

ON GUARD



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Pension surplus trial over Verdict expected in the fall

The trial regarding the \$30-billion surplus taken from the superannuation accounts of the Canadian Forces (CF), the Public Service (PS), and the RCMP has come to a conclusion in the Ontario Superior Court of Justice, in Ottawa. Final arguments began on 1 May, and now the decision regarding who has the rights to the \$30-billion surplus is in the hands of Justice De Lotbinière Panet who is expected to take at least six months to come to a final verdict.

Highlights

This result could have been delayed much further if it weren't for the decision of Justice Panet back in December 2005 to allow 128 internal government documents into evidence. Without these documents admitted as evidence, each topic in the documents would have had to have been discussed and proved during the proceedings. This would have involved calling numerous witnesses to testify and would have lengthened the trial by months.

During the proceedings, the plaintiffs called on several expert witnesses who all disagreed with the crown's claim that there are no assets in the CF, PS, and RCMP superannuation accounts. One particular witness claimed that the surplus in the superannuation accounts is now more than \$42-billion. The plaintiffs state that the superannuation accounts are non-budgetary, specified purpose accounts; and that the funds in a specified-purpose account cannot be used for any other reason than that stated in the account.

Another area of contention was whether or not this case had a constitutional element. It has been disputed that passing Bill-C-78 breached section 15 of the *Canadian Charter of Rights and Freedoms*. The crown stated that there is no disadvantage to any individuals involved - while the plaintiffs argue that employees of the CF, PS, and RCMP have been, and continue to be, disadvantaged for several different reasons.

The making of the trial

The court case challenged the pension surplus related portion of Bill-C-78 that was introduced in the spring of 1999, following failure to reach an agreement on a new pension deal among the bargaining agents, the pensioners' representatives, and the employer. The negotiations ended in December 1998 because the employer refused to discuss the matter of surplus distribution.

Bill C-78 introduced amendments to the superannuation acts that allowed the Minister to withdraw certain portions of the surplus from the superannuation accounts over a period of time up to 15 years. Such withdrawals could only take place for a given plan after an actuarial report on that plan was laid before Parliament.

Three lawsuits challenged the government's decision to take the accumulated surplus. One was filed by the Public Service Alliance of Canada; one by the Professional Institute of the Public Service of Canada on behalf of the other National Joint Council bargaining agents and other organizations, including FSNA; and one was filed by the Armed Forces Pensioners'/ Annuitants'

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Association of Canada in conjunction with SSEA, now the Canadian Association of Professional Employees.

Because the three cases related to the same surplus matter, the three groups of plaintiffs, the government's lawyers, and the Court agreed that the three cases would be heard at the same time, under a single trial. Consequently, the law firms representing each of the cases worked together and held periodic meetings with all of the plaintiffs.

Documents admitted as evidence

In a decision dated 23 December 2005, Justice Panet ruled that 128 internal government documents would be admitted into evidence. These documents support the plaintiffs' argument that plan members legitimately consider that the government, as their employer and sole administrator of the pension plans, should act according to their best interests based on its trust and fiduciary obligations. According to the plaintiffs' lawyers, the documents also show that, in the early 90s, the government instead used the surplus to pay down the national debt by using "opaque" and hidden accounting manoeuvres. They further demonstrate the government's wide discretionary powers to unilaterally seize the assets from the pension accounts.

Most of these documents are statements, written by ministers and high level government officials, on policies covering the pension plans, official statements to plan members (some in the form of information booklets), and briefings to decision makers, including memos to the President Treasury Board and correspondence between Treasury Board and the Ministry of Finance.

Pension funds made up of real assets

When the trial resumed on 26 February 2007, an actuarial expert testified that assets were transferred from the Public Service Superannuation Account to newly created pension plans of local airport authorities, NAV Canada, and Canada Post, providing solid evidence that there were funds in the Public Service pension account.

John Christie, an independent actuarial consultant and Fellow of the Canadian Institute of Actuaries, was the first witness to punch a hole in the employer's argument that no assets existed in the CF, PS, and RCMP pension accounts. He told the Court that when workers were being transferred from Treasury Board to the local airport authorities and to Crown Corporations, assets were withdrawn from the PS pension plan to cover the costs of their pensions that went with them.

"New, independent trustees received a series of cheques and these were invested by an investment manager," Mr. Christie said in explaining how assets were transferred from the PS superannuation account. He added that the PS pension account showed a subsequent reduction due to the transfer.

Origin of deficit

Mr. Christie sat in the witness box for three days and gave his analysis of how the CF, PS, and RCMP pension plans were funded and managed since the 1970s. Using charts and bar graphs, he summarized the results of a series of actuarial evaluations that reported a deficit in the 1970s. He testified that this was predictable given that the actuarial calculated costs were higher than what the employer was required to contribute by law and that the actuary did not make provisions for general salary increases until 1977.

