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CHAPTER 1, PUBLIC SECTOR PENSION PLANS, OF THE SPRING 2014 REPORT OF THE AUDITOR GENERAL OF CANADA

Report of the Standing Committee on Public Accounts

David Christopherson
Chair

SEPTEMBER 2014

41st PARLIAMENT, SECOND SESSION

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has the honour to present its

NINTH REPORT

Pursuant to its mandate under Standing Order 108(3)(*g*), the Committee has studied Chapter 1, Public Sector Pension Plans, of the Spring 2014 Report of the Auditor General of Canada and has agreed to report the following:

CHAPTER 1, PUBLIC SECTOR PENSION PLANS

INTRODUCTION

As the plans' sponsor,[1] the federal government is responsible for the pension plans provided to members of the federal public service, the Canadian Forces and the Royal Canadian Mounted Police (RCMP) (hereafter, these pension plans are collectively referred to as "the three major public sector pension plans"). As of 31 March 2013, these plans represented 95% of the federal government's public sector pension liabilities.[2] Under the superannuation acts that establish these plans, the government has a statutory obligation to provide pension benefits to eligible plan members upon retirement.[3] As they are defined benefit pension plans, the federal government is responsible for ensuring that sufficient funds are available to finance the benefits to which plan members are entitled and any actuarial deficits. Moreover, because the plans have a statutory basis, their liabilities have direct budgetary implications. As of 31 March 2013, estimated net liabilities associated with the benefits under these plans were $151.7 billion.[4]

The three major public sector pension plans are financed by employee and employer contributions, interest and – since the creation of the Public Sector Pension Investment Board (PSPIB) on 1 April 2000 – investment earnings. The plans have two types of accounts: superannuation accounts for contributions made before 1 April 2000, and pension fund accounts for contributions made since 1 April 2000. The plans pay defined benefits to plan members based on salary and years of service; benefits are not affected by economic circumstances, investment returns and/or interest rates.

The Treasury Board of Canada Secretariat (TBS), the Department of National Defence (DND) and the RCMP manage the pension plans under their administrative mandate on behalf of their ministers. The TBS also coordinates the federal government's stewardship duties for other public sector pension plans. The Department of Finance is responsible for providing analyses of Canada's budgetary situation and outlook; the funding adequacy and sustainability of the three major public sector pension plans can have federal budgetary implications.

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1 The Treasury Board represents the federal government as the sponsor of the public sector pension plans.

2 Public Works and Government Services Canada, Public Accounts of Canada 2013 – Volume I: Summary Report and Consolidated Financial Statements, 30 October 2013, p. 6.21. The remaining 5% of the federal government's public sector pension liabilities relates to the Reserve Forces Pension Plan, as well as various retirement allowances and compensation arrangements for members of Parliament, federally appointed judges and other public servants.

3 In addition to providing pension benefits on retirement, the public sector pension plans provide other types of benefits to plan members, including payments to survivors and eligible children, and supplementary death benefits.

4 Public Works and Government Services Canada, Public Accounts of Canada 2013 – Volume I: Summary Report and Consolidated Financial Statements, 30 October 2013, p. 1.18.

In its Spring 2014 Report, the OAG released a performance audit that examined whether the TBS, DND, the RCMP and the Department of Finance carried out selected aspects of their governance and management responsibilities with regard to the three major public sector pension plans.[5] The OAG's audit did not assess the sustainability of these pension plans at a particular point in time, and nor did it examine the administrative process, investment practices or methods used in actuarial calculations.

