Pensions

8

Executive summary

In this chapter, we discuss pension plans' systems and practices to manage pension risks and report progress on our past recommendations.

We recommend that pension plans establish rules and procedures to ensure that pension payments to retired members are stopped when members are re-employed. Alternatively, if these laws are no longer reasonable then the pension plans should seek changes to the law.

We continue to recommend that the Government should establish an oversight body to provide advice to the Government about its pension plans, and to provide guidance and direction to the pension plans. Currently, the pension plans work independent of each other. The pension plans do not receive common guidance on: how to use the surpluses accumulated, how to reduce administrative costs, and what estimates and assumptions to use for calculating pension liabilities. Although the Department of Finance encourages pension plans to use consistent estimates and assumptions to calculate pension liabilities, an oversight body could bring more rigour to the pension plans' governance.

Pension plans have made progress in addressing our other past recommendations. However, pension plans need to improve their documentation of the process for selecting investment managers, their statements of investment objectives, and their verification of investment managers' reports.

Glossary

Actuary – a professional who prepares periodic asset and pension liability valuations for accounting purposes.

Actuarial valuation – an assessment of the financial status of a pension plan for accounting purposes. It consists of the valuation of assets held by a plan and the calculation of the actuarial present value of benefits to be paid under the terms of the plan.

Asset consultant – a professional who provides an analytical review of the money in the pension plan, the asset classes and the investment managers' performance, relative to peers and pension plan targets. The asset consultant monitors each manager's style and risk characteristics and comments on the acceptability of performance. He/she advises the board of directors of the plan on overall investment policy and management that achieves the plan's objectives.

Closed pension plan – a pension plan that does not accept new members into the plan.

Custodian – an organization such as a bank or a trust company that is contracted to monitor investment transactions and to provide record-keeping services for the pension plan. This organization has custody of the assets of the plan and is responsible for executing investment transactions and collecting income.

Defined benefit pension plan – a pension plan that specifies the pension that members of the plan receive on retirement or the method of determining the pension.

Defined contribution pension plan – a pension plan in which the members' contributions are fixed (except for the Saskatchewan Pension Plan whose members can contribute up to $600 each per year), usually as a percentage of pay. A member's pension is based on the member's and the employer's contributions made on behalf of the member and investment earnings on those contributions.

Government enterprises – are Government organizations that have the financial and operating authority to carry on a business. This includes contracting in their own name, and selling goods and services to individuals and non-government organizations as their principle activity and source of revenue.

Government service organizations – are those organizations that are accountable to the Government and either owned or controlled by the Government, and are not Government enterprises.

Investment manager – an individual or organization that manages a portfolio of investments, which includes developing and implementing an investment strategy to achieve the objectives of the pension plan.

Model portfolio – investment manager's selection of a subset of all possible investments, which are monitored and recommended to clients (i.e., investment manager invests on clients' behalf in only 40 companies listed in the TSE 300).

Open pension plan – a pension plan that accepts new members into the plan.

Pension liability – the present value of pension benefits earned as determined by an actuary using the pension plans' best estimates about future events and an appropriate actuarial method as recommended by The Canadian Institute of Chartered Accountants for accounting purposes.

Statement of investment objectives – a document that describes a pension plan's investment policy and lays out key aspects of the pension plan in an orderly manner. This document describes a number of topics including the type of pension plan, nature of plan liabilities, the accepted risk, the degree of diversification of the portfolio, the classes and types of permitted investments, investment objectives and expected rates of return, valuation of investments, conflict of interest, related parties, retention/delegation of voting rights, etc.

Target rate of return – the planned rate of return that the pension plan has established. This rate is typically determined in reference to established indexes. For example, a target rate of return could be 40% of the Toronto Stock Exchange 300 Index and 60% of the Scotia Capital Markets Universe Bond Index.

Unfunded liabilities – the amount by which the pension liability exceeds the assets of the pension plan.

Purpose of chapter

The Government's pension plans are significant to the Legislative Assembly, members of the pension plans, and the public. Through the plans, the Government manages a significant amount of assets and pension liabilities. Note 6 to the Government's summary financial statements for the year ended March 31, 2000 shows an unfunded pension liability of $3.8 billion for government service organizations and a pension surplus of $177 million for government enterprises.