Origin of surplus

However, after 1986, the actuarial evaluations began to report surpluses. These were mainly due to changes in actuarial assumptions, and not through the employer having covered the plan deficits or shouldering unforeseen risks, according to Mr. Christie.

In fact, he demonstrated that the employer had taken what was essentially a contribution

holiday - for which there was no provision in legislation at the time - by using surpluses generated by the funds to reduce the employer's contribution to the plans. As well, the employer had put a cap twice on indexing for inflation in the mid-1980s, which, given the high inflation rates at that time, caused a 6.9% reduction in pension benefits paid out to retirees. The net effect was that the plan members bore a considerable amount of the risk during this period through a lifetime reduction of 6.9% in their indexed pension.

Numbers on a ledger sheet

Mr. Christie's clear and deliberate testimony provided evidence counter to the startling claims made by Toronto litigator Alan Lenczner's opening statement earlier in the trial. Mr. Lenczner led the team of government lawyers in this case. Mr. Lenczner argued that plan members have no claim to the surplus because there was no surplus in the account in the first place but an "over-recording of liabilities." He further argued that the pension accounts are not the pension promised by government but are mere mechanisms to track government costs. "No money flows anywhere... It's just numbers on a ledger sheet," he said.

Fat pensions?

Government lawyers also tried to paint the plaintiffs' claim as superfluous by playing up on the widespread stereotype of

the spoiled bureaucrats with fat pensions. "The point is, as you approach this case," they advised the judge, "this is a generous benefit which many Canadians do not have."

Mr. Christie pointed out that the level of the pension benefits should not be considered in isolation but rather within the actual total compensation package. He also testified that the introduction of Bill C-78 in 1999 significantly increased employee contributions to the pension plans by as much as 21%. The government further introduced additional increases of 0.3% per year from 2005 to 2013. In contrast, changes introduced by the Act only allowed for a slight improvement in benefits to plan members in the range of 1% to 4%.

Mr. Christie said that in his experience as a private consulting actuary representing both pension plan sponsors and employees, he has never seen a case where a significant increase in employee contributions was introduced without a corresponding improvement in benefits, especially when there were actuarial surpluses.

Specified purpose accounts

Following Mr. Christie's testimony, a former government auditor testified in Court that the surplus in the CF, PS, and RCMP pension accounts have now increased to more than \$42 billion.

Scott Milne, an expert in public sector accountancy and former auditor with the Office of the Auditor General of Canada, said that interest and actuarial evaluations have generated additional surplus in the former accounts. Although a total of approximately \$29.18 billion has been taken by the government from 2000 to 2006, roughly \$12.97- billion surplus is still left in the accounts. Contributions to these accounts ceased after 1 April 2000, and were channeled to the new Public Sector Pension Investment Board under Bill C-78. At that time, the surplus in the old account stood at about \$31.25 billion.

Mr. Milne's work with the Office of the Auditor General of Canada included dealing with the Public Accounts of Canada and auditing the public sector pension accounts. He explained in Court that the pension accounts are "non-budgetary" specified purpose accounts, meaning that the funds in the accounts could not be used to pay for government programs or any other purpose but for the pension benefits of plan members. Specified purpose accounts were created under provisions in the Financial Administration Act.

Mr. Milne further testified that the accounting for the pension plans was done on the basis that the plans were funded and that their accounts disclose contributions, investment earnings, actuarial surpluses

as well as the portions of such surpluses retired by the government through amortization. He also said the funds in the accounts meet the definition of "assets," as set by the Canadian Institute for Chartered Accountants, the body that sets accounting rules in Canada.

"We don't make bookkeeping entries for fictional or notional transactions," he said. "They represent real transactions, substantial events."

Surplus attribution

Next in the witness box was Don Lee, a pension analyst with particular expertise in attribution analysis. He presented his attribution analysis for the three pension plans. Mr. Lee's expertise in this area has been accepted by courts and pension tribunals.

He first explained his method of analysis, which consisted of a review of the history of each plan, the factors that contributed to the surplus and a calculation of the extent to which the surplus grew out of employee contributions. In each case, his analysis showed that a significant portion of the surplus in each account can be attributed to plan members' contributions: 42.2% for the PS pension account, 32.1% for the RCMP account and 25.6% of the CF account. His analysis also showed that, in each case, the employer has withdrawn more than its fair share of the surplus.

Constitutional argument

There were then arguments made by the plaintiffs that C-78 breached section 15 of the *Canadian Charter of Rights and Freedoms*. The plaintiffs had claimed that certain sections of the legislation differentiate between employees of the federal public sector and those from federally regulated private sector industries. Specifically, the superannuation acts do not provide the same protections that are available in the federal *Pension Benefits Standards Act*, which prevent employers from unilaterally removing surplus.