The House of Commons Standing Committee on Public Accounts (the Committee) held hearings on this audit on 28 May 2014[6] and 4 June 2014.[7] From the OAG, the Committee met with Nancy Cheng, Assistant Auditor General, and Richard Domingue, Principal. From the TBS, the Committee met with Daniel Watson, Chief Human Resources Officer, Kim Gowing, Director, Pensions and Benefits Sector, and Bayla Kolk, Assistant Deputy Minister, Pensions and Benefits Sector. From the Department of Finance, the Committee met with Nicholas Leswick, Director, Fiscal Policy Division. From the RCMP, the Committee met with Assistant Commissioner Gilles Moreau, Director General, Workforce Programs and Services, Chantal Pethick, Director General, IT Service Delivery, Chief Information Office Sector, and Geneviève Tremblay, Director, Pension Services. From DND, the Committee met with Major General David Millar, Chief of Military Personnel, and Commodore Lynn L. Bisson, Assistant Chief of Military Personnel. From the Office of the Chief Actuary, the Committee met with Jean-Claude Ménard, Chief Actuary. From the Public Sector Pension Investment Board (PSPIB), the Committee met with John Valentini, Executive Vice President, Chief Operating Officer and Chief Financial Officer.

ROLES AND RESPONSIBILITIES

The *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* and the *Royal Canadian Mounted Police Superannuation Act* establish the three major public sector pension plans, and prescribe the legislative obligations and administrative responsibilities of the TBS, DND and the RCMP in relation to their respective pension plans. In its audit, the OAG examined selected aspects of the entities' legislated roles and administrative responsibilities in relation to the pension plans. Nancy Cheng, Assistant Auditor General, remarked that the TBS, DND and the RCMP had carried out their legislated responsibilities.[8]

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5 Office of the Auditor General of Canada, "Public Sector Pension Plans," Chapter 1 in Report of the Auditor General of Canada – Spring 2014, Ottawa, 2014.

6 House of Commons Standing Committee on Public Accounts, Evidence, 2nd Session, 41st Parliament, 28 May 2014, Meeting 29.

7 House of Commons Standing Committee on Public Accounts, Evidence, 2nd Session, 41st Parliament, 4 June 2014, Meeting 31.

8 Meeting 29, 1615.

The OAG examined actions taken by the audited entities in relation to reviewing existing provisions of the pension plans and found that these entities had recommended changes to those provisions. For example, the OAG mentioned that, according to the TBS, the federal government could achieve savings by reviewing the pension buyback provisions of the public service pension plan; the OAG also noted that the pension buyback provisions of the RCMP pension plan reflect the cost of the liability more accurately.[9] Daniel Watson, the TBS's Chief Human Resources Officer, agreed about the need to align the pension buyback provisions for the public service pension plan with those of the Canadian Forces and RCMP pension plans. He explained that "plans developed in different ways [over time] … and it's time now that we accept what the Auditor General has recommended and improve some of the government's issues … [by looking] at the best practices across all of the different plans that we've had over time."[10] Kim Gowing, the TBS's Director of the Pensions and Benefits Sector, told the Committee that work that will align the pension buyback provisions of the public service pension plan with those of the other two major pension plans is expected to be completed by 2015–2016.[11]

SUSTAINABILITY OF PUBLIC SECTOR PENSION PLANS

According to the OAG, demographic factors – such as increasing longevity – and market conditions – such as low interest rates and lower-than-expected investment returns – can have significant effects on pension liabilities and on the federal government's financial position. In the OAG's view, to ensure that its pension obligations are met sustainably without increasing the public debt or taxes, the federal government needs to consider emerging demographic and economic trends, and to have policy options and a proper pension plan design in place.[12]

At the request of the President of the Treasury Board, the Office of the Chief Actuary prepares actuarial reports that assess the difference between the actuarial obligations and the value of the pension plan funds.[13] Jean-Claude Ménard, Chief Actuary, commented on the purpose of actuarial valuations, explaining that:

> These actuarial valuations are conducted every three years, or whenever an amendment is made that has a significant impact on the financial status of a plan. The purpose of these actuarial valuations is to determine the financial position of the plans and to assist the President of the Treasury Board in making informed decisions regarding the financing of the government's pension benefit obligations. The actuarial assumptions used in the

