REPORT TO THE SPEAKER OF THE LEGISLATIVE ASSEMBLY OF MANITOBA RE: BUY BACK OF PAST SERVICE UNDER THE LEGISLATIVE ASSEMBLY PENSION PLAN FOR THE PERIOD APRIL 25, 1995 TO OCTOBER 1, 2004

June 7, 2006

Michael D. Werier
Commissioner

1. Role and Mandate of the Commissioner

This Commission was established by the Manitoba Legislature by way of an amendment to *The Legislative Assembly Act*.

The independent Commissioner's mandate under this Act is to make final and binding decisions in respect of past service for certain MLAs for the period April 25, 1995 to October 1, 2004 under the new Legislative Assembly Pension Plan (LAPP), which was established as a result of an earlier Commissioner's report dated May 14, 2004. Those persons eligible to buy back service are past MLAs who were Members on May 2, 2003 (the end of the 37^{th} Legislature) and may wish to buy back service from April 25, 1995 to June 2, 2003 and persons who are present MLAs and were so from June 2, 2003 to October 1, 2004. Seventy past or present MLAs are eligible to buy back service.

The Legislative Assembly Management Commission (LAMC) has the responsibility to administer the compensation and benefits for Members of the Legislature and was obligated at law to appoint a Commissioner. Michael Werier was appointed as independent Commissioner by LAMC to make the decisions on buy back of service and this Report to the Speaker contains the Commissioner's analysis and decisions.

The purchase of past service under a registered plan such as LAPP is subject to limitations under *The Income Tax Act (Canada)*. Consequently, Members of the Legislature are either unable or are limited in their ability to purchase past service. The decisions in this Report provide a mechanism to facilitate the purchase of past service.

2. Legislative Jurisdiction

The Legislative Assembly Act establishing this Commission was amended by royal assent on June 16, 2005.

The transitional provision in the amendment provides as follows:

> The management commission, as defined in section 52.6 of *The Legislative Assembly Act*, must appoint a commissioner as soon as possible after this Act comes into force. *The Legislative Assembly Act* applies to the commissioner, except that the only responsibilities of the commissioner under that Act are:
>
> (a) to make decisions under clause 52.9(a) in respect of past service for the period from April 25, 1995 to October 1, 2004 under the pension plan established pursuant to the commissioner's report dated May 14, 2004;
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> (b) to report those decisions to the Speaker under section 52.10; and
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> (c) to make regulations under section 52.12 to implement those decisions.

Section 52.9(a) of *The Legislative Assembly Act* states:

The Commissioner must make decisions about:

(a) retirement benefits for members and former members, including the nature and amount of those benefits and how they are to be provided, and contributions toward those benefits

These sections provide authority to the Commissioner to decide the amounts, if any, to be contributed by the Province to facilitate the buy back.

3. Background

It is necessary to review relevant events chronologically to gain a full understanding of the problem. The following are some of the significant historical developments in the evolution of the MLA pension plans:

(a) Pre-1994

Prior to 1994, elected Members of the Legislature contributed to a defined benefit pension plan. A Commission Report in 1994 recommended abolition of this form of pension plan. This plan was considered to be overly generous in comparison to other public sectors and private pension plans.

This was noted by Earl E. Backman, Commissioner for MLA Pay, Allowances and Retirement Benefits on May 14, 2004 respecting the changes in 1994.

> "In Manitoba, there was dissatisfaction with the pension - determining accrual rate of 3%, which was at least 50% higher than most other plans in effect in the province at that time, and indeed still are today. There was also animosity toward the fact that MLAs could retire very early - much earlier than the rest of the population could anticipate. Members needed only eight years of service or three terms and age and service totaling 55 to be eligible for retirement."

Rather than maintain the existing plan and make changes to the accrual rate and/or retirement eligibility, the Legislature chose to suspend the existing plan and a new RRSP plan was instituted in April, 1994.

(b) 1995 Changes

The old defined benefit plan was suspended and is administered as a "Deferred Pension" for Members still serving. Those Members who have since retired receive a pension from the old plan and the benefits from their post 1995 RRSPs.

