



## **PENSION PLAN INFORMATION FOR PRESIDENTS' COUNCIL**

### **Introduction**

Last fall, FPSE requested information from the College Pension Plan concerning the Inflation Adjustment Account. Presidents' Council has studied and reviewed the information in the context of the 2007 round of bargaining. As a consequence of bargaining, FPSE has successfully arranged for a meeting of the Pension Plan partners for the purpose of discussing inflation protection.

The purpose of this document is to provide Presidents with sufficient background information about the structure of the College Pension Plan, the scenarios of interest to Presidents' Council and the context in which those scenarios would operate. The document also attempts to clarify the effects and implications of the various options that face FPSE.

### **I. PLAN BASICS**

The College Pension Plan is one of the strongest plans in the public sector. The plan is jointly run by the government, the employers, and the unions involved in the college sector. The College Pension Plan is a Defined Benefit Plan. The Plan is a joint trust arrangement.

The four Plan Partners are:

- the Government of British Columbia
- PSEA
- FPSE
- BCGEU

The plan is still relatively young with about three active members for every retired member. However, that ratio is quickly changing. The plan expects a large number of retirements over the next several years, along with little growth in the number of active members. Those demographic trends pose some challenges for the pension plan in the years ahead.

### **How do pension contributions work?**

Currently, contributions to the Pension Plan are shared equally by the employer and the employees. There is one contribution rate for all salary earned below the YMPE (Year's Maximum Pensionable Earnings) and a slightly higher contribution rate for salary that exceeds the YMPE.

The YMPE is \$43,700 for 2007.

The contributions rates are described in the table below:

	<b>Employee Contribution</b>	<b>Employer Contribution</b>	<b>Total Combined Contributions</b>
<b>Basic Account</b>	6.86% up to YMPE	6.86% up to YMPE	<b>13.72%</b>
	7.61% beyond YMPE	7.61% beyond YMPE	<b>15.22%</b>
<b>Inflation Adjustment Account</b>	1.09%	1.09%	<b>2.18%</b>
<b>Total</b>	7.95% up to YMPE	7.95% up to YMPE	<b>15.90%</b>
	8.7% beyond YMPE	8.7% beyond YMPE	<b>17.40%</b>

The table above can be confusing. However, the important number to remember is 17.40%. This represents the total employer and employee contributions to the pension fund including the Basic Account and the Inflation Adjustment Account (IAA) for all monies earned over the YMPE. For the sake of simplicity, 17.40% will be used as the total current contribution rate.

The 17.40% contribution is divided as follows: 15.22% is placed into the Basic Account; the remaining 2.18% is placed into the Inflation Adjustment Account. Out of that 2.18%, up to 1% is sent to the Supplemental Benefits Account.

#### **Basic Account:**

The Basic Account is the account that provides retirees with their basic pension. The basic pension is guaranteed. Currently, the market value of the basic pension account is about \$2 billion.

#### **Inflation Adjustment Account:**

The IAA is the account that provides the funds to index pensions for inflation. The IAA is funded using 1.09% contributions each from the employees and the employers. Furthermore, if investment returns are above what is expected, then some of that extra return is moved to the IAA. There has been no transfer of this kind into the IAA for the last several years. Currently, the market value of the IAA is about \$290 million.

Each year, the Pension Board decides what percentage increase should be applied to pensions because of inflation. An actuarially determined amount of money is transferred from the IAA to the Basic Account to provide the indexing increase for the current year as well as all future years. Once the transfer of funds has been made, the new indexed pension amount becomes the guaranteed pension amount. In other words, if indexing were to stop tomorrow, current retirees would not lose the indexing they have received so far.

Unlike the basic pension, inflation adjustment is not guaranteed. Whether indexing is provided in any given year, and to what extent, is dependent on the funds available in the IAA.

**Supplemental Benefits Account:**

A portion of the 1.09% employer contribution to the IAA is diverted from the IAA to the Supplemental Benefit Account. Currently that portion is 1%. This account pays the premium subsidies for the extended health and dental benefits offered by the Plan to retirees. There is no guarantee of either the level of benefit coverage or the premium subsidy.

Currently, the College Pension Plan subsidizes the full cost of premiums for retirees and their dependents if the retiree has more than ten years of service in the plan. Retirees with less than ten years service receive a pro-rated subsidy.

Tax rules require health and welfare benefits for retirees to be paid using only employer contributions. Currently, the total cost of the health benefits cannot exceed 1% of the employer's contribution to IAA. If they do, the cost of the benefits must somehow be reduced.

