Q&As - Cost-of-living Allowance

Public Service Superannuation Plan Trustee Inc.

Why don't I receive full CPI indexing?

'Indexing' in respect of your PSSP pension is an additional amount that may periodically be added on top of the base pension that you receive at the commencement of retirement. It is intended to provide some offset to cost-of-living increases that may occur over time.

The PSSP was modernized in 2010-2012 and a new funding policy was embedded in its legislation, the *Public Service Superannuation Act* (*PSSA*). This funding policy provides for conditional indexing for PSSP retirees. Conditional indexing means that indexing may only be paid if the PSSP can afford it.

The trustee of the PSSP, Public Service Superannuation Plan Trustee Inc. (Trustee), determines if any indexing can be granted based on the rules of the funding policy. This occurs at 5-year intervals. The Trustee would only be able to grant indexing that fully matched the CPI (Consumer Price Index) if the PSSP was extremely well funded and anticipated to remain so for quite some time. At its current funded level, the Trustee is only able to grant a portion of CPI indexing in accordance with the funding policy*.

For further detail as to how the Trustee determines the granting of indexing, please follow this link to the PSSP web site: ***www.nspssp.ca/publicservice/members/your-retirement/cost-living-adjustment***

**It is worth noting, however, that the portion of your retirement income that you receive directly from the Canada Pension Plan and Old Age Security is fully indexed to CPI.*

Why does the PSSP need a funding policy?

Prior to the *PSSA* changes initiated in 2010, the PSSP was running a deficit of approximately $1.5 billion. Those changes restored the PSSP's financial health, incorporated a new funding policy based on objective metrics, and introduced joint responsibility shared between members and employers. The PSSP is now constructed to be sustainable for generations and is designed to treat all PSSP members, actives and retirees, as fairly and equitably as possible. The funding policy has been key in helping the PSSP's funded status remain at or above 100% since 2010.

What is the difference between conditional indexing and guaranteed indexing?

Conditional indexing means it may or may not be granted depending on what the pension plan can afford.

Guaranteed indexing means that indexing is promised at a fixed level on a go-forward basis, no matter the funded position of the plan.

Because it is promised for all years, now and into the future, guaranteed indexing imposes a significant financial cost to a pension plan. This is because the pension plan's actuary is professionally obligated to account, fully and immediately, for the cost of all future years of indexing for every member of the plan. Since the indexing is guaranteed, it must form part of the pension plan's liabilities from the very moment it has been promised.

Conditional indexing, on the other hand, does not provide an indefinite guarantee of indexing. It therefore costs a pension plan much less because the plan only has to account for indexing payments for a specific number of years to a sub-group of the plan's total membership.

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Why doesn't the Province of Nova Scotia pay extra money into the PSSP so that I can receive guaranteed full CPI indexing?

The Province has no responsibility to make extra payments to the PSSP since the changes that were initiated in 2010. The Province is simply one of the forty or so employers that currently participate in the PSSP. Its only obligation is the same as that of any other employer, to pay its share of contributions to the PSSP in respect of its employees. (As discussed above, the cost attached to guaranteed full CPI indexing is, in any event, extremely large and therefore, practically speaking, untenable.)

Why doesn't the PSSP provide guaranteed indexing for all its members?

The PSSP's funding policy does not allow for guaranteed indexing. Guaranteed indexing is very expensive and, if tied directly to full CPI, would drive the PSSP into an immediate deficit position.

The PSSP has a limited amount of funds and must be managed carefully, keeping in mind the interests of its active and retired plan members, as well as the interests of its future generations. The Plan is no longer 'backstopped' by the Province and must 'sink or swim' on its own. This makes it even more important for the Trustee to strictly adhere to the PSSP's funding policy.

If not for all members, why not at least guarantee indexing for current retirees?

A selective payment approach is not permitted under the PSSP's funding policy. Furthermore, it would be fundamentally unfair to those excluded. The PSSP is designed to provide retirement security to all its members equitably.

If the PSSP has a surplus in any given year, why isn't some of that surplus paid to retirees to supplement their pensions?

This is not permitted under the PSSP's funding policy. The Trustee has no discretion to grant ad-hoc or special indexation. Such a short-term focus or approach is not a prudent way in which to manage a pension plan, which must have a very long-term focus.