9 Office of the Auditor General of Canada (2014), para. 1.20.

10 Meeting 31, 1710.

11 Ibid., 1715.

12 Office of the Auditor General of Canada (2014), paras. 1.11–1.12, 1.34.

13 Ibid., para. 1.23.

> actuarial valuations are determine[d] independently by the office and they represent the office's best estimate.[14]

When asked about the government's role in relation to the actuarial assumptions, Mr. Watson told the Committee that the audited entities, with the support of the Department of Finance, the Office of the Chief Actuary and the PSPIB, carry out "ongoing, continual checks" of the actuarial assumptions under which the government operates in order to ensure that they are accurate.[15]

Increased longevity is one risk factor affecting the sustainability of pension plans. Ms. Cheng explained that, as the average Canadian works fewer years and spends more years in retirement, the number of working years per year of pension benefits decreased from 2.9 in 1970 to 1.7 in 2010.[16] Additionally, the OAG noted that, in 2010, the average public service employee spent four more years in retirement than did the average Canadian.[17] Ms. Cheng observed that future increases in longevity will have financial implications affecting the sustainability of the three major public sector pension plans.[18] In this regard, Mr. Ménard indicated that the estimated public sector pension plan liabilities of $151.7 billion – as of 31 March 2013 – included a provision of $7.7 billion to account for future demographic challenges to the plans' sustainability.[19]

Low interest rates and lower-than-expected investment returns are other risk factors in relation to the sustainability of pension plans. In its audit, the OAG found that, in the past three years, the three major public sector pension plans had experienced funding deficits totalling $6.5 billion; to offset these deficits, the federal government recorded special payments to the pension fund accounts of the three major public sector plans totalling about $1 billion over the past two years.[20]

The PSPIB is responsible for investing the post-2000 pension contributions in relation to the three major public sector pension plans, aiming to achieve a long-term rate of return that matches the Office of the Chief Actuary's actuarial valuation of future pension obligations. Currently, the Office of the Chief Actuary assumes that the long-term real rate of return[21] required to meet pension obligations is 4.1%.[22] According to Mr. Ménard, this

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14 Meeting 29, 1630.

15 Ibid., 1715.

16 Ibid., 1640.

17 Office of the Auditor General of Canada (2014), para. 1.12.

18 Meeting 29, 1640.

19 Ibid., 1630.

20 Office of the Auditor General of Canada (2014), para. 1.26. The federal government records special payments to offset the funding deficits based on an amortization period not exceeding 15 years.

21 The "real rate of return" is the inflation-adjusted rate of return.

22 Office of the Auditor General of Canada (2014), para. 1.28.

target rate is consistent with that of the 10 largest pension plans in Canada. Regarding investment performance, John Valentini, the PSPIB's Executive Vice President, Chief Operating Officer and Chief Financial Officer, stated that, in the PSPIB's view, the investment strategy that has been adopted is appropriate to achieve the required target investment return;[23] from 1 April 2003 to 31 March 2013, the PSPIB achieved a rate of return of 6.1% after expenses and inflation.[24] That said, Mr. Ménard also noted that, to account for the current market conditions affecting the PSPIB's ability to meet the 4.1% long-term target, the target rate for the next five years is 3.3%.[25]

The *Public Sector Pension Investment Board Act* requires the PSPIB "to maximize returns without undue risk of loss, having regard to the funding, policies and requirements of the pension plans."[26] In commenting on the PSPIB's legislated mandate and the actuarially derived target investment return, Mr. Valentini stressed that "achieving such a return objective is not risk free." In 2004, the PSPIB adopted a portfolio strategy that diversifies investment options to complement liquid public assets, such as stocks and bonds, with less liquid assets, such as real estate, private equities, infrastructure and renewable resources; less liquid assets typically provide "illiquidity premiums." Given that the PSPIB receives between $4 billion and $5 billion annually in investable funds and will not be required to sell assets to pay pension liabilities until 2030, Mr. Valentini indicated that the PSPIB can use a long-term investment horizon that allows it to benefit from return premiums associated with less liquid investments.

