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## RREGOP HEALTH CHECK-UP

# THE PATIENT IS NOT DOING SO BAD



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## Health check-up in short

### 1 RREGOP<sup>1</sup> health condition on December 31, 2011

- ✓ Actuarial value of the contributors' fund: 40.90 billion dollars
- ✓ Actuarial value of acquired benefits (liabilities): 43.55 billion dollars
- ✓ Actuarial deficit: 2.65 billion dollars

The liabilities take into account the pensions that will be paid out over a period of **more than 70 years**. If they were equal to the actuarial value of the fund we could say that the plan is fully funded. The **2.65 billion dollar** shortfall means that the plan is **93.9%** funded (40.90/43.55).

### 2 Main causes of the health deterioration

#### a) End of the distribution of the 2008 shortfall

The 12 billion dollar shortfall of 2008 was distributed over a 5 year period. It is in the current actuarial valuation that its impact is the hardest felt. However, **from 2009 through 2012 the average return was 9.4%**. With regard to returns, **we can hope that the worst is behind us**.

#### b) New actuarial assumptions

The long term return assumption for the fund has been revised from 6.5% to 6.25%. This slight modification accounts, on its own, for 1.5 billion dollars of the actuarial deficit. Also, the adjustment to the life expectancy tables explains 0.24 billion dollars of the deficit.

### 3 The cure: increased contributions

- 2013: 9.18% of the portion of earnings exceeding \$15841
- 2014: 9.84% of the portion of earnings exceeding \$15225
- 2015: 10.50% of the portion of earnings exceeding 27% of the MPE<sup>2</sup> (unknown)
- 2016: 11.12% of the portion of earnings exceeding 25% of the MPE (unknown)

### 4 Is the cure too expensive?

Comparison of the percentage that represents the contributions based on a \$70 000 annual salary

RREGOP:	_____	7.7% (2014)
Ontario Teachers Pension Plan:	_____	11.9% (2014)
Alberta Teachers Pension Plan:	_____	12.8% (2013)
British-Columbia teachers pension Plan:	_____	12.9% (2013)

**We look good in comparison!**

### 5 Is the health condition of the RREGOP out of control?

**NO.** The RREGOP has suffered its very first funding shortfall in its 40 year history. We are not facing a chronic illness! Even with the 2008 disaster the plan is still 93.9% funded. **The patient must remain under observation but is in a relatively satisfactory and stable condition.**

### 6 Is the RREGOP overweight?

**NO.** The RREGOP already provides for, since 1982, an equal sharing of the costs with the government (50/50) (as proposed in the action plan put forth by Minister Agnès Maltais last December). Moreover, the RREGOP is not as generous as many other plans with regards to the criteria for retirement, the amount of the pension or cost of living adjustments. **In short, the RREGOP is at a healthy weight and in no need for a radical diet.**

### 7 Is the RREGOP deficit borne by all taxpayers?

**NO.** The 2.65 billion deficit of the contributors' fund is **entirely payable by the persons who contribute to the plan and must be replenished by an increase in the contributions deducted from their pay.**

For more information, consult the detailed report in the following pages or at [www.lacsq.org/dossiers/bilan-de-sante-du-rregop/](http://www.lacsq.org/dossiers/bilan-de-sante-du-rregop/). The actuarial valuation is available at [www.carra.gouv.qc.ca/fra/publications/evaluation\\_actuarielle.htm](http://www.carra.gouv.qc.ca/fra/publications/evaluation_actuarielle.htm).

1 Government and public employees retirement plan.  
2 Maximum pensionable earnings for the Quebec Pension Plan.

## Detailed health check-up

### A) INTRODUCTION

The RREGOP<sup>3</sup> actuarial valuation on the 31 of December 2011 was made public on November 11, 2013. The delay between December 2011 and November 2013 represents the time it takes the CARRA<sup>4</sup> to gather, compile and validate all the information concerning participants coming from all the employers covered by the RREGOP and then proceed to actuarial analyses and calculations.





In fact it's a health check-up for the RREGOP performed by the actuaries from the CARRA every three years. It must be noted that only the contributors' fund is considered by this valuation. (We will discuss later about the government's "fund" or what takes its place). Since its publication many commentators have drawn dire, even alarmist conclusions. What are the actual facts? In other words: "Doctor, is it serious?"

