POLICY PAPER

November 2023

HOW CREDIBLE IS THE *LIFEWORKS* REPORT ON A POSSIBLE *ALBERTA PENSION PLAN*?

AN EXPERT REVIEW

Keith Ambachtsheer

KPA Advisory Services is pleased to distribute this expert review of the Lifeworks Report on the creation of a possible Alberta Pension Plan. The review is written by Charles Spina, a recently retired financial services executive with experience overseeing large pension design, actuarial, and administration practices in Canada. He asserts that, had the Lifeworks Report been subjected to the kind of peer review that Canada Pension Plan reports are regularly subjected to, it would have failed the 'approve' test. Specifically, he takes issue with three key aspects of the Report: 1. The cost and complexity of creating a new APP based on the CPP design, 2. The proposed allocation split of current CPP assets, and 3. Projected future APP contribution rates based on that proposed allocation split.A key insight is that assessing the financial consequences of a provincial departure from the CPP today requires the use of a 'windup' valuation. Such valuations, sanctioned by the Canadian Institute of Actuaries and pension regulators, are used in the case of pension plan terminations, which is what effectively Alberta would be doing if it were to exit from the CPP. What would be the likely result from performing such a 'windup' valuation? Read Charles Spina's review below and find out.

Why Placing that Big Bet on the *LifeWorks* Pension Report is a Bad Idea

Charles Spina

No disrespect, but if Captain Kirk were a real person, I think he would be proud of Alberta's Premier Danielle Smith for her audacity. By picking up the torch from former Premier Jason Kenney, she is boldly going where no Premier has gone before in her quest to secede from the Canada Pension Plan, and to that end, embarking on a grievance campaign that has been fueled by the now famous report written by human resources consulting firm LifeWorks.

Now operating under the Telus Health brand, LifeWorks presented its $1.8 million report to Alberta's Ministry of Treasury Board and Finance in August of this year, it having been commissioned by the Kenney government's Fair Deal Panel chaired by former Finance Minister Jim Dinning. Citing Fraser Institute research alleging Albertans' "overcontribution" to the CPP, the Panel recommended "vigorously exploring" the option of setting up its own plan and "conducting the due diligence needed to assure Albertans that benefits and risks are understood and can be positively managed." The bet thereby being placed, one could say that Alberta's pension secession auto pilot was set by the Panel's deterministic language.

Almost ninety pages long, the LifeWorks report's authoritative content is overshadowed by convoluted and contradictory narrative. In two critical areas, Lifeworks' misplaced methodologies have spawned the scripting of talking points that are based more on fiction than fact. In one October press conference, Smith referred to the contributions made to the CPP by young, high earning Albertans as "outsized". At the same press conference, Finance Minister Horner stated that the report was based on "the best information available" and that he was "standing by the validity of the report's interpretation of that information and "its methodology". As a result, many Albertans believe that they are over contributing to the CPP and that it owes them billions of dollars.

The politicians driving the current discontentment narrative apparently have no aversion to doubling down on the parts of the LifeWorks report that have achieved mythological status, especially those concerning the asset transfer value and the relationship of cash contributions to cash benefits. In response, Canada's Finance Minister Chrystia Freeland has at long last asked the CPP's Chief Actuary, Assia Billig, to determine the "reasonable amount" of assets that Alberta would be entitled to if it were to leave. Billig's response can't come soon enough, since at least one other provincial premier, New Brunswick's, has signed on to the pension rip-off myth without question.

The Canada Pension Plan controversy is a manufactured one that has disrupted our federation for the wrong reasons. The CPP is our most stable and sustainable national social institution, covering over 15 million contributing members and more than 6 million benefit recipients, which is far more than all other registered pension plans put together. I won't detail the CPP's retirement benefits or their early/late commencement aspects, or their "drop-in" or "drop-out" provisions. Nor will I detail its disability benefits (inclusive of vocational rehabilitation), survivor, death or orphan benefits. As pension plans go, it is as comprehensive as they come, and it is portable. It is also making impressive progress transitioning from so-called pay-as-you-go funding to partial and full pre-funding of its base and additional benefits. There is also considerable evidence that CPP's investments are well managed. Against this background of stability, sustainability and comprehensiveness, I am calling LifeWorks out for methodological and presentation lapses in three specific areas: the glossing over of the CPP's administrative complexity, the estimation of the asset entitlement, and the alleged overcontributions.