One of the witnesses called by the Crown in response to the plaintiff's *Charter* challenge was Monique Boudrias, Executive Vice-President of the Public Service Human Resources Management Agency of Canada. The essence of Ms. Boudrias' testimony-in-chief was that, with 31 years pensionable service behind her, she remained passionate and committed about her career in the public service and would highly recommend such a path to young people today. All in all, a glowing picture was painted of the employer.

However, the rewards of being a public servant are not relevant to the issue of whether public servants suffer discrimination on the basis of their employment status. What is relevant is the Government's willingness to exploit the perception that federal

government employees constitute a privileged class of underworked, overpaid employees. Such stereotyping is at the root of the plaintiff's claim that public servants are discriminated against.

Stereotyping of public servants

On cross-examination, Ms. Boudrias admitted that she was aware of the widespread negative stereotyping of public servants, and that she found it irritating, given that, in reality, they are highly committed and work extremely hard. She also agreed that public servants are not overpaid in relation to private sector employees. Ms. Boudrias was also quick to agree that given the reality of the hardworking public servant, the stereotype, which remains largely unchallenged, is demeaning, particularly as self-worth is, for many people, tied up in the work they do.

Ms. Boudrias stated that she was aware of the view held by many people that public servants have an overly generous pension plan, and agreed that this view was part of the same stereotype. She agreed the pension plan has always been taken into account by the employer as part of total compensation. She also agreed that the existence of such a stereotype meant that there was a receptive audience for any legislative change, such as the imposition of wage freezes for public servants. Ms. Boudrias expressed surprise when shown



an internal memorandum in which the President of Treasury Board was reported as saying that the Government was prepared to introduce new pension legislation because ministers considered that public servants are viewed by the public as a privileged class.

Finally, Ms. Boudrias agreed that pensions were important to most public servants; that they expected their pension contributions to be used to pay pensions; and that they relied completely on the Government to look after their pension contributions.

Approach to sharing surplus

The Crown's final witness was Bryan Osborne, a private-sector actuary. He was called to testify about the transfer of assets and liabilities from the Public Service Superannuation Account to the Canada Post pension plan in October 2000.

In cross-examination, Mr. Osborne admitted that in 1998, he had been contacted by Treasury Board and asked to provide guidance on approaches to sharing pension surplus. Mr. Osborne had expertise on pension regulatory matters and explained that, in Ontario, any removal of surplus from a continuing pension plan requires the consent of the pension regulator. Mr. Osborne explained that when such consent is applied for, the employer must provide information on the amount of surplus attributable to contributions paid by plan members and that before

the regulator will consent to payment of actuarial surplus out of an ongoing plan, the regulator must be satisfied that surplus attributable to employee contributions remains in the plan.

Mr. Osborne testified that there is no standard actuarial method for calculating surplus attribution but that it generally involved calculating the percentage of the surplus attributable to employee contributions and the percentage attributable to employer contributions. Internal Treasury Board e-mails show that the approach explained by Mr. Osborne was quickly dropped by Treasury Board as it would have resulted in an employer/employee split of the surplus at 60:40, a split that officials termed "too rich".

Canada Post pension plan surplus

With respect to the transfer of assets and liabilities from the PS Superannuation Account to the new Canada Post pension plan, Mr. Osborne confirmed that he negotiated on behalf of Canada Post Corporation (CPC) the amount of assets that would be transferred to Canada Post in order to cover the liabilities assumed. He also confirmed that CPC had negotiated transitional support to help defray the cost of employer contributions under its new pension plan for a period of years. He estimated the total value of this support to be in the order of \$1.5 billion. Finally, Mr. Osborne agreed that assets transferred to the CPC plan produced an actuarial surplus in

excess of \$200 million in the new CPC plan.

Day 15 (2 April 2007) of the pension surplus trial kicked off with the recall, at the request of Justice Panet, of Scott Milne, the expert in public sector accountancy and former auditor with the Office of the Auditor General of Canada. Mr. Milne was asked to clarify several technical points relating to the Public Accounts of Canada.

Justice Panet had also requested written final arguments be submitted in advance. The plaintiffs and Crown filed their written submissions on 11 and 20 April respectively. Either side could file a reply report in response to the written submissions by 27 April. The case resumed in court on 1 May with both sides presenting their closing arguments to the judge. The trial concluded on 3 May.

What next?

It may take at least six months for Justice Panet to release his final verdict. As it is not unlikely that any losing party would appeal the judge's verdict, no one can predict how long it will take for this case to be settled, or even how it will finally end.

This trial costs are shared between the plaintiffs of the three court cases that are being heard jointly. FSNA's total contribution as of 17 April 2007 amounts to \$120,000. ▽