PROPOSAL TO PLAN SPONSORS (REVISED)

REFORMING THE CIVIL SERVICE SUPERANNUATION FUND

October 8, 2013

1. Introduction, Objectives and Context

This proposal is presented by the Union of Public Service Employees (UPSE) and the Canadian Union of Public Employees (CUPE), representing a large majority of members and former members of the Civil Service Superannuation Fund (CSSF).

The objective in presenting this alternative member proposal is to ensure the long-term sustainability of the CSSF.

The stakeholders recognize that any proposal must meet the needs of both the government and the plan members and former members. This proposal builds on the following objectives:

- Meet the stated financial objectives of the current plan sponsor, in particular an annual target budget of $44 million for the CSSF, and to substantially reduce the risk of cost volatility in the future;

- Maintain the integrity and adequacy of the pension promise for former, current and new employees to the degree possible;

- Adopt a reasonable deficit management plan comparable to other public sector plans in Canada, and in doing so ensure inter-generational equity; and

- Employ a governance model that reflects the risk profile of the plan (as amended).

This Alternative Member Proposal for reforming the CSSF meets these objectives.

2. Plan Background

There are four primary trade unions involved in negotiations over the future of the Plan, which represent a large majority of active members in the Plan: UPSE, CUPE, the PEI Nurses Union (“PEINU”), and the International Union of Operating Engineers, Local 942 (“IUOE”). As of the last valuation of the Plan, April 1, 2011, there were 6,997 active members, representing

56% of the liabilities of the Plan. Other membership in the Plan is as follows:

- deferred vested members: 511 (2% of the liabilities of the Plan)
- pensioners and survivors: 2,930 (42% of the liabilities of the Plan)

The break-down of union membership in the Plan based on information provided in June, 2012 is as follows:

Group	Plan Members
UPSE (Health and Civil)	3,140
PEINU	1,112
IUOE	807
CUPE	762
Other	1,162
Retirees	3,059

The Plan currently participates in a master trust investment structure (the “Master Trust”), in which the Plan’s assets are pooled with another pension plans’ assets (the Teachers Superannuation Fund). The Master Trust has both an investment advisory committee and an administration advisory committee.

2. Summary of Alternative Member Proposal

The Alternative Member Proposal suggests two major sets of amendments to the CSSF.

We have proposed comparable changes to the CSSF for illustrative purposes. They are intended to demonstrate the ability of this proposal to meet the financial and other objectives above. The exact combination of benefit reductions and contribution increases will be finalized by agreement of plan stakeholders, but in every case will meet the financial objectives stated above.

The two sets of proposed changes are:

- implementing benefit reductions (on past and future service) for the CSSF which are changes comparable to other plans in the public sector in Canada;

- implementing joint governance and sponsorship.

These changes are also accompanied by a set of economic assumptions and methods that are both (i) fair and reasonable and (ii) comparable to other public sector pension plans in Canada.

In summary, the changes proposed are:

CSSF

Indexation

- Reduction in post-retirement indexing in respect of past and future service from 100% to 60% of CPI

- Conditional, ad hoc indexing from 60% up to 100% of CPI

Early Retirement Subsidies

- Delay the availability of unreduced early retirement subsidies from facts 30/60 to 32/62

Benefit Formula

- Final average earnings base changed from "best 3" to "best 5" years

Economic Assumptions

- Discount rate of 6.5%

- Updated mortality assumptions

- Plan deficit amortization period of 15 years

- Plan funding to 100% of best estimate on accounting basis

3. Comparative Financial Impact of Proposals

The chart below compares the impact of the Government Proposal and the Alternative Member Proposal as a percentage of payroll. The numbers in the chart below are based on figures provided in March and June, 2013 by the plan actuary.