Before going further into this health check-up it would serve well to begin with a short course in "medicine 101". This will allow us to define a few basic notions useful to understand the present state of health of the RREGOP.

### B) BASIC NOTIONS<sup>5</sup>

#### 1 Defined benefit pension plans

In a defined benefit pension plan such as the RREGOP:

-  the amount of the pension is known in advance and is set by the number of years of participation in the plan;
-  the pension is assured and paid until death;
-  the liabilities concerning plan financing as well as the risks associated with a financial crisis, financial market returns and life expectancy are borne collectively by the persons who contribute to the plan and the employer;
-  poor returns or shortfalls have no impact on the pension paid to retirees.

#### 2 Pension plan liabilities

The liabilities of a pension plan represents all the promises towards all the participants, active or retired (promises of pensions or acquired benefits). In other words, it is the amount required to pay all the pensions for all the persons already retired until their death and those of all the active participants when they retire.



In the RREGOP, **each year of contribution** generates an amount of pension payable at retirement. The liabilities therefore must provide for, amongst other, pension benefits acquired during the first working years of persons barely 20 years of age at the time. These benefits, **already acquired now**, will only be payable upon retirement perhaps in 40 years time. These sums will then be paid until death, perhaps 30 or more years later. Thus, the liabilities of a pension plan must provide for sums **that are only payable in 70 or 80 years time**.

#### 3 Pension fund

Contrary to most pension plans, the RREGOP has two distinct funds: the contributors' fund and the employer's fund (government of Quebec). These two funds are responsible for 50% each of the expenses for pensions payable to all retirees, present and future.

##### a) The RREGOP contributors' fund

It is the fund made up of the contributions deducted on salaries and of the returns on investments. This fund is managed by the *Caisse de dépôt et placement du Québec*.

##### b) The government's fund

Firstly, it must be noted that the government did not put any money in an actual fund between 1973 (creation of the RREGOP) and 1993. It simply paid its share (50%) of the pensions payable each year. However, in 1993, the government established the *Fonds d'amortissement des régimes de retraite* (FARR), in which it deposits sums for all its pension plans, the RREGOP being one of them. In 2013, the FARR had about 60%<sup>6</sup> of the funds required to pay for its part of acquired pensions. The government has committed to reach 70% of the funds required by 2020.

3 Government and public employees retirement plan. On December 31, 2011 525 000 active participants from the education, health and social services and public service networks were covered by the plan.

4 Commission administrative des régimes de retraite et d'assurances (the plan administrator).

5 Also see "RREGOP: Myths and realities" and "Qu'on se le dise: Le RREGOP n'est pas au bord de la faillite" at [www.lacsq.org/dossiers/bilan-de-sante-du-rregop/](http://www.lacsq.org/dossiers/bilan-de-sante-du-rregop/).

6 QUÉBEC, MINISTÈRE DES FINANCES (2012-2013). *États financiers consolidés du gouvernement du Québec*, p. 124.



### C) RREGOP HEALTH CHECK-UP

#### 1 Doctor, generally, what is the health condition of the RREGOP in reference with its last check-up on December 31, 2008?

##### Comparison of the financial state of the RREGOP in 2008 and in 2011

	2008	2011
Actuarial value of the RREGOP	\$37.78B	\$40.90B
Value of acquired benefits (liabilities)	\$34.72B	\$43.55B
Surplus or actuarial deficit (net liabilities)	Surplus of \$3.06B	Deficit of \$2.65B

To better understand the impact of the 43.55 billion dollars in liabilities, one must remember that this amount includes all promised pensions for a period of more than **70 years**.

As for the actuarial value of the plan (40.90 billion) it is the result of an adjustment made to its market value (value of the fund if it sold tomorrow morning). This adjustment serves to distribute the gains and shortfalls of the plan over a five year period. This avoid that the “x-ray” of an actuarial valuation taken at one particular point in time be too heavily weighted by punctual financial market ups and downs that would not be representative of the long term evolution of the fund. Just as you would not consider as representative, the weight registered on the scale on January 2 after Holiday feasting!

However, the fluctuation from a 3.06 billion dollar surplus to a 2.65 billion dollar shortfall undoubtedly shows that the state of health of the RREGOP has deteriorated between 2008 and 2011.

#### 2 Doctor, what explains the deterioration of the state of health of the RREGOP?

Here are two of the major reasons.

