role in any reform process. The Union Coalition is prepared to work with government to implement an alternative, sustainable and less problematic solution.

The Labour Coalition Alternative would feature all of the following elements:

1. **A real and meaningful joint governance framework.**

Joint governance is the standard model in Canada's most successful public-sector pension plans. It is a model with a proven track record of success. The parties who pay for the Plan, and assume the risks of funding it, should be able to make the decisions about Plan design. Plan members and their representatives should not be expected to assume governance responsibilities without the basic tools to govern properly. This central principle, which we accept, was articulated by the Government of Alberta's own commissioned report, *"Establishing Effective Pension Governance Arrangements: A Report on the Local Authorities Pension Board's Proposal"* (the "Cortex Report"), in November 1999. However, the restrictive and narrow governance proposal currently advanced by the Alberta government is entirely incompatible with the principle articulated in the Cortex Report. As long as the LAPP is essentially controlled by government through a unilateral, regulated contribution cap and highly restrictive regulatory provisions, the principle of the Cortex Report remains ignored.

2. **A significant package of different, yet less damaging benefit adjustments.**

All parties agree that the LAPP faces no sustainability crisis, and is viable in its current form. The Labour Coalition however, is prepared to examine changes to the Plan that will reduce its costs now, and enhance its ongoing sustainability in the future. The Union Coalition has retained a third-party actuary who has costed a series of alternative benefit and Plan design adjustments that avoids targeting members in problematic ways. The alternative package would:

- a. **Maintain the current provisions for early retirement and indexing.** Plan members value these meaningful retirement provisions and they pay for them through their monthly contributions. They are attracted to work for, and remain employed in the public sector, despite systemically lower wages than are available in the private sector. These Plan provisions allow members to retire before they are unable to work and their pension income has some modest inflation protection. The Plan membership cannot accept that these elements of their compensation package — valued at approximately 2.5-4.5% of payroll — will simply be eliminated.

- b. **Change the commuted value on termination using the funding discount rate, not the solvency discount rate.** Currently when a Plan member withdraws his/her pension entitlement out of the Plan in the form of a commuted value, the solvency discount rate is used to calculate the value of the member's pension. Since solvency discount rates are driven by long-term interest rates, which are at historic lows, commuted values are currently inflated to very high levels. This has become very costly to the Plan. Other pension plans have been tightening their commuted value rules for this very reason,. In this context, and since the LAPP does not fund for solvency, we believe it would be prudent to use the higher funding discount rate rather than the solvency discount rate to calculate commuted values, for both past and future service. This will:
- result in lower, yet still fair, commuted values;
 - limit a significant liability to the Plan, and;
 - reduce the current service cost of the Plan up to 1% of payroll.
- c. **Adjust commuted value payouts by funding ratio.** Currently, when a member takes his/her pension as a commuted value, the full value of the pension is paid, even though the Plan is not fully funded. This member does not contribute to funding any deficiency left in the Plan at the time the member leaves the Plan, yet they still receive a fully funded commuted value. This is unfair and again represents a significant cost. We propose to adjust termination value payouts (for both past and future service) by the funding ratio, so that a member currently taking a termination value would receive 81% of the value of their commuted pension, as the plan is 81% funded. Again, this will:
- result in lower, yet still fair, termination values;
 - limit a significant liability to the Plan;
 - reduce the current service cost of the Plan up to 0.7% of payroll.
- d. **Re-amortize the LAPP deficit.** The current LAPP deficit is being balanced on a re-amortization schedule of 15 years. Given the Plan does not fund for solvency because its employers are large, stable, public-sector entities, and given the Plan's conservative actuarial assumptions, it would be prudent to move to a longer amortization schedule for the current deficit. Many other jurisdictions have extended amortization periods in the past. This still ensures the deficit would be amortized in a reasonable and safe amount of time, but would lower the annual cost. **Moving to a new amortization period of 20 years for the current deficit period and a "fresh start" on payments would reduce the annual special payment bill by 3.21% of payroll.** Even if the 15-year period is maintained and the current deficit is re-amortized over the next 15 years, the annual special payments would reduce by 2.1% of payroll.
- e. **The Coalition commits to further integrate the LAPP with CPP if the Alberta government supports and pressures the federal government for CPP expansion; if the Canada Pension Plan (CPP) is expanded; or, an equivalent universal Provincially-sponsored is established.**

Alberta is possibly one of only two provincial governments not supporting improvements to the Canada Pension Plan — improvements that could bring meaningful retirement security to the 11 million Canadians without workplace pension plans. The Alberta government could be much more supportive of CPP expansion and of pressuring the federal government to make the needed changes to CPP.