CSSF FUNDING

Item	GOV	ALT
Required funding amount*	9.0%	9.0%
Funding to 90% per current policy (best estimate)	-3.9%	-3.9%
Extension of amortization period to 20 years**	-1.0%	-1.0%
Net target funding requirement necessary through benefit changes	**4.1%**	**4.1%**
Reduce all post-retirement indexing to ad hoc	-12.5%	N/A
Conversion to career average ad hoc indexed capped at AIW	-8.5%	N/A
Early retirement to factor 32/62	-1.2%	-1.2%
Reduce post-retirement indexing to 60% CPI and 40% ad hoc	N/A	-5.5%
FAE 3 to FAE 5	N/A	-1.4%
TOTAL IMPACT	**-22.2%**	**-8.1%**
OVER-CORRECTION	**18.1%**	**4.0%**

* As percentage of payroll, projected from Dec 31, 2012, assuming discount rate of 6.5%.
** We have included the option of extending the normal 15 year amortization period to 20 years to demonstrate the impact on funding as a percentage of payroll. Elsewhere in this proposal we have assumed a 15 year amortization period.

The Government Proposal creates a net positive impact in funding requirements of 22.2% which is 18.1% more than is needed. This is a very large reduction in funding requirements. **The Government Proposal has significantly "over-corrected" the problem.**

ESTIMATED FINANCIAL IMPACT

Item	Government	Alternative
CSSF (8.37% of payroll)	$29.3m	$29.3m
Additional 4%	$14m	N/A
Deficit amortization (15 years)	N/A	$3.5m
Totals	**$43.3m**	**$32.8m**

Under the Alternative Member Proposal, the benefit structure is substantially maintained, the annual cost of the CSSF more than meets Government requirements of $44 million, and the deficit is eliminated in as little as two years.[1]

4. Comparative Impact on Pensions

The primary differences in the two proposals are the magnitude of the reductions in pension accrual rates (basic pension at retirement) and post-retirement indexation. These differences can produce very different pension benefit outcomes for members, particularly new members to the plans.

The following table estimates the percentage change in pensions produced by the two proposals under three scenarios: (a) all pre-retirement earnings indexing is provided, (b) no pre-retirement earnings indexing is provided, and (c) indexing is provided 50% of the time.

Members of the plan currently see wage or salary increases in two forms: by moving up the salary grid set out in collective agreements, and by bargaining increases to the grid from time to time. Although each employee’s career path differs, the combined effect of grid and bargained increases are typically greater than the average industrial wage (AIW).

The following sets out the impact on pension benefits for two typical full career members. One earns average wage increases over their working lifetime equal to the AIW. The second earns increases at a rate of 1% per annum above the AIW.

[1] The impact on the CSSF deficit is explained in the next section.

GOVERNMENT PROPOSAL COMPARED TO CURRENT PLAN

SALARY INCREASE	AMOUNT OF INDEXING GRANTED		
	All indexing	No indexing	50% indexing
AIW increases only	+2%	-39%	-19%
AIW+1% increases	-14%	-47%	-31%

If a member makes an increase equal to the AIW and indexing under the plans are granted 100% of the time, the Government Proposal would slightly increase the pension amount granted to the member. However, this is both not a typical salary increase and relies on a very significant assumption of 100% ad hoc indexation. If indexation is only awarded 50% of the time, the benefit amount falls almost 20%. If a member earns 1% above the AIW and indexation is granted all the time, the benefit amount falls nearly 14%. If a member earns 1% above the AIW and indexation is granted 50% of the time, the benefit falls just over 30%.

Under the Government Proposal, the fundamental pension promise is altered. The benefit is no longer predictable, and may result in potentially significant cuts to pension benefits compared to the current plan. These potential benefit cuts are a reflection of the financial impact of the Government Proposal, which reduces the benefits in the plan sufficiently to generate a very significant surplus ($114m) on an accounting basis.

5. Financial Accounting and Funding

We have assumed that for the purpose of the proposed changes to the plans the plan sponsors will use the "best estimate" accounting assumptions to determine the size of the unfunded liabilities associated with the plans, and the projected funding requirements for the plan.