Unlike the Basic Account and the IAA, the Supplemental Benefits Account is not a "fund". Instead, the account is set up on a pay-as-you-go basis. Sufficient funds are diverted from the employer's contributions to the IAA to pay for the actual cost of covered benefit premiums.

The portion of the employer's IAA contribution that is spent on providing extended health and dental coverage reduces what is available to the IAA. Funds cannot be transferred from the Basic Account or the IAA to the Supplemental Benefits Account.

**Some facts about the near future****Plan valuation**

The College Pension Plan will undergo a valuation this year. A valuation is essentially an actuarial analysis of the Pension Plan's financial health. The valuation will determine whether the Plan is in a surplus or deficit position, and will recommend appropriate contribution rates. Currently, there is an expectation that the valuation will result in a deficit that will cause a small increase in the contribution rate. The rate increase would affect the contribution to the Basic Account only. The valuation will also examine the IAA and may result in modifications to current IAA modelling and predictions.

**Extended health and dental benefits**

Barring any significant changes, health and dental benefits costs are expected to hit the 1% ceiling in 2009. This means that health and welfare benefits will actually cost the full 1% to provide to pensioners (currently, it costs approximately 0.7%) At that point, the Pension Board will have to reduce the cost of benefits by either reducing the coverage that is available through the benefit plans or transferring more of the premium cost to retirees and their dependents by reducing the premium subsidies.

**Inflation protection**

On the inflation protection front, current modelling predicts that the IAA can provide full indexing of pensions until 2022 (about 15 more years). At that point, the IAA will be able to provide partial or minimal indexing only.

The IAA Model is included as an attachment to this document. The model shows the effect of changing certain assumptions. The current funding policy could cause the Board to fund less than full inflation protection next year.

## **II. THE ECKLER SCENARIOS**

At the request of FPSE, Eckler Partners provided an analysis of several scenarios concerning the indexing of pensions.

Option A is very clear in its implications: full indexing would require that there be an increase in the total contribution rate of over 10%. A more detailed description of Options B, C1 and C2 follow.

### **Scenario B:**

#### **What is it?**

Scenario B would provide an inflation protection guarantee of 2.5%. (The scenario could, instead, provide a guarantee of 68% of CPI each year.)

#### **How would it work?**

The current IAA fund along with the contribution increase would be used to fund the guarantee. The full IAA fund would be moved to the Basic Account.

Up to 1% of the employer's contribution would continue to be set aside for the provision of extended health and dental benefits.

#### **What would be the contribution increase?**

The total contribution rate would increase 4.45% from 17.40% to 21.85%.

#### **What would be the effect on current employees?**

Current employees would see their pension contribution rise by 2.225%.

#### **What would be the effect on current retirees?**

Current retirees would receive a guarantee of 2.5% inflation protection. Benefit coverage would continue to the extent that the employer's 1% contribution could maintain it. Because the entire IAA would be devoted to the guarantee, there is a high likelihood that indexing beyond 2.5% would not be available for an extended period of time.

### **Scenario C1:**

Scenario C1 would provide an inflation protection guarantee of 1.5%. (The scenario could, instead, provide a guarantee of 41% of CPI each year.)

#### **How would it work?**

The current IAA fund along with the contribution increase would be used to fund the guarantee.

Up to 1% of the employer's contribution would continue to be set aside for the provision of extended health and dental benefits.

**What would be the contribution increase?**

The full contribution rate would increase by 0.04%

**What would be the effect on current employees?**

Current employees would pay an additional 0.02%.

**What would be the effect on current retirees?**

Retirees would be assured of receiving up to 1.5% indexing. Whether additional indexing would be available is unclear since all of the IAA would be subsumed into the Basic Account.

Retirees would continue to receive benefits to the extent possible under the current 1% employer contribution maximum.

**Scenario C2:**

Scenario C2 would provide an inflation protection guarantee of 1.0%. (The scenario could, instead, provide a guarantee of 27% of CPI each year.)

**How would it work?**

The current IAA fund would be used to fund the guarantee. Up to 1% of the employer's contribution would continue to be set aside for the provision of extended health and dental benefits.

**What would be the contribution increase?**

Under this option, there would be no increase to the contribution rate.

**What would be the effect on current employees?**

There would be no financial effect on current employees.

**What would be the effect on current retirees?**

Current retirees would be guaranteed up to 1% indexing each year. Most, but not all, of the IAA would be dedicated to the guarantee, consequently, there would likely be some provision of inflation protection beyond the 1%. Indexing beyond 1% would not be guaranteed.

Retirees would continue to receive benefits to the extent possible under the existing 1% employer contribution maximum.