##### a) End of the distribution of the 2008 shortfall

We don’t have to be reminded how disastrous 2008 was for financial markets and the majority of pension plans around the world. The RREGOP contributors’ fund suffered losses of over **12 billion dollars** (about **25%** of the assets). As this shortfall is distributed over a 5 year period it is in the present actuarial valuation that its impact is the most felt. In fact, the effects of 2008 explain the major portion of the present funding shortfall. The good news is that we will no longer suffer from that impact.

On the other hand, the excellent returns obtained by the RREGOP fund after 2008 (average yearly returns of **9.4%** between 2009 and 2012) are also distributed over a 5 year period. Thus we do not yet see their full impact, the positive effects will be more visible in the next actuarial valuation on December 31, 2014. We can add that the returns for 2013 appear to be very good also. **In short, with regard to returns on investments we can hope that the worst is now behind us<sup>7</sup>.**

##### b) New actuarial assumptions

The actuarial assumptions are, in a way, forecasts established by actuaries as to the state of health of the plan in the future. There are numerous assumptions and they do not all have the same impact on the plan. We will examine two that are of great importance: the assumptions concerning investment returns and the assumptions concerning life expectancy.

In previous actuarial valuations, the actuaries assumed a medium to long term return rate of 6.5% for the RREGOP. For the present valuation they chose to forecast the return rate at 6.25%. Trivial, one could say! This minute modification accounts, on its own, for 1.5 billion of the shortfall.

It must be noted that this 6.25% assumption used by the CARRA actuaries has been validated by independent actuaries and is in compliance with the Canadian Institute of Actuaries standards of practice. As mentioned earlier the yearly average rate of return for the years 2009 through 2012 was **9.4%**. For the years 2003 through 2012 this average rate of return was **6.5%** in spite of the 2008 disaster. Finally, since the establishment of the RREGOP in 1973 the average rate of return is **9.3%**.

As for life expectancy, you will not be surprised when we say that it has been on the rise for many years. This improvement in life expectancy beyond the assumptions utilized in the past years, is badly hurting many pension plans. Indeed, it entails that pensions will be paid over a longer period. The RREGOP does not completely elude this fact but the life expectancy charts used by the CARRA up to now were somewhat closer to the new assumptions that are being recommended nowadays. An adjustment was made to these tables for the current actuarial valuation, it had a lesser impact (0.24 billion dollars) than in other plans. It is not impossible that another adjustment will be required for the next actuarial valuation, but part of the effort has already been given.

7 For more details concerning RREGOP investment returns consult, [www.carra.gouv.qc.ca/pdf/rendements\\_RREGOP\\_2012\\_f.pdf](http://www.carra.gouv.qc.ca/pdf/rendements_RREGOP_2012_f.pdf).

### 3 Doctor, is there a cure?

**YES.** There is one that is automatically dispensed by virtue of the RREGOP regulations: an increase of contributions over the next three years. These increases will permit the long term stabilization of the RREGOP.

To be clear, the following contribution rates are made up of two elements: the contribution for current service and the contribution to balance the fund.

On December 31, 2011, the contribution needed to meet all the RREGOP's promises (current service) had to be increased to 7.60% of the salary mass for all the participants (in comparison with 6.77% on December 31, 2008). But, since there is a 2.65 billion shortfall that must be replenished over a 15 year period, a balance contribution of 0.82% must be added bringing the rate of contributions to 8.42% of the salary mass.

However, there is an exemption built in to the RREGOP rate of contribution. The rate is not applied to the total salary but only on the portion that exceeds this exemption. Since the establishment of the RREGOP in 1973 up until, and including, 2011, this exemption has always been equal to 35% of the maximum pensionable earnings (MPE) for the Quebec pension plan (QPP). The percentage of the MPE used to establish the exemption is being lowered by 2% each year until it reaches the 25% level in 2016 that will be applicable in the future.