Using numbers provided by the plans' actuary and government office, the projected surplus (deficit) as at Apr 1, 2014 is as follows:

Item	$ Millions	Total
Projected deficit (original)	(68)	
Projected deficit reflecting reduced discount rate to 6.5% and updated mortality assumptions	(202)	(270)

Impact of Government Proposal	**384**	**114**
Impact of Alternative Member Proposal	190	(80)
Impact of recognition of investment gains 2013	40	(40)
Impact of joint governance on Government liabilities	**50%**	**(20)**

The financial impact (on an accounting basis) of the Government Proposal is a positive change of $384 million, which eliminates the existing projected deficit to generate a surplus of $114 million.

In contrast, the Alternative Member Proposal makes more modest benefit changes and addresses the accumulated deficit in the plan in a very short time.

For the purpose of this proposal we have assumed in this proposal that 6.5% is an acceptable discount rate and the deficit will be estimated at $270 million for the CSSF.

The total impact on the liabilities of the Alternative Member Proposal as at April 1, 2014 is $190 million. This reduces the projected deficit to $80 million. If the CSSF also recognized the projected annualized investment gains from 2013 (projected to be $40-45 million for the CSSF), the deficit would be reduced to $40 million.

Whatever the final estimate of the liabilities of the plans, the subsequent financial impact of the conversion to joint sponsorship permits the Government to report only 50% of that plan deficit as its responsibility, that is, between $20 and $40 million. **We estimate that, if contribution rates remain the same, that deficit can be eliminated in as little as two years**.[2]

Given the Alternative Member Proposal's reduction in benefits, assumption of risk by members and the conservatization of the economic assumptions in

[2] This rapid reduction in the projected deficit is due to the decrease in normal cost contribution requirements caused by the Alternative Member Proposal, which permits a portion of the existing contribution requirements to be applied against the projected deficit in addition to special payments required to amortize the deficit over 15 years.

valuing the plan's liabilities, we believe this range of deficit amounts is reasonable and is consistent with other public sector plans in Canada.

6. Features of Joint Sponsorship

Along with other amendments set out in this proposal, structuring the plans as a jointly sponsored pension plan (JSPP) will:

- significantly reduce employer's risk of future cost increases by expressly transferring 50% of that risk to members; and

- provide a structure which allows both members and the Government to actively participate in the administration of the Plan and to actively manage the risks associated with the Plan.

From the Government's perspective, a primary economic rationale for conversion to a JSPP is to achieve a 50% decrease in the accounting liability of the Government. This reflects the transfer of the risk of 50% of future contribution changes to members. The Government can immediately reflect this change in their financial statements and reduce long-term liabilities. This can be described as a significant cost saving to Government in comparison to the current accounting treatment of the plans' liabilities.

In order to reflect members' assumption of 50% of the funding risk of the Plan, members of the Plan are provided equal responsibility in the sponsorship and administration of the Plan. Members and the Government will have equal responsibility for future decisions about the Plan, including decisions about plan design, benefits, and spending of surpluses in the future.

Other Public Sector Plans Have Adopted Joint Governance

Several other public sector plans have adopted this structure. For example, although each plan has different specific benefit and funding terms, the following plans are all jointly sponsored and jointly governed:

- Nova Scotia Healthcare Employees Plan
- Public Service Pension Plan (British Columbia)
- Local Authorities Pension Plan (Alberta)

- Saskatchewan Health Care Employees' Pension Plan
- Healthcare Employees Pension Plan (Manitoba)
- OPSEU Pension Trust
- Hospitals of Ontario Pension Plan (HOOPP)
- Ontario Teachers' Pension Plan
- Public Service Superannuation Plan (Nova Scotia)

Many other public sector and broader public sector pension plans across Canada employ this structure.

The following lists the features of joint governance in terms.

Joint Sponsors

The new JSPP would be sponsored jointly by the Government and the collective bargaining agents of members of the plans.

The most appropriate and reasonable reflection of the risk-sharing in the plans (as amended) is for both the employer and bargaining agents to become sponsor parties to a joint sponsorship and trust agreement, the terms of which set out the features discussed below.