**III. USEFUL FAQS****1. What is the CPI trend?**

The table below shows the CPI for the last ten years. The CPI appears to be tracking within a range of 1 to 3%. The ten year average for CPI is 2.06%. The five year average is 2.08%. Given central bank policies in North America and Europe, it is reasonable to assume that this trend will continue. The CPI trend is important because assumptions about the CPI have a significant impact on the ability of the IAA to provide full indexing. The expected trend can also inform our decisions about what the best options are for our members.

Year	98	99	00	01	02	03	04	05	06	07	Ten year average
%CPI	1.6	0.7	2.6	2.7	2.6	2.3	2.2	1.8	3.4	0.7	<b>2.06</b>

**2. What would happen if all of the employer’s 1.09% contribution were used for inflation protection?**

This is a difficult question. Currently, health and welfare benefits are funded using part of the employer’s portion of the IAA contributions. As long as a portion of the employer’s contribution is used to pay for the benefits, subsidy of the premiums can be continued to a greater or lesser extent.

If all of the employer’s contribution were used for inflation protection, there would be no money available to pay for benefit premiums. The benefit plans could continue but retirees would have to pay for their own benefits. Odds are that a decision of this type would meet with significant opposition. Conversely, putting all of the employers 1.09% into the IAA would effectively result in an almost 1% increase in IAA contributions.

The options considered in the Eckler document all operate on the assumption that 1% of the employer’s contribution remains available for benefits. Consequently, none of the Eckler scenarios would, in and of themselves, negatively impact the provision of extended health and dental benefits to retirees.

**3. What is the difference between providing a guarantee of full inflation protection and a capped guarantee of inflation protection?**

**Caps:**

Inflation protection is capped at a certain amount. For example, if inflation protection were capped at 2%, retirees would receive CPI increases up to 2%. If CPI was higher than 2%, retirees would not receive any more than 2%.

Capping can also work as a percentage of the CPI. For example, inflation protection could be capped at 50% of CPI. In that case, retirees would receive half of the actual CPI increase each year regardless of what the CPI increase was.

Capping is one of the options available to the Pension Board to in order to extend the life of the IAA.

**Guarantees:**

A guarantee of inflation protection is more complicated than capping. Inflation protection can be either fully guaranteed (retirees are guaranteed to always receive the full CPI) or partially guaranteed (retirees are guaranteed to receive CPI up to a certain percentage.)

Under the existing Plan structure, an actuarially determined amount of money would have to be moved from the IAA to the Basic Account in order to guarantee full or

partial inflation protection. The actual amount of those funds would depend on the amount of the guarantee.

Any money left in the IAA could be used to provide additional inflation adjustments beyond the guarantee or to pay for benefits. Inflation protection above the guaranteed amount and benefits would continue to not be guaranteed.

If the entire IAA was transferred to the Basic Account to meet the requirements of a guarantee, then the guaranteed inflation adjustment would also effectively be a cap since no additional funds would be available to provide increased inflation adjustments unless there was a plan surplus.

**4. Can we address inflation protection over a period of time or must a decision be made right away? What are the differences?**

If we were to achieve guaranteed full indexing today, pension contributions would have to rise significantly. Although full guaranteed indexing is a laudable goal, it is also an unlikely outcome at this juncture.

There are partial measures which we can undertake now or implement over a period of time. These include the partial indexing guarantees mentioned earlier.

There is an advantage to waiting a short while before making any firm decisions. Among other things, the College Pension Plan is about to undergo a valuation. That valuation will give us a better idea of the current state of the Plan including the IAA. This will give FPSE members better information on which to base complex decisions. For example, if the Government is prepared to increase contributions to the IAA, what are the best options for us to exercise? If contribution rates are set to rise as a result of the valuation, how much of an additional increase will members be willing to shoulder in order to strengthen indexation?

**5. What if we do nothing?**

The FPSE and, by extension, the other partners can choose to do nothing. However, the Pension Board is obligated to act in best the financial interest of the plan. The Pension Board cannot choose to do nothing.

If there is no change in the contribution rate to the IAA, sooner or later the Pension Board will have to reduce indexing. Failing that, at some point, the IAA will run out of funds and full indexing will end. That point is currently estimated to occur in 2022, 15 years from now.

Although full protection can be maintained for another 15 years, the Plan's policies require the trustees to take action once the timeframe for provision of full indexing falls below 20 years. For the last few years, the trustees have suspended the IAA funding policy. However, the trustees are unlikely to continue suspending the policy. Once the policy is no longer suspended, the Pension Board will have to act. A number of options will be available to the trustees including reducing indexing to a percentage of CPI, capping indexing at a certain percentage, or subtracting a specific percentage from CPI.