The premise of the funding policy is to look at the PSSP's surplus/deficit situation every 5 years to set indexing (if any) for the following 5 years. If some indexing can be granted, this gives retirees some certainty about the level of inflation protection for an extended period of time, rather than having to wonder from year to year whether there will be indexing or not.

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What would happen to the PSSP if it provided guaranteed indexing at 2% per year, now and into the future?

The PSSP's liabilities are made up of hundreds of thousands of retirement years of pension payments for its members, retired now and retiring in the future; and for which the PSSP is obligated to account.

There currently exist liabilities in the PSSP comprised of about 750,000 retirement years of pension payments, the two biggest categories being: 500,000 retirement years for active members (about 17,500 actives who will collect pensions from ages 59 to 87, on average); and 250,000 retirement years for current pensioners and spouses (16,800 pensioners and spouses collecting pensions for another 16 years or so, on average).

Moving from conditional indexing to guaranteed indexing would have a serious and detrimental effect on the PSSP. Providing guaranteed indexing at 2% would immediately cost the PSSP $1.265 billion by increasing its liabilities by this amount. This is due to the effect of compounding. A guaranteed 2% per year increase in the PSSP's current liabilities, compounded over the many decades that those liabilities are due to be paid, immediately balloons those liabilities by this very large amount. Looking at its last year-end valuation, as at December 31, 2018, paying guaranteed indexing at 2% would cause the Plan's funded status to drop to 82%*.

**Based on the December 31, 2018 Actuarial Valuation Report, page 2, the Plan's 'Hypothetical Position if Fully Indexed'. The Actuarial Valuation Report is prepared annually by the PSSP's independent actuary, currently Mercer (Canada) Ltd., in accordance with applicable law and accepted actuarial practice in Canada*

How do other public sector pension plans in Canada deal with indexing for their retirees?

Canadian jointly-sponsored public sector pension plans have increasingly been adopting conditional indexing; and some plans provide no indexing at all. The ability of a pension plan to pay indexing ultimately depends on the plan's funded health.

How does a pension plan's membership demographic influence its funded status? What does the PSSP's membership look like?

A pension plan's 'membership demographic' often refers to its ratio of actively contributing members to its retirees in receipt of pensions. The PSSP is a very mature plan, having only 1.04 active members for every 1 retiree, or a ratio of 1.04:1. (By comparison, 15 years ago the PSSP had 1.5 active members for every retiree.) This means that, every year, pensions paid to PSSP retirees exceed the contributions paid in by active employees and matched by their employers by a significant amount (about $180 million in fiscal 2018-19). This imbalance has been worsening year-over-year as the 'baby boom' cohort moves into retirement, and it continues to negatively impact the funding of the PSSP*.

** This gap between contributions and benefits paid has been offset by investment returns. The PSSP's investment returns are consistently solid, measured over various time periods. The most recent 10-year annualized net return figure is 7.97%. (Taken from the fiscal year 2019-20 Q1 Investment Report.) The changes to the PSSP initiated in 2010, together with steady investment returns, have kept the Plan's funded status at or above 100%, on a going concern basis, despite the mounting demographic challenges.*

Most other Canadian public sector pension plans have stronger ratios of active members to retirees than the PSSP's.

A pension plan's membership demographic is a very difficult thing to change. The Trustee recognized the Plan's low ratio of actives to retirees and undertook a new membership growth initiative in 2015. While this is not going to fully solve the demographic issue, growing the active membership does expand the Plan's overall base and is helpful to the Plan.

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Why don't active members and employers pay more so I can receive full CPI indexing?

The PSSP's active members and its employers already pay substantial contributions. The December 31, 2018 Actuarial Valuation Report details (on page 9) that the combined contributions from members and employers totaled about $194 million for that year. The actual required contribution cost for that period was only about $141 million, resulting in what actuaries refer to as a 'current service cost excess' of about $53 million.

This means that active members and their employers are already making significant payments to help keep the PSSP on a sustainable track.

Is there any risk that my base pension itself might be reduced?

No. The PSSP's legislation specifically protects your base pension. It also protects any previous indexing that has already been applied to your base pension amount. Conditional indexing applies only on a go-forward basis.