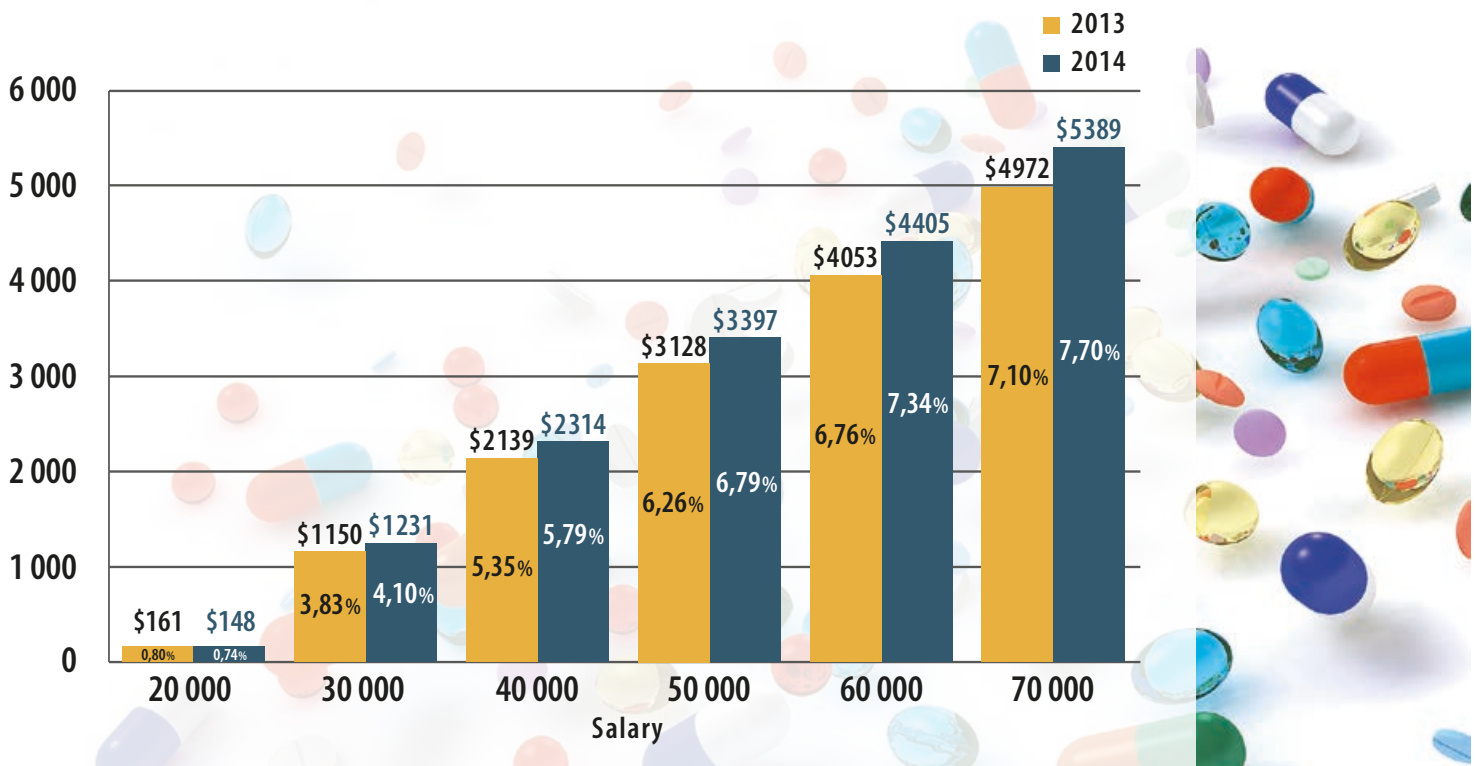
In concrete terms, when it is said that the RREGOP rate of contribution in 2013 is 9.18% that means that one contributes 9.18% of the portion of his or her salary that exceeds 31% of the MPE, either 31% of \$51 100 or \$15 841. It should be noted that the MPE increases every year.

#### Rate of contribution for 2013 to 2016

Year	MPE	Exemption in % of MPE	Rate of contribution	Salary for contributions
2013	\$51 100	31%	9,18%	Salary-(51100\$x 31%) = Salary-\$15841
2014	\$52 500	29%	9,84%	Salary-(52500\$x 29%) = Salary-\$15225
2015	unknown	27%	10,50%	Salary-(MPEx29%)
2016	unknown	25%	11,12%	Salary-(MPEx25%)

Let's take a look at what the rates of contribution represent in dollars and in percentage of the total yearly wages (without the exemption).