GOVERNANCE

According to the OAG, properly designed governance frameworks for pension plans implement the "best practice" principles of responsibility, fairness and accountability, and support effective decision-making.[27] In its audit, the OAG examined the manner in which the legislated governance framework for the three major public sector pension plans distributes responsibilities among the administrative entities and adheres to these principles.

A. Responsibilities

In the OAG's view, sound governance practices for pension plans require the plan sponsor, in collaboration with the plan administrator, to describe and document clearly the roles, responsibilities and accountability of participants in the governance process. The OAG found that the governance framework for the three major public sector pension

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23 Meeting 31, 1700.

24 Meeting 29, 1630.

25 Meeting 31, 1710.

26 Department of Justice, Public Sector Pension Investment Board Act, S.C. 1999, c. 34, s. 4(1)(a), pp. 3–4.

27 Office of the Auditor General of Canada (2014), para. 1.35.

plans disperses the roles and responsibilities among the audited entities, and that these entities tend to operate independently and to limit their accountability to their legislated responsibilities.[28]

As the plans' sponsor, the federal government is responsible for ensuring the financial sustainability of the three major public sector pension plans. The OAG found that the government had not delegated, to the TBS, responsibility for performing sustainability assessments.[29] Ms. Cheng said that the current legislation governing public sector pension plans does not include the responsibility to conduct systematic assessments of plan sustainability. She indicated:

> It would be reasonable to expect that the plans be designed to be sustainable and affordable. We recommended that the [TBS], in collaboration with the RCMP and [DND], periodically assess the pension plans' sustainability. If deemed appropriate they should recommend changes to plan designs so that they are up to date, affordable, and fair to current and future generations.[30]

When asked whether the OAG was recommending that parliamentarians consider legislative amendments to assign responsibility for conducting systematic sustainability assessments, Ms. Cheng clarified that:

> if the legislators see fit to streamline [the assignment of responsibility for conducting systematic sustainability assessments through legislation] … so much the better, but the recommendation wasn't begging for legislated change. I think … there's good agreement from all parties involved and they feel that they have mechanisms and ways to work within that legislated framework. So we're not prescriptive in terms of suggesting that [the] legislation needs to be amended.[31]

In its audit, the OAG determined that, although it is not legislatively required to perform sustainability analyses, the TBS had assessed the three major public sector pension plans' sustainability upon request by the federal government, rather than on a proactive or regular basis.[32] Mr. Watson indicated that the legislative changes to the pension plans announced in the 2012 federal budget were designed to ensure the plans' sustainability,[33] and that these changes were not the result of the OAG's audit because "work [in relation to the legislative changes] was ongoing well before [the OAG's] audit

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28 Ibid., para. 1.37.

29 Ibid., para. 1.43.

30 Meeting 29, 1615.

31 Meeting 31, 1715.

32 Office of the Auditor General of Canada (2014), para. 1.42.

33 Meeting 29, 1700.

began."[34] The budget[35] increased the pensionable age by five years to 65 years for employees joining the plans on or after 1 January 2013, and will gradually raise the employees' share of contributions to the plans from 39% as of 31 March 2013 to 50% by 2017–2018.[36] In this regard, Mr. Watson remarked that "[t]hese reforms are expected to provide $2.6 billion in savings by the fiscal year 2017-18, and more than $900 million in annual savings after that. In addition to helping ensure the sustainability of plans, these actions will contribute to the ongoing stability of [the plans'] pension costs as a percentage of pensionable payroll."[37]

When asked about the OAG's opinion on the two changes mentioned above, Ms. Cheng replied that the scope of the OAG's audit did not include an assessment of the adequacy of these changes.[38] Additionally, when questioned about the OAG's opinion on the impacts of these changes on the sustainability of the three major public sector pension plans, Ms. Cheng indicated that the two changes will "have a positive impact on the [pension] liability moving forward. They alone though [do] not support the fact that there has been a full assessment of sustainability."[39]

The OAG recommended that the TBS, in collaboration with DND and the RCMP, perform periodic sustainability assessments and issue recommendations on any changes needed to the design of the three major public sector pension plans.[40] According to the OAG, the TBS has analyzed other pension designs, such as defined contribution plans.[41] When asked about the consideration that is being given to changing the plans' design from defined benefit to defined contribution,[42] Mr. Watson, Major General David Millar, Chief of Military Personnel at DND, and Assistant Commissioner Gilles Moreau, Director General

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34 Ibid., 1650.