In the section of its report titled Implementation Costs, Lifeworks superficially estimates that it would cost between $100 million and $1 billion to set up the administration of an Alberta pension plan, depending on whether the CPP continues to manage it, or Alberta takes it in-house. Such imprecision from a consultant that purportedly has deep pension expertise makes the absence of rigor, most notably the lack of even a cursory process map to illustrate how pension administration works, all the more puzzling. It also indicates the risks that Alberta would be facing if it decides to do its administration in-house or outsources it to the private sector. As someone who has managed a pension design, actuarial and administration practice numbering over fifty billable staff, I would rate the CPP as being off the administrative complexity scale. One Phoenix disaster is enough, but I fear that that is what would happen if the delusional thinking about administration continues to influence discussions of in-house feasibility.

I don't deny Alberta's right to secede from the CPP and I do not question the qualifications of the LifeWorks actuaries who conducted the analyses that have led Smith and Horner to say the things they have said. I am taking issue, though, with their judgment in approaching the contribution and asset issues the way they have. At the heart of the matter is the Appendix titled Detailed APP Financial Results and Actuarial Model. It contains tables, one of which displays a projection of contributions and benefits for the base CPP benefit out to the year 2100.

It starts contributions off at a significantly lower rate than the current CPP contribution rate. It also assumes that an Alberta plan would start off with a CPP asset transfer of $334 billion on January 1, 2027, or 53% of the total projected base CPP assets on that date, which is when Alberta could legally activate its own plan.

Although LifeWorks had the good sense to acknowledge that its initial calculated asset entitlement of $637 billion as of December 31, 2021 (117% of base CPP assets as of that date) was “unrealistically large”, it then re-calculated it according to its “alternate and reasonable interpretation” of the section of the CPP Act that sets out the method of calculating a seceding province’s asset entitlement. LifeWorks quite rightly points out that its table values are highly sensitive to the starting asset value. If Chief Actuary Billig reports back to Finance Minister Freeland that the percentage of CPP assets available to Alberta is closer to the 15% that Alberta plan members represent of the total CPP plan membership, which is what I expect, the significantly lower starting asset value in that pivotal LifeWorks table makes its projection of next to no value as a basis for further exit/no exit discussion. The reason is that with the corrected starting value, and potentially other revised assumptions, Lifeworks’ “pay-as-you go” algorithm could well show that with lower starting CPP contribution rates in the early years, CPP benefits will exceed contributions in the later years of its projection, and that the contribution rate would have to increase more than its projected increases in the later years to ensure continuing solvency. Lifeworks’ $334 billion asset estimate, therefore, is little more than informed speculation, which in this context, is more dangerous than an uninformed guess.

Not to over dramatize, but need we be reminded that continuing solvency is precisely what the U.S. Social Security regime is grappling with? Unreduced benefits are expected to be payable until only 2037, when reserves are projected to become exhausted. Unless the funding rate changes in the meantime, payroll taxes will be enough to pay only 76% of scheduled benefits. The Social Security Board of Trustees projects that an immediate reduction in benefits of about 13%, or an immediate increase in the combined payroll tax rate from 12.4 % to 14.4%, or some combination of the two, will be required for full payment of scheduled benefits for the next seventy-five years.

The most authoritative source of the CPP’s funding status is the Chief Actuary’s report, which is required every three years under Section 115 of the Canada Pension Plan Act. The last one was issued at the end of 2022 for its December 31,2021 valuation. The report is exhaustive, far exceeding statutory requirements, and it includes the disclosure of the methodology employed for its estimate of revenues and expenditures, the main expenditure being the plan’s benefits. The current report is the first one that takes into account the new additional plan benefit whose provisions were enacted in 2019.

As with previous reports dating back to the 90s, the current CPP report was externally peer reviewed. Peer review ensures that reports meet high professional standards and that they are based on reasonable methods and assumptions. The report’s authors note that peer review recommendations have resulted in many report improvements over the years; which begs the question, what kind of peer review did LifeWorks’ report undergo? For instance, the CPP has gradually shifted its plan funding approach to one that can be referred to as pre-funding. The approach is elaborated in the Chief Actuary’s report. LifeWorks states in its report that it has done an “apples to apples” analysis and followed the CPP’s methodology. Both assertions are hard to accept. LifeWorks should have stopped when it produced its first asset value estimate and deferred the question to the Chief Actuary.