The new plan was not a defined benefit plan. Rather, under the new plan in 1995, Members who have been elected since 1995 had the option of a contributing to a RRSP plan. Members paid 7% of their total pay to an RRSP (of their choosing), including a spousal RRSP. The Government of Manitoba (Province) contributed a matching 7%.

In the event a Member could not contribute a full 7%, they could elect to contribute to a Tax Paid Trust.

(c) May 14, 2004 and June 8, 2004 Reports and Supplementary Report to the Legislature by Earl E. Backman, Commissioner for MLA Pay Allowances and Retirement Benefits

Backman's mandate was established in December, 2002, under *The Legislative Assembly Act*. The mandate was to review and make recommendations to the Legislative Assembly about the appropriate salary, allowances and retirement benefits for Members. Backman sought out and received significant input from various groups and members of the public, including The Manitoba Chamber of Commerce, The Canadian Taxpayer's Association, The Manitoba Federation of Labour, The Manitoba Government Employees' Union, and others.

In the May 14, 2004 report, Backman made a number of significant findings. In particular, he noted that:

> The absence of a Pension Plan for Members probably contributes to eliminating a sector of Manitoba citizenry from running for elected office; especially those in mid-career pension-based employment where they cannot "afford" or are reluctant to consider breaking the continuity of their contributory years.

He also noted that Manitoba's contribution rate to RRSPs of 7% matched by the Province is among the lowest in Canada.

Furthermore, he said it would have been preferable to fix the problems with the old defined benefit plan rather than to discard it completely; but that public resentment of pension plans was a driving force in 1994. However, he noted in

2004 that based on his consultations there was "little acrimony" this time around and there was a higher acceptance of pension plans for elected officials.

(d) Backman, in his May 14, 2004 report, made the following recommendation:

Recommendation #6 - Pension Plan - Re Section 3.4 of the Members' Guide

That the existing RRSP Plan remains available to Manitoba Members as an option.

That a Defined Benefit Pension Plan be made available as a time-limited sign-up alternative option for existing and newly elected future Members with the following major principles of operation:

- *7% contribution rate by the Member on all basic and additional indemnities;*
- *Full vesting of contributions after 1 year of service;*
- *Normal retirement age of 55;*
- *Accrual rate of 2% for pension calculation purposes;*
- *The average of the best 5 years of eligible total compensation since 1995 be used in the computations.*

That existing Members be allowed to purchase eligible prior service back to 1995 at the full actuarial cost of same by transfer from their own RRSPs at present value or payment by cash. If legislation allows, severance pay for "grandfathered" MLAs with pre-1995 service can be used to purchase past service at the time of retirement.

That other provisions resemble the Civil Service Superannuation Plan for Government employees as closely as possible and practical.

That the Civil Service Superannuation Board be the Administrator of this Plan.

In order for existing Members to access this option it is suggested that a six month time limit be placed on the decision to sign up and further it should be a one time only option that is not available later. The same option period should be available for newly elected Members in the future.

(e) Aftermath of the Backman Reports

Backman's May 14, 2004 report was not adopted by the Legislature as it could only be accepted in its totality. The Legislature ultimately accepted the final recommendation of the June 8, 2004 report that legislation be enacted creating the role of an Interim Commissioner who would have the legal authority to determine the pay and benefits of MLAs and remove the necessity for MLAs to vote on their own compensation. The legislation was enacted June 10, 2004.

(f) The Legislature ultimately created the new LAPP and accepted Backman's recommendation that "existing Members be allowed to purchase eligible prior service back to 1995 at the full actuarial cost of same by transfer from their own RRSPs at present value or by cash". This later proved to be unworkable due to tax restrictions as discussed later in this Report.

At the time, the provisions for buy back of service were incorporated into the Members' Retirement Benefits Regulation which sets out the text of the defined pension plan for Members of the Legislative Assembly of Manitoba. The relevant provisions are set out in s. 26 of the Regulations.