35 Bill C-45, A second Act to implement certain provisions of the budget tabled in Parliament on March 29, 2012 and other measures, amended the Public Service Superannuation Act, the Canadian Forces Superannuation Act and the Royal Canadian Mounted Police Superannuation Act. Bill C-45 received Royal Assent on 14 December 2012.

36 Treasury Board of Canada Secretariat, Annual Report: Report on the Public Service Pension Plan – For the Fiscal Year Ended March 31, 2013, 28 March 2014, p. 7.

37 Meeting 29, 1620.

38 Meeting 31, 1725.

39 Ibid., 1700.

40 Office of the Auditor General of Canada (2014), para. 1.46.

41 Ibid., para. 1.42

42 With a defined contribution pension plan, a fixed amount or percentage of salary is designated as the contribution rate, and the amount of the pension benefit is based on the assets in the plan at the time of retirement; the amount of assets is affected by investment returns. Accordingly, under a defined contribution pension plan, the investment risk is borne by the plan beneficiary.

Workforce Programs and Services at the RCMP, replied that their respective entities are not considering such a change.[43]

To address the OAG's recommendation regarding the need to conduct systematic sustainability assessments of the three major public sector pension plans, Mr. Watson stated that, going forward, the TBS intends to duplicate the sustainability assessment process that was followed in the lead-up to the changes announced in the 2012 federal budget. He mentioned that the TBS will establish a senior interdepartmental committee with the TBS, the Department of Finance, DND and the RCMP as members, and that this committee "will manage pension-related issues across departments and coordinate work across departments on the government's response to the Auditor General's report."[44]

When asked for details regarding the work plan of the senior interdepartmental committee, Mr. Watson replied that the committee expects to start meeting in summer 2014 and will work on formalizing a process for conducting systematic sustainability assessments for the three major public sector pension plans.[45] He also spoke about the work plan, and indicated:

> Later this fiscal year, or at the beginning of the next fiscal year, we want to make sure we've done a good benchmarking study. We want to look at other similar players around the world to see what the best practices are in governance. From there, we hope to have a plan that we're able to have considered and approved in the following fiscal year.[46]

The Committee notes that the government has been receptive to the OAG's recommendation in relation to conducting systematic assessments of pension plan sustainability,[47] and recommends:

RECOMMENDATION 1

That, by 31 December 2015, the Treasury Board of Canada Secretariat, in collaboration with the Department of National Defence and the Royal Canadian Mounted Police, report to the Standing Committee on Public Accounts on its progress in formalizing a framework for conducting systematic assessments of sustainability for the three major public sector pension plans.

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43 Meeting 29, 1650.

44 Ibid., 1620.

45 Ibid., 1705.

46 Ibid.

47 Ibid, 1710.

RECOMMENDATION 2

That, by 31 December 2015, the Treasury Board of Canada Secretariat, in collaboration with the Department of National Defence and the Royal Canadian Mounted Police, report to the Standing Committee on Public Accounts on the results of its benchmarking study of pension plan governance and sustainability.