So where do we go from here? LifeWorks has shown us that following the CPP Act's method of determining the value of asset transfers is an exercise in futility. We must therefore look for an analogous construct. That construct is the plan "wind-up", using arcane pension terminology. To my knowledge, the CPP's Chief Actuary has never published an estimate of how assets should be distributed to participating jurisdictions if the CPP were to "wind-up", simply because it was not necessary. Wind-ups are well understood by pension actuaries and the methods to be followed are well defined. They can be forced by a regulatory authority or they can be set in motion by a plan sponsor, such as an employer that is part of a multi-employer plan. Prescribed procedures determine allocatable assets and their distribution, especially when, as is often the case on wind-ups, the assets are insufficient to fund future benefit payments.

Until now the Chief Actuary has assumed that the CPP was a "going concern" for valuation purposes. Not to pre-empt Billig, and certainly not to oversimplify the task ahead, Freeland's request may require that a hypothetical wind-up valuation be employed to estimate Alberta's available assets, without it being called that name for obvious practical and political reasons.

Critical will be the determination of the CPP's expected asset/liability funded ratio as at the end of 2026. In essence, this approach freezes the present value of liabilities for two groups: (1) contributing members who have earned future benefits; (2) members whose periodic benefits are being paid, or have been incurred but have not commenced, or been paid as a lump sum (such as the death benefit). Concurrent with Alberta's liability determination, accrued liabilities should be estimated for each of the other eleven participating CPP jurisdictions.

Since the CPP's assets are not segregated by province and territory, and the sum of all allocatable assets cannot exceed the actual total value of CPP assets as of the same date, principles of equity and fairness demand that Alberta's asset value claim be proportional to the CPP funded ratio. Stated differently, Alberta's claim on CPP assets should be proportional to the percentage of Alberta's liabilities to the total CPP liabilities. Regardless of the actual dollar value of the result, we can say with certainty that CPP benefits are not close to being fully funded (i.e., the CPP funded ratio is less than 100%), on either a solvency or a "going concern" basis. So hypothetically, if Alberta's accrued CPP liabilities amounted to 15% of total CPP liabilities, it would be entitled to 15% of CPP assets. If CPP Chief Actuary Billig were to adopt this allocation approach, it would require a re-write of that problematic asset transfer section of the CPP Act.

Why did Life Works not consult the CPP Chief Actuary directly when writing its report, or Alberta's own pension regulator for that matter, since its pension superintendent belongs to CAPSA (Canadian Association of Pension Supervisory Authorities)? Among CAPSA's roles is the promotion of harmonized pension standards and practices, and plan wind-up procedures are part of those harmonized standards. Although Alberta's superintendent has no jurisdiction over the CPP, it does publish its own wind-up guidelines, and LifeWorks would have been guided by them when doing wind-ups for other pension clients. My final question is why did LifeWorks not at least make reference to the detailed hypothetical wind-up educational note that was issued by the Canadian Institute of Actuaries this past March?

So there are the questions, but they are best answered by other people.

Profile of Charles Spina

Recently retired, I have acted in relevant executive capacities at several organizations, including that of VP and office head of a leading pension design, actuarial and pension administration consultancy numbering over 50 billable staff, which was sold to the Morneau Shepell organization in the early 2000s. Morneau Shepell was re-branded LifeWorks, which has now been subsumed under the Telus Health banner.

I was a member of the investment committee of a large institutional fund for ten years, serving as chairperson during the worst years of the financial crisis.

My article, Employee Life and Health Trusts: Legal Construct or Innovation Catalyst?, which was published in Benefits and Pensions Monitor in 2012, reviewed the then recently enacted ITA provisions governing ELHTs. ELHTs for the first time permitted the pre-funding of trusteed life and health benefits.

My academic credentials include a History MA from the University of Ottawa (thesis remains the most comprehensive review of World War ll bond financing campaigns), and an MBA from Western/Ivey.

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Published by KPA Advisory Services Ltd., Toronto, Canada

416.925.7525. www.kpa-advisory.com

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