

## RTAM Board Response to the Sale October 2007 Report

On November 30, 2007, Honourable Peter Bjornson, Minister of Education, Citizenship and Youth provided the Retired Teachers' Association of Manitoba (RTAM) with a copy of a report, prepared by Mr. Tim Sale, entitled Teachers Retirement Allowance Board COLA and Associated Issues (October 2007).

Minister Bjornson informed RTAM representatives that both the Government and The Manitoba Teachers' Society (MTS) support the report and expressed his hope for RTAM support, adding that he is uncomfortable moving forward without RTAM's written endorsement. In response to the Minister's request, RTAM is submitting this report as its response to the Sale Report, in addition to a letter dated January 30, 2008 sent to him.

Mr. Sale has stated that the report recommendations "*should be seen as a package*". The RTAM Board, through its Pension Committee, has thoroughly reviewed, as a "package", the Sale report and its recommendations, including consulting with a number of professional advisors. **On the basis of this review, RTAM cannot provide endorsement of the "package" of recommendations, because they do not sufficiently address RTAM's concerns and fundamental objectives regarding the long-standing and complex COLA problem.** We believe that a fair COLA resolution for retired teachers means a long-term fix now and must include measures for significant funding. The funding recommendations are simply too minimalist in approach and too narrow in scope.

RTAM comments in response to the Sale report (herein after the report) and its recommendations, section by section, follows.

### **RTAM Comments on Mandate**

In describing the execution of the mandate, the report concludes that "*the advice and recommendations which follow at the end of this report will strengthen the future capacity of the PAA*". While the recommendation to enhance the funding of the PAA is a helpful piece, it is only one means of modest funding which may result in only modest improvements in COLA payments for retirees. **More significant lump sum funding and/or a long-term funding plan to fix the COLA problem now are needed.**

In the execution of the mandate, the report also concludes that the recommendations recognize "*the priority of fully funding Account A - - -*". The report does not explain this statement, but the omission of an explanation is significant in what it fails to explain.

While RTAM understands the importance of funding the basic benefit, RTAM believes that both issues facing the Plan - 1. the new entrant contribution shortfall and 2. the COLA problem – should be priorities.

However, RTAM takes strong exception to the statement and believes that it is unfair to retired teachers for two reasons (a and b):

a) With respect to the priority of funding Account A, the report makes no recommendation for a contribution increase. It makes no specific mention of the contribution shortfall of current actives, but especially of new entrants, that needs to be addressed by a contribution increase, as it has been demonstrated by TRAF's actuary that their contributions are insufficient to support their future final pension cost. The failure to make a recommendation for a contribution increase makes the recommendations regarding funding in this "package" too narrow in scope.

The contribution shortfall is currently being subsidized by Account A surplus. This surplus is attributable in part, perhaps 50% or more, to the past contributions of retired teachers and the fund earnings on those contributions. This subsidy effectively means that retired teachers are helping to subsidize this shortfall and draws down the potential surplus that could be available to help resolve the COLA problem for current retirees. This situation is unfair to retired teachers.

b) Taking into account MTS proposals and discussions at the Pension Task Force meetings, the statement recognizing the priority of the basic benefit means that there shall be no use of Account A and/or surplus to fund the PAA. It explicitly supports the position of MTS in this regard – protection of the basic benefit and concomitant positions prohibiting the use of Account A and/or surplus for transfer to the PAA to help solve the COLA problem. RTAM profoundly disagrees with this MTS position and believes the report exhibits a bias towards the position and efforts of MTS (as well as minimizing the Government's matching cost).

In contrast, the report does not recognize RTAM's priority concern that more significant long-term funding solutions be considered. At the Pension Task Force meetings, Mr. Sale was dismissive of the statements by RTAM of its objectives, principles and arguments regarding a long-term resolution of the COLA problem, and flatly turned down any suggestion by RTAM of significant funding measures, specifically the use of surplus and special payments by the Province, as have occurred in other provinces.

TRAF's Actuarial Valuation Report indicates an actuarial surplus for accrued service. The past contributions of retired teachers and earnings on those contributions comprise roughly half of the assets and have contributed to this surplus. In fact, our actuary has indicated to us that retired teachers comprise

50% of the accrued liabilities of the Plan. There are surplus funds in Account A currently and RTAM has legitimate grounds to claim retired teachers have the right to access the use of at least their proportionate share of the surplus funds to help solve the COLA problems of current retirees.