In relation to the TBS's analyses used as the basis for introducing the reforms to the three major public sector pension plans that were announced in the 2012 federal budget, the OAG stated that it had been unable to assess these analyses in detail because the TBS had provided it with limited information; according to the TBS, these analyses constitute Cabinet confidences.[48] When asked about the OAG's difficulties in obtaining the detailed documentation from the TBS, Mr. Watson replied that the TBS had shared more than 400 documents and three TBS submissions with the OAG, and that it had received no disputes concerning relevant documents being withheld under inappropriate grounds.[49] He also explained that:

> it's important to differentiate between the evidence around the decisions we did make and the decisions we didn't make. The assumptions that support the decisions that we did make are assumptions largely based on the work of the Chief Actuary, and those actuarial assumptions are available in various reports. … What's being talked about in [relation to documents constituting Cabinet confidences] are the decisions we decided not to proceed with.[50]

In this regard, Ms. Cheng remarked that the TBS had followed due diligence in its decisions regarding the sharing of documentation with the OAG.[51] She also noted that, notwithstanding the OAG's inability to obtain all of the evidence it had requested, the OAG was able to issue a recommendation regarding the need to conduct systematic sustainability assessments of the three major public sector pension plans.[52]

B. Funding Policy

According to the OAG, the development of a funding policy that defines a pension plan's funding objectives and guidelines is an important element of that plan's governance framework. A funding policy provides guidance to ensure that a pension plan has adequate funds to meet pension obligations in a manner consistent with the principle of

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48 Office of the Auditor General of Canada (2014), para. 1.42.

49 Meeting 29, 1655.

50 Ibid., 1710.

51 Ibid., 1655.

52 Ibid., 1710.

intergenerational fairness.[53] Ms. Cheng observed that the legislative framework governing the three major public sector pension plans does not include a funding policy.[54]

The OAG noted that the superannuation statutes prescribe the funding of the three major public sector pension plans but do not include considerations of risk tolerance or acceptable contribution levels. Consequently, in the absence of a funding policy, the PSPIB and the Office of the Chief Actuary must make assumptions regarding the plan sponsor's risk tolerance and funding preference; inaccurate assumptions can result in costs for taxpayers.[55] In this regard, Ms. Cheng commented: "So far the [PSPIB] has assumed that the funding risks required to meet the rate of return on assets set by the actuary are acceptable to the government."[56]

In its audit, the OAG noted that the TBS's Pensions and Benefits Sector had started to draft a funding policy in 2010–2011 that was expected to be finalized in 2013–2014; at the time of the audit, the funding policy had not been completed.[57] The OAG recommended that the TBS – in collaboration with DND, the RCMP and other supporting entities[58] – finalize and implement a funding policy.[59] In discussing the factors that had prevented the completion of the funding policy, Mr. Watson explained that the delay was due to the TBS having done a considerable amount of work in relation to the changes to the three major public sector pension plans that were announced in the 2012 federal budget.[60] Additionally, he mentioned that the TBS's Pensions and Benefits Sector was not fully staffed, noting that "[w]e have just recently made some significant hires and continue to do so, but it is one of the areas in the economy where people who are this good at this type of issue are in high demand."[61] He also said that completing the funding policy "is a very important part [of the TBS's work], to make sure you don't have one generation paying for another in an unfair way. In fact, we're trying to set up the plan so each

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53 Office of the Auditor General of Canada (2014), paras. 1.47–1.49. A pension plan does not adhere to the principle of intergenerational fairness in relation to its funding of pension obligations if one generation must contribute financially to the funding of pension obligations of another generation.

54 Meeting 29, 1615.

55 Office of the Auditor General of Canada (2014), paras. 1.50–1.52

56 Meeting 29, 1615.

57 Office of the Auditor General of Canada (2014), para. 1.49.

58 Supporting entities include the Department of Finance, the Office of the Chief Actuary and the Public Sector Pension Investment Board.

59 Office of the Auditor General of Canada (2014), para. 1.54.

60 Meeting 29, 1705.

61 Ibid., 1715.

generation pays for itself as it reaches retirement."[62] He mentioned that the TBS expects to complete the funding policy in 2015–2016.[63]

The Committee would like to monitor the government's progress in finalizing and implementing a funding policy, and recommends:

RECOMMENDATION 3

That, by 31 December 2015, the Treasury Board of Canada Secretariat, in collaboration with the Department of National Defence, the Royal Canadian Mounted Police and other supporting entities, report to the Standing Committee on Public Accounts on the progress made in finalizing and implementing a funding policy for the three major public sector pension plans.