> 26(1) Subject to the limitations under the *Income Tax Act* (Canada) respecting the purchase of past service under a registered pension plan, pensionable service may be purchased as follows:
>
> > (a) an MLA or former MLA, having elected under section 22 to become a member, may purchase pensionable service for all or any part of the period from April 25, 1995 to October 1, 2004 that he or she was an MLA;
> >
> > (b) an MLA electing under clause 22(1)(a) to become a member may purchase pensionable service for all or any part of the period that he or she was an MLA from October 2, 2004 to the beginning of the pay period for which he or she begins making contributions by source deduction.

26(2) The following rules apply to a purchase of service under clause (1)(a):

1. A former MLA's election to purchase the service is to be included in his or her election under clause 22(1)(c) to become a member, and must specify the period of service to be purchased.

2. An MLA's election to purchase the service may be made no later than the earliest of

(a) the day before he or she begins to receive a pension under this Part;

(b) six months after he or she last ceased to be an active member; and

(c) December 1 of the year in which he or she reaches the age of 69 years.

3. The purchase price for the past service is equal to the full actuarial cost of the period of service to be purchased, as determined by the plan's actuary as of the day the election to purchase the service was filed. It is payable to the administrator as a lump sum, or by installments with interest as determined by the administrator.

(g) Report of the Interim Commissioner for MLA Pay

Dr. Jerry L. Gray was appointed Interim Commissioner. His mandate was to decide the compensation levels of MLAs. In his report dated May 5, 2005, he also made the following recommendations regarding pension plans as a result of his finding that the buy back of service had proven unworkable:

4.0 Recommendations

The purpose of the recommendations is to suggest policies or actions that would facilitate the implementation of the specific salary decisions and/or improve the decision process in the future.

4.1 Review of Past Service Buy Back

4.11 The past service buy back program of the Legislative

> Assembly Pension Plan (LAPP) should be reviewed in view of the fact that MLAs are unable to purchase past service to the extent recommended by the May 14, 2004 Commissioner's report due to limitations under *The Income Tax Act* (Canada).
>
> *The intent of the Commissioner's recommendation has proven to be unworkable for many MLAs and the past service buy back provision needs to be reviewed and changed accordingly.*

The above recommendations resulted in the amendments to *The Legislative Assembly Act* referred to earlier which led to the creation of the role of a Commissioner to deal with the problem of purchase of past service by MLAs and ultimately resulted in this Report. Gray also made the following observations:

> <u>Overall Compensation Levels of MLAs</u>
>
> It is my view that the overall compensation level of the MLA role is below the level of responsibility and complexity of similar roles in both the public and private sectors. If we want excellence in Manitoba's public service, the level of compensation must be at a level that will increase the chances of attracting individuals who have the capability to handle the complexity of the role.
>
> <u>Future Compensation Issues</u>
>
> Having the lowest paid Premier and MLAs of all of the Canadian provinces should not be a sign of pride for Manitobans. This is a situation that should be rectified as soon as possible. My view is that this unfortunate and inequitable situation has developed because of the politicization of the compensation process in the past. Hopefully, this will be resolved in the future with a Commissioner who has the authority to make decisions about compensation for all of the roles in the Legislature.

These observations confirmed Backman's earlier findings.

4. <u>The Limitations under The Income Tax Act</u>

As stated earlier, Gray found that Backman's recommendations to purchase past service had proven to be unworkable. This is because there are certain tax requirements under Canadian tax law when an individual purchases past service under a registered pension plan.

The Income Tax Act requires that an individual Retirement Savings Plan ("RSP") or similar registered vehicle assets must be transferred or rolled over to the MLA Pension Plan to reduce the Past Service Pension Adjustment ("PSPA") created by the buy back, before such service can be recognized.

The PSPA in effect reduces a person's RRSP limit retroactively.

5. <u>The Amount Required to Buy Back</u>

In order to buy back full service for the period between 1995 and 2004, the MLAs will have to pay the Past Service Liability which actuaries have calculated for each MLA. The Past Service Liability is the pension obligations that the MLAs would have had if the new defined benefits plan was in effect in April, 1995. Part of arriving at the Past Service Liability is to predict the retirement age of each MLA. Retirement is possible as early as age 55, however, the actuarial assumptions assumed that a MLA would retire no earlier than age 59. Age 59 is the current average retirement age of civil servants in Manitoba.