Finally, RTAM appreciates having been included in the discussions at the Pension Task Force. However, the report, in referring to the “parties” and to “consensus” and “agreement”, uses these terms inconsistently. Sometimes it refers to the Government and MTS and sometimes it refers to the Government, MTS and RTAM.

At the Pension Task Force, RTAM indicated support for one item under discussion – *a change in the method of crediting interest to the PAA / the “better of” method* – but, in stating that the change was a helpful piece to enhance funding, made it clear that this statement should not be seen as an affirmation of the minimalist and piecemeal approach to funding that was apparent at the meetings. RTAM notes that some of the recommendations and modelling were not part of the Pension Task Force discussions.

## **RTAM Comments on Background**

This section of the report addresses several topics which require a response from RTAM.

### **A. Premises**

The description and analysis of factors causing difficulties with the PAA are used to develop a set of premises, stated or implied, that in turn become an argument for the report’s recommendation of a maximum 2/3rds CPI COLA.

These premises are:

- that the PAA was designed to pay 2/3rds COLA;
- that the actuary had stated cautions regarding PAA funding design of a 2/3rds COLA to 9%;
- that the TRAF Board, by paying out more than 2/3rds COLA, paid out too much;
- that the responsibility for the problem lies with the TRAF Board.

RTAM does not agree that the original design was to pay a 2/3rds CPI COLA. RTAM's understanding of historical fact is different from that of the report. We do not concur with the report's interpretation of the boxed statement by the TRAF Board actuaries of the time in Appendix 1.

In a September, 1977 article entitled "Pension Talk Bill 52" Mr. George Strang, former MTS staff officer, explaining the establishment of the PAA and COLA provisions, stated:

*The present level of contribution is expected to offset the full increase in the cost of living adjustment provided the cost of living does not increase more than five to six per cent per year.*

The report **omits any acknowledgement of the Teachers' Pension Act**, in which Sections 10(7) and 10(8) define a 100% Consumer Price Index (CPI) COLA, and also specify an actuarial reduction should such a COLA adjustment result in an unfunded liability in the PAA.

Further, in the late 1980s the COLA provisions in the Civil Service Super-annuation Act were amended to provide for a "*maximum annual adjustment to two-thirds of the increase in Consumer Price Index (Canada) until the Indexing Benefits Account can pre fund anticipated adjustments for the next twenty years*"

(CSSB 2006 Annual Report), *when the original COLA provisions in the Teachers' Pension Act were not amended in the same way.*

The TRAF Board is an administrative board charged with administering the Teachers' Pension Act. It is required to follow the Act and has no authority to make changes to the provisions of the Act. It had no power as an administrative board to change the COLA pay-out defined in the Act.

It is RTAM's understanding that the warnings of the TRAF Board actuary were advising that the PAA funding levels were not sufficient to finance COLAs in the future to the extent that they had been in the past should inflation levels rise to the high levels experienced in the late seventies and early eighties. (Inflation had abated since 1984 allowing for improved COLA grants.)

RTAM notes that the TRAF Board had assured that these warnings were highlighted in the Comments and Recommendations of the TRAF Actuarial Report as at January 1<sup>st</sup>, 1987. These warnings continued to be highlighted in subsequent Turnbull triennial Actuarial Valuation Reports. Such warnings were meant to inform the relevant decision-making parties, the Government and MTS, of this developing problem. The report shows a lack of understanding of the role of the TRAF Board as the administrator of the Act and the constraints upon the Board for any action not specified in the Act, as compared with the authority and the responsibility of the Government working in conjunction with MTS. The responsibility for dealing with these actuarial warnings was that of the Government and MTS. For twenty years nothing was done.

The report Appendix 1 and 2 makes selective reference to the actuary's PAA Reports and correspondence with the TRAF Board of the time, through the Acting Chairperson, Ms. Anne Monk. We do not agree with the report's interpretation of the objectives of the Board in writing the letter. It omits Mr.