C. Reporting

According to the OAG, given the complexity of pension plan reporting, the governance framework for pension plans should ensure that information in relation to a plan is communicated in a way that adheres to the principles of transparency and accountability.[64] In its audit, the OAG indicated that the TBS and the Department of Finance should provide complete, consolidated, clear and understandable information to stakeholders about the three major public sector pension plans, their sustainability and their impact on the federal government's budgetary balance. In its audit, the OAG recommended that the TBS, in collaboration with DND and the RCMP, prepare a proposal for a consolidated report on the three major public sector pension plans that would contain clear and understandable information.[65]

In response to the OAG's recommendation, Mr. Watson mentioned that the TBS will collaborate with DND and the RCMP to prepare a proposal for a new consolidated report for consideration by the plan sponsor; if the proposal is accepted, this report will be published in 2015–2016.[66]

The Committee would like to monitor the government's progress in updating the manner in which it communicates information about the three major public sector pension plans, and recommends:

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62 Meeting 31, 1725.

63 Meeting 29, 1705.

64 Office of the Auditor General of Canada (2014), para. 1.58.

65 Ibid., para. 1.65.

66 Meeting 29, 1625.

RECOMMENDATION 4

That, by 31 December 2015, the Treasury Board of Canada Secretariat, in collaboration with the Department of National Defence and the Royal Canadian Mounted Police, report to the Standing Committee on Public Accounts on its progress in finalizing a proposal for a new consolidated and simplified report on the three major public sector pension plans, their sustainability and their impact on the federal government's budgetary balance.

PRE-2000 PENSION OBLIGATIONS

The OAG examined whether the TBS and the Department of Finance had considered options for management of the pension obligations in relation to contributions made prior to 1 April 2000. The notional amounts in the superannuation accounts are considered to represent a notional portfolio of long-term Government of Canada bonds. Legislation requires these accounts to record notional interest credits on a quarterly basis, as though the notional amounts were invested in such bonds;[67] these interest credits totalled $8.5 billion in 2012–2013.[68] As the superannuation accounts do not hold assets, they are unfunded; pension obligations in relation to contributions made prior to 2000 are paid out of current income. According to the OAG, as of 31 March 2013, these unfunded pension obligations totalled approximately $151 billion.[69]

In discussing the process used by the federal government to account for its unfunded pension liabilities, Nicholas Leswick, the Department of Finance's Director of the Fiscal Policy Division, explained: "There is no actual money; it's an unfunded obligation. But it is a line item, in the sense that we bring that interest expense into the government's income statement on an annual basis."[70] He also observed that Canada "is very much a leader in the context of the [Organisation for Economic Co-operation and Development] in the sense that we fully recognize the liability associated with these plans, whether funded or unfunded, on our balance sheet in the Public Accounts of Canada."[71]

In its audit, the OAG indicated that, in 2008, the Department of Finance had analyzed the implications of funding the pre-2000 pension obligations; the interdepartmental committee established to study the matter did not issue a conclusion. The OAG noted that, according to the Department of Finance's analysis, the federal government could fund these pension obligations by issuing bonds and investing the

67 Office of the Auditor General of Canada (2014), Appendix A, p. 32.

68 Ibid., para. 1.77.

69 Ibid., para. 1.73.

70 Meeting 29, 1705.

71 Ibid., 1700.

proceeds in a portfolio at the PSPIB. Depending on the difference between the investment returns and the interest paid on the bonds, this strategy could affect the federal government's budgetary balance.[72] Recognizing that the PSPIB does not have a role in policy decisions regarding the funding of pension liabilities, Mr. Valentini said that he viewed the above-mentioned strategy to fund the pre-2000 pension obligations favourably, adding that the PSPIB would be able to manage these funds.[73] Additionally, Mr. Ménard explained that if the pre-2000 pension obligations were to remain unfunded, the share of unfunded pension obligations in the government's total pension obligations would be expected to decrease over time. He noted that, at present, roughly one third of all pension-related debt is invested with the PSPIB and the remaining two thirds is unfunded; by 2040, tangible assets will support roughly 90% of the government's total pension obligations.[74]