6. <u>The Overall Nature of the Problem</u>

The problem is that many MLAs do not have sufficient RRSP holdings to pay down the PSPA to zero and be in a position to buy back service of all their past service. Also, members over the past years may have contributed to a spousal RRSP and cannot use this asset to reduce their PSPA and buy back service. Further, certain members chose to invest in tax paid trusts which would not be eligible for roll-over to buy back service.

7. <u>The Issues</u>

There are two main issues to be addressed in coming to a decision. They are:

1. Should the Province contribute to the buy back of service and, if so, in what amount?

2. Should MLAs who, for whatever reason, do not have RRSP holdings (spousal RRSP tax paid trust) to reduce the PSPA, be entitled to the same contribution from the Province, and if so, what form should it take?

8. <u>Consultations</u>

In preparation of this Report, I reviewed past reports dealing with MLA compensation and legislative debates surrounding changes to the MLA pension plan in 1994. I also met with representatives of the LAMC. A canvass of all affected MLAs, including retirees, was done to solicit particulars respecting their personal RRSP situations. A review was done of the existing pension plans of the Legislatures across Canada.

Furthermore, consultations were held with tax and actuarial experts. In particular, Dennis Ellement of Ellement & Ellement, actuaries for the Civil Service Superannuation Board and the LAPP Plan, provided comprehensive and detailed analysis relating to the buy back, including actuarial assumptions, past service costs, and estimated PSPA for all affected MLAs.

As well, I was provided with possible allocation methods of funding the buy back together with sample calculations relating to various MLAs and the pension buy back possible cost allocation.

9. <u>Factors Considered</u>

The amendment to *The Legislative Assembly Act* dealing with buy back of past service does not provide specific factors on which to determine whether the MLA and the Province should share the cost of purchasing past service. It was known, however, at the time that there were a myriad of difficulties facing MLAs.

The question is the quantum or the potential of a percentage of purchase cost to be paid by the Province, if any.

The legislation (regulation) does not give any specific guidance as to what criteria should be applied in determining the two main issues.

I have considered a number of factors in arriving at a decision in this complex matter. These include:

- The unique requirement of the MLA role, including the lack of job security and the accountability process
- General compensation principles, policies and practices in the public sector
- Pension plan in place for Legislatures across Canada
- The public sensitivity to the compensation and pensions of elected officials

In the final analysis, as Commissioner Gray stated in his report in dealing with all the factors relevant to MLA compensation, fairness is the most reasonable approach. I have used this approach in reaching the decisions contained in this Report.

10. A Case Study

There are a number of options available to allocate responsibility for the funding of past service including, the MLA being totally responsible, the Province being totally responsible, or some form of cost sharing between the parties.

Since 1994, MLAs and the Province have each contributed 7% of pensionable salary. The actuarial calculation of current service costs of the LAPP pension is 22.76% of pensionable salary as at October 1, 2004. The first question is whether the remaining 8.76% should be shared. If each party shares 4.38%, each would have responsibility for 19.25% of the full actuarial buy back cost.

A case scenario is presented for illustration purposes of one possible method of allocation:

A. Calculation of Possible Buy Back

Historical MLA contributions	7%
Historical Province contributions	7%
Possible MLA top-up	4.38%
Possible Province top-up	4.38%
Total average service costs (based on current actuarial calculations)	22.76%
Potential Province share of full Buy Back	4.38/22.76%=19.25% of the actuarial cost
Example MLA RRSP assets	$ 90,166
Cost of full pension Buy Back (based on actuarial calculations)	$209,676
PSPA (estimated by actuary)	$123,655
Portion of full Buy Back possible	72.9%