Turnbull's response in writing in which he concurred that his statements did not reflect actual legislation or the agreement between the Government and MTS. There is no evidence provided in this report for the implied linking of Appendix 1 and 2 with the change of actuary.

## **B. Demographics**

One omission in the report's analysis of the factors causing difficulties with the PAA is the demographic change that has occurred. The ratio of retirees to actives is much higher today than thirty years ago. Therefore, the COLA contributions by the active teachers are today insufficient to support COLA payments to a much greater number of retirees. This is not the fault of the actives nor the retirees, as clearly this Plan flaw was not dealt with by those who had the responsibility – the Government and MTS. The current generations of retirees are being unfairly penalized. If the ratio was the same as thirty years ago, we don't believe there would be this COLA problem.

## **C. RTAM Positions and Statements**

### 1. RTAM seeking of 100% COLA

The report's assertion that RTAM's position is 100% COLA is wrong. No such position was taken by RTAM at the Pension Task Force or in any of its supporting materials. We have consistently stated our position is that we are prepared to discuss a reduction in COLA benefits when there are serious and meaningful discussions on long-term funding solutions and/or a long-term funding plan.

### 2. Retired Teachers have underpaid

Our actuary advises us that the comment that we have underpaid for a COLA ignores the fact there is a surplus on an accrued liability basis.

## **D. Incremental Solutions**

RTAM never indicated any support for incremental improvement to the PAA funding problem. We see this as ignoring the needs of current retirees.

### **RTAM Comments on Options for Addressing COLA Issues.**

The report identifies three types of options for improving the capacity of the PAA. RTAM cannot agree that options to improve the funding of the PAA are limited to only three.

The report has indicated that a *“wide variety of measures have been employed”* in other jurisdictions which have faced COLA problems. RTAM has been unable to get any attention paid to alternative ideas, many of which have been used in other provinces, it has suggested as options in meetings with both the MTS and the Government and at the Pension Task Force. Other provinces have been able to deal with pension issues by agreeing on significant long-term funding solutions and/or a substantive plan, while Manitoba has been unable to.

#### *Option 1: Increasing active members' contributions to the PAA.*

This measure has been a solution in other provinces and is one option among many that could be considered in the future as a long-term solution to the COLA problem.

#### *Option 2: Changing the nature of the benefit.*

RTAM regards changing the COLA benefit as a benefit reduction.

Our comments regarding this matter are dealt with in our response to recommendation #3.

The report strongly recommends that the parties should consider delay of age entitlement for COLA - what effectively would be a two-tier plan. This should be

considered only as a last resort should no long-term funding solution be achieved for retired teachers.

*Option 3: Changing the investment rules for the PAA*

RTAM comments on alternative (c), agreement among the parties as to alternative (c), and the conditions attached to alternative (c) are dealt with in our responses to recommendation #5.

## **RTAM Response to the Sale Report Recommendations**

### **#1**

*Recommendation: all future benefits must be actuarially sound*

RTAM is in full agreement that the basic benefit account and the PAA/COLA account must be properly funded. However, RTAM takes strong exception if this recommendation means no use of current and future surplus to finance improvements in COLA now and in the future.

The current system dealing with changes to the Plan has proved to be dysfunctional. The responsibility, under the Teachers' Pension Act, lies not with the TRAF Board, which is an administrative board, but with the sponsors, the Government and the Manitoba Teachers' Society who are responsible through an ad hoc process of the Pension Task Force.

RTAM would agree that mechanisms must be established to more effectively deal with necessary changes. However, the report makes no recommendation regarding such. RTAM, which has no status in the Teachers' Pension Act, believes that it is important that it be included in any future discussions that occur as a result of this recommendation.

**#2**

*Recommendation: Current contribution level may not be sufficient to sustain the basic benefit*

By postponing a decision regarding a contribution increase to address the new entrants' contribution shortfall (and that of actives') until after the next TRAF Actuarial Valuation, the subsidization of this shortfall by Account A surplus, which has occurred for a number of years, continues. RTAM notes that in Pension Task Force discussions there was studious avoidance of mention of the problem of the new entrants' contribution shortfall.

RTAM takes strong exception to the continued use of surplus for said subsidy. RTAM also takes strong exception to the position of MTS, and now apparently the Government, that allows for the use of surplus for the purpose of subsidizing the active cohort contribution shortfall, while refusing to allow for the use of surplus to address the COLA problem for the retiree cohort.