Given the potential benefits – including increased transparency, accountability and simplicity – and risks of funding the pre-2000 pension obligations, the OAG recommended that the Department of Finance and the TBS perform a cost-benefit assessment of funding these obligations and issue recommendations to the plan sponsor.[75] Acknowledging the Department of Finance's agreement with the OAG's recommendation[76] and its commitment to finalize the assessment,[77] the Committee would like to monitor the government's progress in evaluating policy options regarding its unfunded pension obligations, and recommends:

RECOMMENDATION 5

That, by 31 December 2015, the Department of Finance, in consultation with the Treasury Board of Canada Secretariat, report to the Standing Committee on Public Accounts on the results of its assessment of the funding of pre-2000 pension obligations.

CONCLUSION

In the context of an aging population and challenging economic conditions, employees of the public service, the Canadian Forces and the RCMP expect the federal government to ensure that their pension plans are affordable and sustainable over the long term. Canadian taxpayers expect the government to manage these plans in a way that prevents adverse budgetary consequences. The Committee acknowledges the government's agreement with the OAG's recommendations in the Spring 2014 Report and

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72 Office of the Auditor General of Canada (2014), paras. 1.74–1.75.

73 Meeting 31, 1700.

74 Meeting 29, 1700.

75 Office of the Auditor General of Canada (2014), paras. 1.80–1.81.

76 Meeting 29, 1620.

77 Ibid., 1700.

the entities' intention to resolve the issues identified in it. According to the action plans submitted by the TBS and the Department of Finance, the entities expect to have implemented the measures contained in their action plans by the end of 2015–2016.

The Committee recognizes that, when compared to the public pension regimes in other developed countries, Canada's public sector pension plans are solid and liabilities are reported in a transparent fashion. That said, the Committee agrees that the federal government, through its administrative and supporting entities, needs to: formalize its framework for conducting systematic sustainability assessments for the three major public sector pension plans; finalize and implement a funding policy; finalize a proposal for a consolidated and simplified report; and complete its assessment of the funding of pre-2000 pension obligations.

APPENDIX A
LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
Department of Finance	2014/05/28	29
Nicholas Leswick, Director, Fiscal Policy Division		
Department of National Defence		
David Millar, Chief of Military Personnel		
Office of the Auditor General of Canada		
Nancy Cheng, Assistant Auditor General		
Richard Domingue, Principal		
Office of the Superintendent of Financial Institutions		
Jean-Claude Ménard, Chief Actuary, Office of the Chief Actuary		
Public Sector Pension Investment Board		
John Valentini, Executive Vice President, Chief Operating Officer and Chief Financial Officer		
Royal Canadian Mounted Police		
Gilles Moreau, Director General, Workforce Programs and Services		
Treasury Board Secretariat		
Kim Gowing, Director, Pensions and Benefits Sector		
Daniel Watson, Chief Human Resources Officer		
Department of Finance	2014/06/04	31
Nicholas Leswick, Director, Fiscal Policy Division		
Department of National Defence		
Lynn L. Bisson, Assistant Chief of Military Personnel		
Office of the Auditor General of Canada		
Nancy Cheng, Assistant Auditor General		
Richard Domingue, Principal		
Office of the Superintendent of Financial Institutions		
Jean-Claude Ménard, Chief Actuary, Office of the Chief Actuary		

Public Sector Pension Investment Board

John Valentini, Executive Vice President, Chief Operating Officer and Chief Financial Officer

Royal Canadian Mounted Police

Gilles Moreau, Director General, Workforce Programs and Services

Treasury Board Secretariat

Kim Gowing, Director, Pensions and Benefits Sector

Daniel Watson, Chief Human Resources Officer

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings* (Meetings Nos. 29, 31 and 33) is tabled.

Respectfully submitted,

David Christopherson

Chair