#### Contributions to the RREGOP for 2013 and 2014



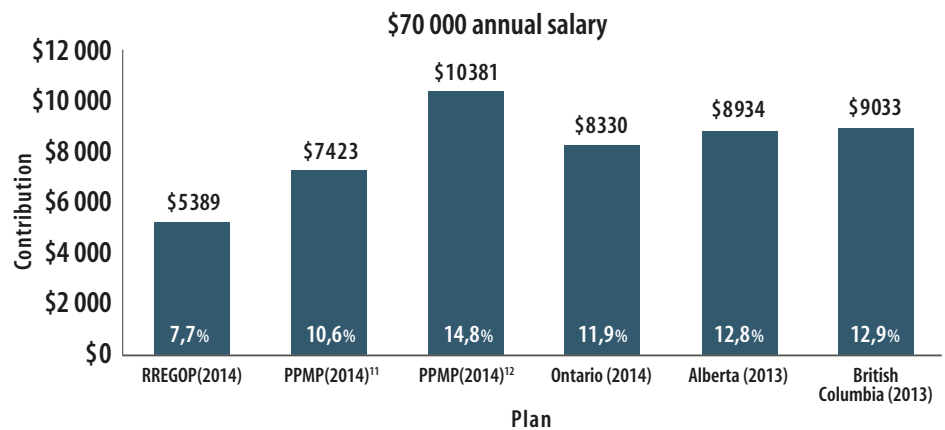
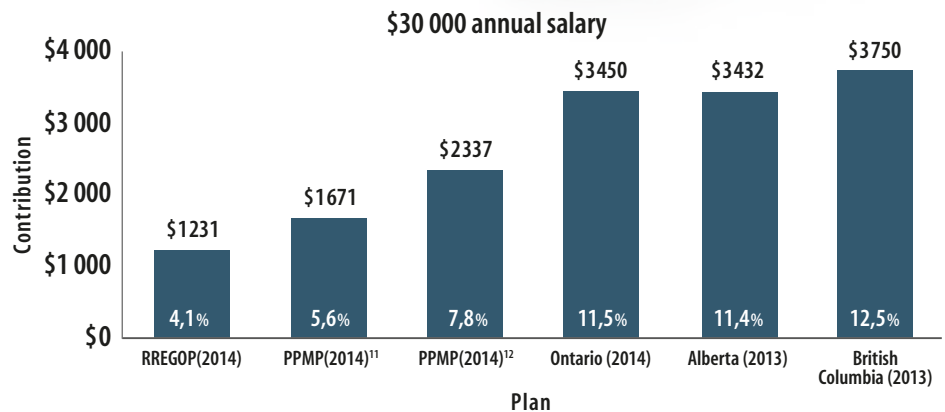
**4 Doctor, is the cure too expensive?**

**NO.** The issue is not whether the RREGOP is too expensive but rather if we feel it is worth the price. Considering the undeniable value of a defined benefits plan and the importance to be able to count on a sufficient, assured and stable retirement income we believe that the RREGOP is well worth the price. For that matter, all the specialists, including those members of the D'Amours committee<sup>8</sup>, agree on the fact that defined benefits plans are the safest and most efficient way to assure a decent retirement income. One could say that it is a bit more costly, but it's better than candy.

We also have to keep in mind that all defined benefit plans are somewhat costly. However, as the two following charts will show, **the RREGOP, compared to other plans elsewhere in Canada, shows very well.**



**Comparison of the RREGOP, the PPMP<sup>9</sup> and plans in other provinces<sup>10</sup>**



As we have shown, based on an annual salary of \$70 000, the percentage of the total salary represented by the contribution is clearly lower for the RREGOP (7.7%) than for other plans (from 12 to 13% in the other provinces shown). Even if you find the RREGOP to be expensive these charts can only lead to one conclusion: We are not doing that bad!

8 Committee set up by the government of Quebec to analyze the pension system in general and defined benefits plans in particular, a report was submitted in April 2013.  
 9 Pension Plan for Management Personnel.  
 10 Elementary and secondary teachers' pension plan. Examples calculated on the basis of data available on their respective websites.  
 11 Real contributions.  
 12 Contribution the management personnel would have had to pay had the government, following a temporary agreement, not borne part of the contribution over and above its habitual 50% share.



**5 Doctor, is the health condition of the RREGOP out of control and will the cost of the cure increase indefinitely?**

**NO.** The RREGOP has just suffered its first funding shortfall in its 40 year history. We are not facing a chronic illness. Obviously, no one wants to hear the word deficit. But considering the scale of the 2008 disaster the RREGOP has managed quite well. Indeed, the plan is still **93.9%** funded. In other words it has 93.9% of the funds necessary to cover all its liabilities. Those are enviable results.