This situation results in an imbalanced and unfair treatment of retired teachers and is an issue that must be addressed by the Province, effectively the ultimate sponsor of the Plan.

**#3**

*Recommendation: A maximum 2/3rds CPI COLA cap and an inflation ceiling cap of 8%*

RTAM regards the recommendation for the COLA benefit to be capped at a maximum 2/3rds CPI COLA and an inflation ceiling of 8% CPI as a benefit reduction. **RTAM cannot support these recommendations.**

RTAM has consistently and frequently stated, to both representatives of the Government and MTS, that it understands that, in today's circumstances, a 100% COLA may not be possible, and that it is prepared to discuss a reduction in the COLA benefit when serious and meaningful discussions occur on long-term funding solutions. RTAM saw no serious or meaningful discussions about long-term funding for the COLA problem on the part of either MTS or the Government at the Pension Task Force meetings. RTAM's position in representing its members is responsible, reasonable and prudent. Our actuary has supported us in the rationality of our approach.

Again, the report's assertion that RTAM's position is 100% COLA is wrong. No such position was taken by RTAM at the Pension Task Force or in any of its supporting materials. It misrepresents RTAM's positions and comments on COLA objectives and appears to us as an attempt to paint RTAM in an unfavourable light not only by stating that we are unrealistic but also implying we are unreasonable, thereby eroding our credibility.

**a) Regarding a maximum 2/3rds COLA**

Again the report posits its premise that the PAA was designed to pay 2/3rds COLA and again ignores the provisions of the Teachers' Pension Act, that has the formula which determines how much COLA is to be paid annually.

It also describes this recommendation as one that "will largely mirror" the Civil Service Superannuation Plan (CSSP). That Plan does have a provision for a maximum 2/3rds CPI COLA, a COLA cap which has been legislated in the CSSP since the late 1980s when no such legislative amendment has ever been made to the TRAF Plan. However, the CSSP has no inflation ceiling cap and there are other provisions that are not comparable.

It has been a long-standing principle of RTAM that a TRAF COLA benefit comparable with that of the CSSP is unfair to retired teachers. It is unfair because teachers historically made different arrangements than civil servants:

- a) teachers have **paid a higher** contribution rate and a higher percentage of their total contributions to their indexing account (now 16.7% vs. 10.2%). Teachers have paid 60% more than civil servants for inflation protection.
- b) teachers **gave up** disability benefits in their pension plan while civil servants retained them.

Additionally, teachers are a different demographic group than the civil servants and it is not necessarily appropriate that they be treated in the same manner.

This recommendation is supportive of the MTS position and a long-standing government position. From RTAM's perspective, no consensus was reached on such COLA target during Pension Task Force meetings. We believe that it must have been concluded in discussions that occurred outside the Pension Task Force meetings.

#### **b) Regarding Inflation Ceiling Cap**

The recommended inflation ceiling cap of 8% CPI is inconsistent with the 9% cap indicated in the exhibit in Appendix 1 that the report used to support the funding design premise.

Our actuary informs us that this recommendation is meaningless, as there is not sufficient funding for a COLA payment to a 2/3rds of 8% CPI (5.33%) COLA inflation ceiling cap.

**Note: Comments on #4 are included with #6**

**#5**

*Recommendation: Changing the method of crediting interest to the PAA to the "better of" method*

RTAM can support a change in the interest crediting method for the PAA to a method of crediting the "better of" fixed income returns or total fund returns. RTAM can also support a three-year moving average backdated to 2005. RTAM is appreciative that the report supports RTAM's suggestion for the "better of" method. MTS was initially strongly opposed to this suggestion.

In indicating support for this change, RTAM has stated that this is a modestly helpful piece in enhancing the funding of the PAA that may result in modest improvements in COLA. Unfortunately, from RTAM's perspective, Pension Task Force deliberations focused on this one means as a measure to enhance funding of the PAA. In the absence of more significant funding, RTAM regards this as a minimalist and piecemeal approach that is simply tinkering. It is insufficient to address this long-standing and complex problem. More significant funding measures now are needed to address the COLA problem of current retirees.