In this chapter, we discuss:

- the status of systems and practices to manage pension risks;
- progress on our past recommendations; and
- our future plans for work in this area.

Government pension plans

This chapter reports on 16 of the Government's pension plans. There are ten defined benefit plans and six defined contribution plans.

In **defined benefit plans**, the Government promises to pay each member a pension based on the member's salary and years of service. For the Municipal Employees' Pension Plan, the municipal employers and school boards promise to pay the pensions. In 1978 (1980 for the Teachers' Superannuation Plan), the Government reduced its risk that its pension costs would be greater than expected, by closing its defined benefit pension plans to new members, except for the Judges of the Provincial Court Superannuation Plan and the Municipal Employees' Pension Plan. Since 1978 (1980 for the Teachers' Superannuation Plan), new Government employees become members of defined contribution plans.

The ten defined benefit plans included in this chapter are:

- Judges of the Provincial Court Superannuation Plan;
- Liquor Board Superannuation Plan;
- Members of the Legislative Assembly Superannuation Plan;
- Municipal Employees' Pension Plan;

- Public Service Superannuation Plan;
- Power Corporation Superannuation Plan;
- Saskatchewan Government Insurance Superannuation Plan;
- Saskatchewan Telecommunications Pension Plan;
- Teachers' Superannuation Plan; and
- Workers' Compensation Board Superannuation Plan.

In **defined contribution plans**, the Government and the plan member each pay a fixed percentage of the member's salary into a fund (the Government no longer contributes for the Saskatchewan Pension Plan and members do not contribute for Saskatchewan Research Council Employees' Pension Plan). The member's pension is based on the accumulated contributions (i.e., total contributions made by the member and the Government over the member's career) and the investment earnings on these contributions.

The six defined contribution plans included in this chapter are:

- Capital Pension Plan Inc. (this plan includes employees of the Saskatchewan Gaming Corporation, Saskatchewan Government Insurance, Saskatchewan Transportation Company, Saskatchewan Water Corporation, and certain other agencies);
- Members of the Legislative Assembly Superannuation Plan;
- Public Employees Pension Plan (this plan includes employees hired by the Public Service Commission, Saskatchewan Telecommunications, and Saskatchewan Power Corporation);
- Saskatchewan Pension Plan;
- Saskatchewan Research Council Employees' Pension Plan; and
- Staff Pension Plan for Employees of the Saskatchewan Legal Aid Commission.

Status of systems and practices used to manage pension risks

In Chapter 5 of our 1996 Spring Report, we outlined the risks and the systems and practices that the Government needs to manage pension plans. We expect pension plans to:

- comply with the authorities governing their activities relating to financial reporting, safeguarding assets, revenue raising, spending, borrowing, and investing;

- keep accurate and complete records to meet significant reporting needs;

- safeguard their investments;

- manage cash flows;

- maximize investment earnings within levels of acceptable investment risk; and

- submit timely reports to the Legislative Assembly, plan members, and Government agencies. These reports should permit the evaluation and comparison of planned performance to actual performance (e.g., targeted investment rates of return and actual rates of return).

Summary of audit conclusions

Based on our audits of pension plans with year-ends on or before December 31, 2000, we conclude:

- **all pension plans complied with authorities governing their activities relating to financial reporting, safeguarding assets, revenue raising, spending, borrowing, and investing, except the following pension plans did not have rules and procedures to ensure retired members who return to work for the Government are paid according to the law:**
  - **Members of the Legislative Assembly Superannuation defined benefit Plan (MLA Plan);**
  - **Public Service Superannuation Plan;**
  - **the Liquor Board Superannuation Plan;**
  - **Workers' Compensation Board Superannuation Plan;**
  - **Power Corporation Superannuation Plan; and**
  - **Teachers' Superannuation Plan.**

Also, the Department of Finance is not paying allowances to surviving spouses as required by *The Members of the Legislative Assembly Superannuation Act, 1979* (see Chapter 9 (Finance) in this report). In addition, certain provisions of *The Members of the Legislative Assembly Superannuation Act, 1979* are not consistent with Canada's *Income Tax Act* (see Chapter 9 (Finance) in this report).