It is a fact that successive sizeable increases in contributions have been and will continue to be necessary until 2016. However these increases are for the most part due to the 2008 storm and the review of certain actuarial assumptions (return on investment assumptions, increase in life expectancy, etc.). The worst is now behind us.





Even though some factors could still push us towards further increases in the rate of contributions, others, specifically the excellent returns obtained over the past few years could diminish or eliminate their impact. It is not impossible that more increases in contributions occur after 2016 but, in the medium term, we could also see some stabilization. **In short, the patient must remain under observation but he is in a relatively stable and satisfactory condition**<sup>13</sup>.

**6 Doctor, is the RREGOP overweight and should it be subjected to the “horse medicine” prescribed for municipal pension plans?**

**NO.** Defined benefit plans in general and the RREGOP in particular are often pictured as the “Cadillacs” of pension plans. As we have seen above, they are in fact the best pension plans. Is that to say that they are too “luxurious”, too “shiny” or too “fat”?

We do not want to nourish a discussion where certain commentators depict public sector pension plans as “fat cat” plans. Let us simply remind that a pension plan is in fact deferred salary that is only one component of an overall remuneration package that can also include group insurance, holidays, legal holidays, etc. In such, it is disingenuous to assess a plan today without taking into account the overall context in which it was negotiated.

Be what it may for other plans but it is important to specify that the RREGOP is far from being in such an insecure financial situation as some municipal pension plans and is in no way overweight. To prove our point, here are some of its characteristics:

-  equal cost sharing between employer and contributors (50/50 compared to many plans that are 60% or 70% employer funded, some even more);
-  retirement criteria without reduction set at 35 years of service or 60 years of age;
-  accumulation of benefits set at 2% per year and coordination at 65 years of age thus reducing that 2% to approximately 1.3% (compared to some plans that are over 2% or do not provide for coordination)
-  partial cost of living adjustments (compared to full cost of living adjustments).

**In short, the RREGOP is at a healthy weight and in no need of a radical diet!**

Let us add that **the Plan of action introduced by Minister Agnès Maltais last December does not concern, in any way, the RREGOP.** Moreover, the principal measure put forth by the government is to render a 50/50 cost sharing of future obligations compulsory. The RREGOP has been doing that since 1982<sup>14</sup>!

Anyway, should there be discussions concerning the RREGOP they would take place within the framework of the collective bargaining process for the renewal of public and parapublic collective agreements that will expire on March 31 2015.

13 Also see “RREGOP: Myths and realities” and “Qu’on se le dise: Le RREGOP n’est pas au bord de la faillite” at [www.lacsq.org/dossiers/bilan-de-sante-du-rregop/](http://www.lacsq.org/dossiers/bilan-de-sante-du-rregop/).

14 Also see “RREGOP: Myths and realities” and “Le RREGOP: un exemple à suivre” at [www.lacsq.org/dossiers/bilan-de-sante-du-rregop/](http://www.lacsq.org/dossiers/bilan-de-sante-du-rregop/).

### 7 Doctor, do we have to look into other remedies?

**NO.** Beyond increased contributions, the other possible cure would be a revision of the benefits provided by the RREGOP to reduce the overall cost. Some groups are being compelled to make very difficult choices at this time because the rate of contributions for their plan has become untenable (see charts on p. 5).

The RREGOP is not only far from being too costly, it does not have a weight issue that would justify a crash diet. Instead of going the way of a “remedial cure” we took advantage of the last negotiations in 2010 to give the RREGOP a preventive treatment.

Indeed, we moved from a “levelled premium” funding and actuarial valuation method to a “single premium” method. Essentially the modification was brought forth to provide for greater stability of the rate of contributions in the long term. Without this precautionary measure, the increases in contributions would have been even greater.

Clearly it would be premature to envisage adjustments to the RREGOP at this point, when we have only just put in place, in 2010, conditions to provide for greater stability of the rate of contributions. We must also keep in mind that the present situation is, for the most part, due to the 2008 setback. It seems wiser to wait, at least, for the next actuarial valuation on December 31, 2014 (that will be made public in October 2016) before giving a clearer opinion concerning long term perspectives.