Our professional advisors counsel us that the achievement of a 2/3rds CPI COLA pay-out resulting from a change to the "better of" method is very uncertain and that the pay-out will be variable from year to year.

Actuarial analysis indicates that the "better of" method will result in an expected additional 0.5% COLA increase on average annually over the current estimated projection for future COLAs of 0.8% - i.e., a 1.3% COLA in relation to the assumed inflation rate of 2.5%.

The "better of" method will only effectively result in a COLA increase on average annually of approximately \$8.00 per month pre-tax on a \$20,000 base pension

and of \$12.50 per month pre-tax on a \$30,000 base pension, over the current COLA projected increase of 0.8%.

Our professional advisors made clear that the estimated additional 0.5% COLA **is not guaranteed**. Compared to the current fixed income method, the “better of” returns method may be better, resulting in higher additional COLAs, or they may be worse, resulting in lower additional COLAs. The “better of” returns may not produce much higher returns than the fixed income method, resulting in COLAs that may be approximately the same as the current projected 0.8% COLA.

We are advised that prognostications of a 2/3rds COLA are speculative. Our professional advisors advise us that a 2/3rds COLA is **dependent on low inflation** and very **dependent on consistently high investment returns**. **The average TRAF historical returns cannot be used as accurate predictors of future returns.**

As a result of such advice, we are skeptical of the report's predictions of a 2/3rds COLA in 2008. Already, in the proposed first year of the agreement, TRAF's total fund investment returns fall short of the Fund's historical average of 10%. They fall short of the verbal assertions of Mr. Sale to the RTAM Board regarding TRAF's high returns the past 3 to 4 years of 12% to 15% and TRAF's historical average, which implied the continuation of such high returns in order to convince us to 'take the deal'.

RTAM believes that it would be **imprudent** to put reliance on expectations of rates of return equal to or higher than the TRAF historical returns in its assessment of the achievability of a 2/3rds COLA.

RTAM does not accept that agreement on the recommendation for the “better of” method proposal “*is conditional on agreement that for ten years, COLAs be limited to no more than 2/3<sup>ds</sup> CPI ...*” (p.7). No discussion of a tie-in occurred at the Pension Task Force meetings.

Teachers have paid for inflation protection. Account A has had the benefit of the higher equity returns earned on the PAA assets especially in recent years, as the PAA is credited with fixed income returns. Retired teachers, on whose PAA contributions these equity returns have been earned, have been denied the benefit of these higher returns.

In fact, the report specifies that the proposed change involves a “ten-year catch-up” – i.e., the “better of” method is a bridging measure to adjust for the fact that the PAA assets have been under-credited, especially in recent years.

Now, when the only means of funding recommended – the “better of” proposal - to improve the funding of the PAA in the near term is using earnings on past contributions retired teachers have made and is an apparent catch-up measure, we are told we can only get this modest funding measure if we agree to a COLA benefit reduction. **This tie-in hardly seems to meet the test of fair and equitable treatment of retired teachers.**

#### **#4 and #6**

*Recommendation: The creation of a reserve account through excess interest*

RTAM is of the view that the funding inadequacy of the PAA itself should be addressed.

With respect to the concept of a reserve account, our professional advisors have indicated to us that, as a 2/3rds COLA may not be achieved every year, in those

years there will be no excess interest for a reserve account. They also caution that there will not likely be sufficient funding at the end of the ten-year period to finance a 2/3rds COLA.

RTAM takes strong exception to this recommendation as it is detrimental to the current generations of retired teachers. Having paid for inflation protection, and having experienced twenty years of inaction and nine years of resulting inadequate COLAs, they will be capped at a 2/3rds COLA in a given year when the "better of" method results in interest that supports a higher than 2/3rds COLA. The current retirees will have to wait ten years for any benefit from this proposal. Many of our older retirees retort that they will be dead.

RTAM would note that the ballpark estimated figures, for the amount of funding required to pay for a 2/3rds COLA, are what is needed to cover the costs related to the additional COLA benefits over the current projected COLAs for existing retirees, actives, deferreds and new teachers who will join the Plan in future years. The ballpark costs for the liabilities for the future COLA benefits of current retirees are **significantly less**.