- **all pension plans kept accurate and complete records to meet reporting needs;**
- **all pension plans adequately safeguarded their investments;**
- **all those pension plans that have unfunded liabilities managed their cash flows; and**
- **all pension plans submitted timely reports except for the Teachers' Superannuation Plan (see Chapter 4 (Education) of this report).**

Certain pension plans need to ensure that they comply with the law

Pension plans need to comply with the law. The Members of the Legislative Assembly Superannuation defined benefits Plan, the Public Service Superannuation Plan, the Liquor Board Superannuation Plan, the Workers' Compensation Board Superannuation Plan, Power Corporation Superannuation Plan, and the Teachers Superannuation Plan do not have rules and procedures to comply with the laws governing the payment of pensions to the retired plan members.

The Superannuation (Supplementary Provisions) Act (Superannuation Act) applies to the Liquor Board Superannuation Plan, Power Corporation Superannuation Plan, the Public Service Superannuation Plan, and the Workers' Compensation Board Superannuation Plan. The Superannuation Act requires the plans to stop retired members' pension payments if the retired members return to work on a temporary or casual basis for the Government for more than 6 months in a fiscal year. The Superannuation Act also requires that, if a retired member receiving a pension is re-hired by the Government as a permanent employee, the members' pension should be stopped from the day the member starts work.

The *Teachers Superannuation and Disability Benefits Act* has a similar provision. It requires retired teachers receiving a pension who teach more than 60 days in a year (reduced from 120 days after the 1998-99 fiscal year) to receive a reduced pension. Also, *The Members of the Legislative Assembly Superannuation Act* requires that pension payments for the Members of the Legislative Assembly Superannuation Plan be stopped upon re-employment.

None of these pension plans have systems and practices to ensure they are complying with the law when retired members receiving a pension are re-employed by the Government.

We recently reported a similar concern regarding retired teachers who return to work and receive pensions from the Teachers' Superannuation Plan. On March 14, 2001, this matter was discussed at the Standing Committee on Public Accounts (PAC). These discussions are available for review at http://www.legassembly.sk.ca. The following views were expressed during this discussion:

> Employees earn their pension during their employment. Pensions are part of an employees pay package. Therefore, pensions are deferred salaries. When they retire they begin receiving their deferred salary. It may be difficult to establish cost-effective systems to find retired members who are re-employed by the Government. Also, Saskatchewan's workforce demographics have changed since the requirement to stop pensions on re-employment was enacted. The new demographics might lead to eliminating this requirement.

Also, in past discussions of pension plans, legislators considered pensions to be deferred salaries.

In addition, retired members who return to work are not able to rejoin the pension plan and provide additional contributions to improve their pensions. Retired members' pensions are also not increased to reflect the period when their pension is stopped. As a result of the discussion at PAC, the Plans may want to consider whether their respective law(s) are still necessary. However, if the law(s) are not changed, the Plans are responsible to ensure they have a system to comply with the law.

1. **We recommend that the Plans establish rules and procedures to ensure all retired members receiving a pension, who have returned to work for the Government, are paid in accordance with the law. Alternatively, the Plans should seek changes to the law.**

Progress on our past recommendations

Since our 1996 Spring Report, we have regularly followed-up on our recommendations for pension plans. We also continued to make recommendations for the pension plans resulting from our study of pension plans' systems and practices to maximize their investment earnings within acceptable risk levels.

We followed-up on our past recommendations to monitor the Government's and its pension plans' progress in addressing our recommendations. Our follow-up work does not constitute an audit. Our follow-up procedures included examining the plans' financial statements for their years ended March 31, 2000, June 30, 2000, and December 31, 2000 and discussing progress with pension plan administrators.

The following section describes how the Government and its pension plans are progressing in addressing our past recommendations.

Advisory Committee

We recommended, in our 2000 Spring Report, that the Government should establish a task force to study the many issues related to pension plans. A task force (advisory committee) could examine:

- the significant future cash requirements of the Government's pension plans and how to address those requirements;
- what should be done with the surplus accumulated in some pension plans;
- whether members of all plans should make the same contributions and receive the same benefits;

- whether current administrative responsibilities should be combined under fewer organizations to help reduce administrative costs and/or improve investment earnings;

- whether all pension plans use consistent estimates and assumptions to calculate their pension liabilities; and

- why some plans have their own laws that govern them while other plans establish a plan document under *The Pension Benefits Act, 1992* that governs their plan.