B. Pension Buy Back Possible Cost Allocation

RSP transfer	$ 90,166
MLA top-up share to Buy Back	$ 22,362

Province top-up share to Buy Back	$ 40,363
Pension Buy Back Total Cost	$152,891

C. Province's Possible Share of Cost

Province share to pension Buy Back	$ 40,363
Province share to cash compensation	$ 0

In the above scenario, the MLA by reason of the limitations in *The Income Tax Act*, is able to buy back 72.9% of the full buy back which equates to $152,891. If the MLA has $90,166 in a RRSP, and the Province's share is 19.25% of $209,676 which equals $40,363, then the MLAs top-up is $22,362. This would have to be paid by the MLA and would be tax deductible. An issue arises as to the appropriate time frame for this MLA to pay his or her "top-up" share. A further issue arises as to the interest adjustment since October 1, 2004.

11. Decision

I have considered all of the factors listed earlier in the report and have been guided by the findings of the previous Commissioners. The challenge is to strike an appropriate balance between the need to be fair and reasonable to MLAs (who are entitled to a fair pension for their work and commitment) with the interests of the Manitoba taxpayers. I am also mindful and sensitive of the competing demands made on the Provincial Treasury.

The decisions made in this Report attempt to strike the appropriate balance and deal with the many factors at play in determining fair and appropriate MLA compensation.

I have also taken into account that the retirement plan put into effect in 1995 put MLAs into a disadvantaged and inferior position compared to similar jurisdictions. Previous Commissioners recommended and the Legislature determined that the existing RRSP plan be replaced and that a new LAPP be instituted. As set out earlier, the buy back of service is to be at full actuarial value. In many instances Members do not have sufficient RRSP value to allow for full buy back of service under *The Income Tax Act* or any RRSP holdings to mitigate the PSPA.

In light of the above, I have decided that the fair and reasonable way to effect to buy back given the costs involved and the income tax restrictions is to have the Province contribute to this buy back of service. Without it, it is probable buy back would be severely restricted in terms of numbers of Members and past years purchased. This would leave past and present MLAs with small pensions which do not properly acknowledge their years of service.

During the past period April 25, 1995 to October 1, 2004 Members have contributed 7% to their RRSPs or tax paid trusts and the Province matched this contribution. I am advised that the 14% in contributions represents 61.5% of the average current cost of pensionable service under the plan that was established in 2004.

I have decided that the remaining 38.5% should be split equally (19.25% each) between Members and the Province. Therefore those who decide to purchase past service will be entitled to purchase it for 80.75% of the actuarial cost at October 1, 2004, plus interest at a rate to be determined by the plan administrator from October 1, 2004 to the date of actual purchase.

An MLA who elects to purchase service may pay for it by transferring funds from his or her RRSP and making additional contributions, as necessary. I have decided that the additional contributions may be made in equal installments over a period of up to three years, plus interest at a rate to be determined by the plan administrator.

There are Members who may be eligible to purchase past service, but are unable or choose not to do so, or who choose to purchase less than they are eligible for. It is necessary to treat all Members equally and I have decided that the Province shall compensate these Members for the otherwise forgone part of the share.

I have decided that these Members will be entitled to a benefit equal to 19.25% of the actuarial cost as at October 1, 2004 of the cost of the service they are eligible for but do not purchase. I have decided that the benefit will be paid as a lump sum to a locked-in trust account where it will earn interest at prevailing rates. This will include interest to the date of purchase or payment.

I am advised that these locked-in trust accounts are maintained by the Province for MLAs who are not able to make the 7% RRSP contributions and receive a matching contribution from the Province, and therefore there is an existing vehicle in place to accommodate these accounts. Other vehicles such a registered compensation arrangement (RCA) were considered but deemed inappropriate as they are more viable for the private sector.

I am advised by the actuary that the estimated cost of the Province's contribution will be approximately $1.56 million as at October 1, 2004. It is essential to note that this amount is well below what the Province's contributions would have been (over and above the 7% contribution) if the defined benefit plan had been maintained after 1995 with a reduced accrual rate and a different early retirement privilege.

DATED this 7th day of June, 2006.

"Michael D. Werier"

Michael D. Werier
Commissioner