### **#3, #5, and #6: Additional Comments**

*Recommendation: A ten-year duration for each of these four proposals*

This time period allowing for essentially bridging measures for enhancing funding of the PAA does not provide for sufficient funding for a long-term fix for the COLA problem for retired teachers. There are neither guarantees as to the funding capacity of the PAA at the end of the ten year duration, nor any guarantee regarding a plan for further funding.

Further, it is of concern that an agreement to this "package" of recommendations may mean **no opportunity** for further long-term funding to address the

COLA problem during this ten year period.

**#7**

*Recommendation: Creating a PAA in the Provincial share of the Fund*

RTAM notes that this recommendation has no effect on TRAF's share in funding of the PAA nor TRAF's 50% share of COLA payments.

However, RTAM would note that Government officials, at the time of their announcement regarding the government's borrowing of \$1.5 billion to deal with its share of the unfunded liability for TRAF, made statements to the effect that these funds would provide a better financial context for dealing with pension matters. RTAM will be closely monitoring what transpires in this respect.

**#8**

*Recommendation: Allowing more changes to the Plan by regulation*

RTAM will reserve judgment on this recommendation until it has an understanding of what items may be included in the regulations. It is important for RTAM to be included in any discussions regarding changes that might occur as a result of this recommendation.

**Additional Comments on Issues Related to RTAM's Objectives**

**A. Verbal Comments Made to RTAM**

Mr. Sale has stated verbally to RTAM that it has taken a long time for the COLA problem to develop and that it will take a long time to climb out of the "valley". He has also stated to RTAM that his recommended measures to fund the PAA should be seen as a first step and that RTAM could continue to work for further long-term funding.

A first step implies that further steps are necessary, the logic of which implies a plan. Yet the report makes neither such "advice" statements nor recommendations regarding the need for further long-term funding steps and/or a plan for such.

It is of concern to RTAM that, in the absence of any such recommendations or written memorandum of agreement that constitutes a commitment, there is no guarantee there will be any commitment to further steps for long-term funding. Moreover, the report limits the PAA funding recommendations to a ten-year duration. It is of concern to RTAM that this provision shuts the door for any further discussion on long-term funding solutions for another ten years. In the absence of recommendations and written commitment regarding funding and in light of the history of inaction on this COLA problem, it would be imprudent to accept these implied promises without written commitment.

## **B. Long-Term Funding**

RTAM proposes the following:

1. That, for fairness and equity for retired teachers now:

*The "better of" proposal for crediting interest to the PAA (with a three-year moving average backdated to 2005), without conditions attached,*

*should be implemented immediately through a legislative change to the Teachers' Pension Act.*

2. That a commitment be made, in the form of a memorandum of agreement (as has occurred in other provinces), to continue Pension Task Force discussions with a commitment to have serious and meaningful discussions on long-term funding solutions and/or a plan for long-term funding.

In this regard, RTAM notes the following positions regarding long-term funding solutions and/or a plan for long-term funding (including but not limited to):

- Lump sum transfer(s) to the PAA
- The use of Account A for the PAA
- The use of surplus for the PAA, at minimum that which is attributable to the liabilities associated with retirees.
- Acknowledgement that special payments may be needed
- A contribution increase to address the new entrants' contribution shortfall
- As previously stated, when significant long-term funding solutions and/or a substantive plan for long-term funding are known, RTAM is willing to discuss a reduction in the COLA benefits to one of less than a 100% COLA

RTAM notes it has previously presented, to both MTS and the Government, its suggestions for long-term funding options in a document entitled "*RTAM Long Term Solutions for Addressing the COLA Issue*".

**Conclusion**

RTAM remains committed to working on behalf of its members by continuing to seek long-term funding solutions for a fair resolution of the COLA problem for retired teachers. RTAM is appreciative that it has been included in recent discussions at the Pension Task Force and looks forward to continued discussions regarding a resolution to the long-standing COLA problem.

We would like to thank those who have been helpful to us in this process – our actuary at Eckler Partners and various TRAF professionals.

Once you have completed your review of our response, we would be pleased to meet with you to discuss our response in more detail.

Prepared by:  
RTAM Pension Committee  
Chairperson, Anne Monk  
January 22, 2008.

Approved by:  
RTAM Board  
January 24, 2008