In March 2001, PAC considered this recommendation and did not agree. We have further considered this issue.

We think there is a need for an oversight body. There does not appear to be a person or body that provides guidance and direction to all Government pension plans no matter whether they report through the Department of Finance, the Department of Education, or through the Crown Investments Corporation of Saskatchewan.

The pension plans operate independently of each other. Government pension plans do not have a common oversight body to provide guidance and direction on governance related matters. The pension plans do not receive any guidance on how to use the surpluses accumulated, how to reduce administrative costs, and what estimates and assumptions to use for calculating pension liabilities. Although the Department of Finance does encourage pension plans to use consistent estimates and assumptions to calculate pension liabilities, an oversight body could bring more rigour to pension plans' governance.

An oversight body could provide advice to the Government on the administration of its pension plans including how best to use surpluses in some plans, reduce administrative costs of the plans, and to manage pension liabilities.

2. We continue to recommend that the Government should establish an oversight body to provide advice to the Government about its pension plans, and to provide guidance and direction to its pension plans.

Documentation of process for selecting investment managers

In our 2000 Spring Report, we recommended:

- All pension plans should document their process for selecting investment managers.

In March 2001, the Standing Committee on Public Accounts (PAC) concurred with our recommendation.

We are beginning to see some progress in this area. During 2000, the Power Corporation Superannuation Plan documented its procedures for selecting investment managers.

Pension plans need to do more work in this area.

Saskatchewan Pension Plan should clearly set out and state risk level

In our 1999 Spring Report and 2000 Spring Report, we recommended:

- the Saskatchewan Pension Plan's *statement of investment objectives* should clearly set out and state the risk level acceptable to its plan members and the Government. The pension plan's investment objectives should be based on the risk level acceptable to plan members and the Government.

In March 2001, PAC considered this matter and concurred with our recommendation. Management told us it is considering how best to address this recommendation. We look forward to seeing progress in this area.

The Government should use consistent estimates

In our 1999 Spring Report and 2000 Spring Report, we recommended:

- The Government calculate its pension liability for each of its defined benefit pension plans using consistent estimates.

Defined benefit pension plans need actuarial valuations, at least every three years, to reflect changes in the membership, the plan document and/or legislation, and the reasonability of assumptions used to determine the pension liability. Pension plans may need to have actuarial valuations done in between the three-year period if pension plan documents, assumptions, and/or legislation are changed significantly.

Some pension plans are still using inconsistent estimates to calculate their pension liability for accounting purposes. Most government defined benefit pension plans used 3.25% as their long-term inflation estimate for valuations completed in 1999 and 2000. The Saskatchewan Telecommunications Pension Plan, on the other hand, used 2.6% as its long-term inflation estimate. The Saskatchewan Government Insurance Superannuation Plan used 3.75%.

The Government's defined benefit pension plans should use consistent estimates and assumptions to calculate their pension liabilities. The inflation rate used to calculate pension liabilities for defined benefit pension plans should be the same for all of the Government's pension plans because they all operate in the Saskatchewan economy.

Pension plan administrators have many duties including setting the assumptions for actuarial valuations. Because there is only one Government of Saskatchewan and there is only one economy in Saskatchewan, the inflation assumption should be the same for all the pension plans to ensure the financial results of the pension plans are comparable. Also, when the financial information from all of the pension plans is included in the Government of Saskatchewan's summary financial statements there should be only one inflation assumption. The Government needs to tell the various pension plans its inflation assumption so that the assumption is used consistently.

The Government should monitor all defined benefit pension plans to ensure they all use consistent estimates to calculate their pension liabilities. An oversight body could ensure that all Government pension plans use consistent estimates and assumptions to calculate their pension liabilities.

In March 2001, PAC considered this recommendation and concurred with the recommendation in principle. PAC also recommended that the

Government should continue to work towards using consistent estimates for inflation for all its defined benefit plans.

Statements of investment objectives should clearly set out the plans' assessment of acceptable risk

In our 1998 Spring Report, we recommended:

- Pension plans' *statements of investment objectives* should include a clear assessment of the risk level acceptable to plan members and the Government.