The LAPP has been “integrated” with CPP since 1966 — meaning as CPP grew, the benefits under the LAPP were reduced. This coordination has been based on the understanding that Plan members received the same amount of total pension under the two plans. If the CPP were expanded, the Coalition members would similarly agree to a further proportional integration of the LAPP, by reducing the accrual rate within the LAPP. This step alone could significantly improve the Plan’s sustainability, resulting in cost and liability savings for LAPP employers and government. This further integration could be structured to provide the same level of pension benefits for members, depending on the particular method under which CPP expansion happens.

The Coalition believes all Albertans and all Canadians are entitled to a decent pension. The Redford government should do everything possible to ensure that this outcome is realized. The mechanics and cost implications of further LAPP integration would of course depend on the particular timelines and structure of any future CPP expansion. Our calculations show that if the Canadian Labour Congress plan to double CPP benefits were followed, the accrual rate within the LAPP could eventually be adjusted from 1.4% below Yearly Maximum Pensionable Earnings (YMPE) to 0.8% below the YMPE. This would represent a significant reduction in the cost of the Plan. There would be a shifting of costs from LAPP contributions to CPP contributions, but because of the overall funding structures of these plans, there would be overall cost savings to employers. The reduction in the LAPP accrual rate would reduce the current service cost by 3.9% of payroll and past service cost by 4.4% of payroll when the new CPP benefit is fully implemented, for a total savings of 8.3% of payroll. Then the CPP contributions would rise by approximately 4.88%, for a net savings of 3.5% of payroll. However this small increase in cost would be balanced by a significant reduction in LAPP liabilities going forward.

- f. The Coalition supports the government’s position on immediate vesting. The government proposes that effective Jan. 1, 2016, benefits for active members will be vested immediately, rather than after two years of plan membership. The Coalition accepts this proposal.

These six changes would save a total of nearly 4% of payroll from the current annual cost of the Plan. This is well within the range of cost savings that the government’s changes produce. However, these changes ensure a high-level of cost savings and sustainability for a Plan that is already affordable and sustainable, without weakening crucial benefits of the Plan. The savings

come from closing costly loopholes, limiting liabilities and making changes in the interest of fairness to all Plan members. They also provide for a more significant reduction in future liabilities than the government's changes, along with ensuring retirement security for all Albertans. The analysis performed by a third-party actuary working on behalf of the Coalition is attached as Appendix B.

3. The continuation of the defined-benefit nature of the Plan.

All Plan members deserve security in retirement. That security is best provided by a defined-benefit plan. The government has proposed what they term a "target-benefit" plan which shifts most risks from employers to Plan members. We reject the notion of a government-controlled contribution rate cap, and the possible reducibility of accrued pension benefits.

Conclusion

The Union Coalition solution strengthens the LAPP and provides it with long-term stability. This alternative vision is much superior to the short-term thinking behind the Redford government's proposals which will only serve to weaken and destabilize the LAPP.

We would prefer to work with government on this more positive approach than be forced to accept the unilateral and damaging directions government so far has made.

Our solution would preserve an LAPP that we can afford and sustain. Our solution would ensure that LAPP members can retire with dignity. Our solution will ensure the Plan provides a decent retirement income with security for public service members who have worked and contributed significantly to the Plan during their careers.

Our solution is mindful of the larger pension crisis in Canada. It seeks a commitment from the Alberta government to support expansion of the Canada Pension Plan, helping to secure a better retirement for all Albertans and all Canadians.

The Coalition is taking a longer-term view and looking beyond the often misplaced and shallow fears about defined-benefit pension plans. Defined-benefit plans like the LAPP have proven themselves to be good for members and good for the province. The model has worked for 50 years, through good times and bad. We expect it to work for future generations as well. We owe a duty to those that follow us, to pass on to them the legacy and benefits we have received from the visionaries who built our pension system and entrusted it to our care.

Our proposals meet the needs of government while still meeting the modest and reasonable needs of Plan members not only now, but also into the future.

We repeat. We wish to work with government to implement a strong and stable LAPP and a broader vision for true pension reform.

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