### 8 Doctor, is it true that cost of the health care given to the RREGOP is to be borne by all tax payers?

**NO.** As a rule, a defined benefit plan has only one fund. The eventual funding shortfalls are entirely the employer’s responsibility.

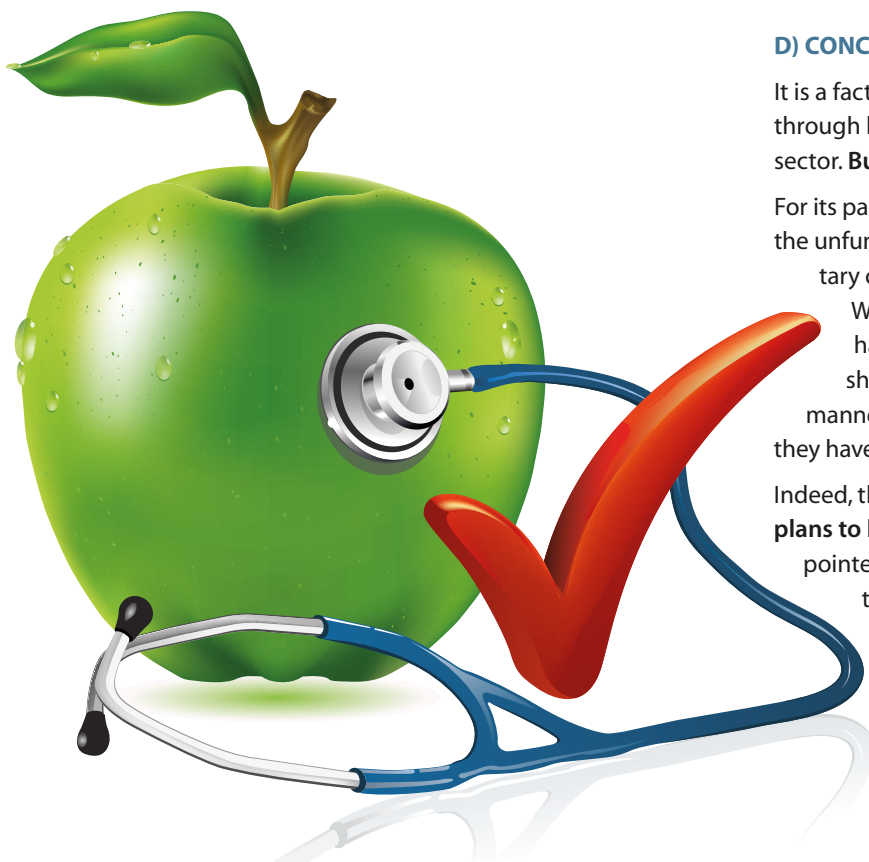
That is not the case for the RREGOP. As we have seen, the contributors’ fund has a 2.65 billion dollar shortfall which represents only 6.1% of its liabilities. Only the contributors will have to replenish this shortfall by way of the increased contributions deducted from their pay.

As for the government’s fund, the deficit stems from the fact that successive governments from 1973 to 1993 set no money aside to meet their obligations. The RREGOP contributors can surely not be blamed for the budgetary choices made by those governments.

So, why would it be inappropriate for the government to pay its share (50%) of its employees’ pension plan knowing that this constitutes, in fact, deferred salary included in an overall remuneration package? To question whether the government should pay its share of the RREGOP is tantamount to questioning whether the government should even pay its personnel!<sup>15</sup>



15 Also see “RREGOP: Myths and realities” at [www.lacsq.org/dossiers/bilan-de-sante-du-rregop/](http://www.lacsq.org/dossiers/bilan-de-sante-du-rregop/).



#### D) CONCLUSION

It is a fact that many defined benefits plans are presently going through hard times, both in the private sector and in the public sector. **But the RREGOP, for one, is not at death's door.**

For its part, the government of Quebec is solely responsible for the unfunded portion of the RREGOP in the FARR. Its budgetary choices over the last decades are of his own making.

Without wanting to cast blame, it would be, on the other hand, profoundly unfair to transfer this burden onto the shoulders of government employees. It would be an odd manner by which to recognize the caution and moderation they have demonstrated with regard to their pension plan.

Indeed, the RREGOP's contributors' fund is **one of the only plans to be almost fully funded (93.9%)**. Rather than being pointed out as being undue financial burden for the population, **government employees should be cited in example for having succeeded in keeping the RREGOP in a relatively enviable state of health.**

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