In October 1998, PAC concurred with our recommendation.

We continue to monitor pension plans' progress in this area. Pension plans' *statements of investment objectives* (statements) continue to generally improve. Teachers' Superannuation Plan still does not clearly set out the plan's assessment of acceptable risk level of its members and the Government.

Teachers' Superannuation Plan provides little or no information on membership demographics in its statement. Also, the Teachers' Superannuation Plan, in its *statement of investment objectives,* provided little information on its unfunded status.

Teachers' Superannuation Plan should include this information in its *statement of investment objectives* to help understand the pension plan and its risk assessments.

Statements should clearly set out investment objectives

In our 1998 Spring Report, we recommended:

- Pension plans' investment objectives should be based on the risk level acceptable to plan members and the Government.

In October 1998, PAC concurred with our recommendation.

We continue to monitor pension plans' progress in this area.

Generally, we found pension plans established and clearly stated their investment objectives in their *statements of investment objectives*. However, pension plans need to continue to improve their *statements of investment objectives*.

Power Corporation Superannuation Plan needs to improve the information on the plan's asset class expected rate of return (e.g., expected return on short-term securities, bonds, Canadian equities, etc.). Teachers' Superannuation Plan needs to improve guidelines on acceptable related-party transactions, clearly outline cash flow requirements, and outline what terms would result in ending an investment manager's contract.

Teachers' Superannuation Plan, Capital Pension Plan Inc., Power Corporation Superannuation Plan, and Saskatchewan Government Insurance Superannuation Plan need to establish policies that investment managers must follow for selecting investment dealers. Power Corporation Superannuation Plan needs to include a suggested format that investment managers must follow when reporting on compliance with the plan's investment policy.

The pension plans need to make more progress in this area.

Verification of investment manager compliance reports

In our 1999 Spring Report and 2000 Spring Report, we recommended:

- Pension plans should verify investment managers' compliance reports.

In March 2001, PAC considered this matter and concurred with our recommendation.

To help pension plan administrators effectively evaluate investment manager performance, they need independent assurance on the accuracy of the investment manager's reports. Pension plans must ensure that the investment manager has complied with the terms and conditions set out in the statement of investment objectives that define acceptable risk.

Several pension plans are working on processes for obtaining independent assurance of compliance reports from investment managers. These plans are Capital Pension Plan Inc., Saskatchewan Government Insurance Superannuation Plan, and Power Corporation Superannuation Plan.

We will continue to monitor the progress that pension plans are making in verifying investment manager compliance reports.

Reporting of investment performance

In our 2000 Spring Report, we recommended:

- The Workers' Compensation Board Superannuation Plan, Capital Pension Plan Inc., and Saskatchewan Pension Plan disclose their actual and targeted rates of return in their audited financial statements.

In March 2001, PAC considered this matter and did not concur with our recommendation.

The pension plans addressed in the recommendation have further considered this issue. The Workers' Compensation Board Superannuation Plan has included its investment performance in its audited financial statements for the year ended December 31, 2000. Capital Pension Plan Inc. told us it plans to disclose investment performance in its 2001 audited financial statements. Additional credibility is added when actual and targeted rates of return are included in the financial statements because the information is audited.

More and more pension plans are deciding to include investment performance in their audited financial statements. This good plan governance is not just restricted to Saskatchewan. We observe that other plans, such as the Ontario Teachers' Pension Plan and the Alberta Teachers' Retirement Fund Board, report investment performance in their audited financial statements.

Saskatchewan Pension Plan continues to disclose its actual and targeted rate of return separately in its annual report. We plan to continue to encourage Saskatchewan Pension Plan to show this information in its audited financial statements.

Management of the Saskatchewan Pension Plan told us they are considering disclosing the plan's actual and targeted rates of return in its audited financial statements.

Our future plans

We plan to continue to examine the systems and practices pension plans use to manage their key risks. We note several pension plans in Canada have been sued or are being sued for improperly carrying out their governance responsibilities. We think that the Government can reduce its risk of losses by ensuring its pension plans use sound governance practices. We have begun the process of developing criteria to study pension plan governance. We will report these criteria in a future report.

In addition, in a future report, we will provide an update on the progress pension plans have made in improving their annual reports.

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