Sponsor Powers

The joint sponsors would retain the major functions of sponsors of a pension plan: determining the plan design and funding arrangements and the right to amend and terminate the plans and trust agreement on mutual agreement.

Changes to the plans or Trust Agreement that are purely administrative or that could characterized as "house-keeping" and without monetary impact should be allocated to the trustees. These decisions include day-to-day administrative decision-making and investment activities.

The costs of administration and of the trustees are paid by the plan's fund.

Sponsor Dispute Resolution

A deadlock and mandatory dispute resolution mechanism will form part of the trust agreement and require the sponsors to either reach agreement over any decision of the sponsors or submit to binding arbitration.

Board of Trustees

- Equal number of union and employer trustees on a board of trustees.
- Co-Chairs of the board of trustees, with one Co-Chair elected or appointed by the Government or its trustees; the member trustee shall rotate between participating bargaining units;
- One vote per trustee; no tie-breaking vote;
- Decision making by majority provided quorum and minimums are met;
- Super-majority requirements (two-thirds in favour) for fundamental changes to the plans; and
- Deadlock-breaking mechanism

Powers

The trustees will be responsible for administering and operating the plans through their delegates and agents, which can be staff or third party service providers, depending on need and expertise available.

It is anticipated that there would be no change to the current set of agents and service providers (including the pension administration role performed by government staff), and only the identity of the administrator would change.

Funding Model

The cost of any future increases in normal cost would be automatically shared 50/50 as between the employer and members or addressed as otherwise agreed by the sponsors.

The cost of any future unfunded liabilities would be automatically shared 50/50 as between the employer and members or addressed as otherwise agreed by the sponsors.

As the funding levels permit, any excess may be used to fund a contingency reserve to a maximum to be determined by the sponsoring parties (or as determined by the trustees).

7. Objectives and Criteria

In Government's June 2012 presentation to the unions "Financial Challenges Facing Public Sector Pensions in PEI", four principles were identified:

- Protect integrity of the dollar value of current pension promise;
- More equitable sharing of risk among stakeholders to better balance plan costs;
- Target a sustainable structure that is flexible enough to adapt to changing future conditions; and
- Maintain inter-generational equity and fairness.

In a May 2013 Government presentation entitled "Pension Review", the following principles were identified as measures of success:

- Adequacy of benefits;
- Equity between groups;
- Level of expense; and
- Volatility of expense.

This proposal has built on these principles, and articulated them as follows:

- Meet the stated financial objectives of the current plan sponsor, in particular an annual target budget, and to substantially reduce the risk of cost volatility in the future;
- Maintain the integrity and adequacy of the pension promise for former, current and new employees to the degree possible;
- Adopt a reasonable deficit management plan comparable to other public sector plans in Canada, and in doing so ensure inter-generational equity; and
- Employ a governance model that reflects the risk profile of the plan (as amended).

The following table summarizes how each proposal meets these criteria:

Criterion	Government	Alternative
Level of expense (budget of $44 million)	Pass	Pass
Accounting treatment of deficit	Creates $114 m surplus	Eliminates deficit in as little as 2 years
Volatility of expense (future risk)	Substantial reduction	Reduces 50%
Equity	Pass	Pass
Adequacy of benefit	Fail	Pass
Governance model (relative to risk)	Fail	Pass

We believe that the Alternative Member Proposal is a more appropriate and reasonable approach to ensuring the long-term sustainability of the plans, because it meets both the members and Government's needs.

7. Summary Conclusion

We believe that the Alternative Member Proposal **better meets** the criteria the stakeholders identified for the reform of the CSSF. We note that the Alternative Member Proposal:

- **Substantially reduces** the government's April 1, 2014 projected financial accounting deficit of $270 million for the CSSF to a figure between $20 million to $40 million (depending on other economic assumptions within the control of Government), and pays that deficit within as little as two years;

- **More than balances** the current on-going funding equation;

- **Operates within** the government's defined funding envelope of $44 million; and

- **Significantly reduces** by 50% the government's future risk and volatility.