Creating an Alberta Pension Plan – An APP

Good For Albertans and Alberta and…

good for the rest of Canada too…

Topics to be covered:

- A Very Brief Introduction of myself and Libertas Alberta
- Some terms we need to understand...
- A brief history of Public Pensions and the CPP
- What is Alberta’s – and Albertan’s – share of the CPP Fund
- What are the implications of that Share compared to the actuarial need.
- And what would an APP mean for Albertans - working and retired - and those who employ them.
- The CPP and how it is managed
- The concerns Canadians should have about the CPP
- How an Alberta Pension Plan should be managed

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A Very Brief Introduction of myself and Libertas Alberta

To develop Policies and successful Pathways for their implementation that will:

Expand Freedom in Alberta

Some terms we need to understand

- Defined Benefit Pension versus Defined Contribution or Money Purchase plans…
- Actuarial versus 'simple' math calculations
- Private Equity (Private Placement) versus public ally-traded assets
- Mark to market
- Settlement Options
- Liquidity
- Management expense ratio (MER)

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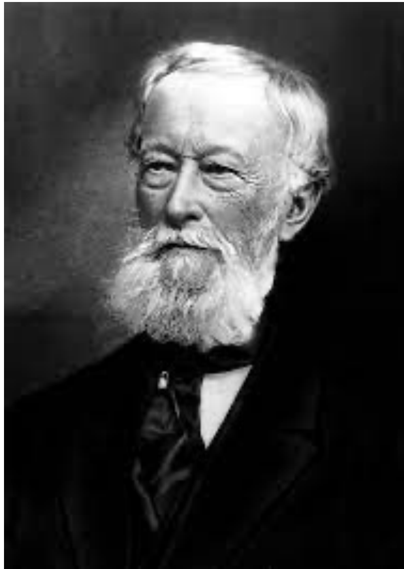
A *Brief History* of Pensions and the CPP

1855 - Alfred Krupp

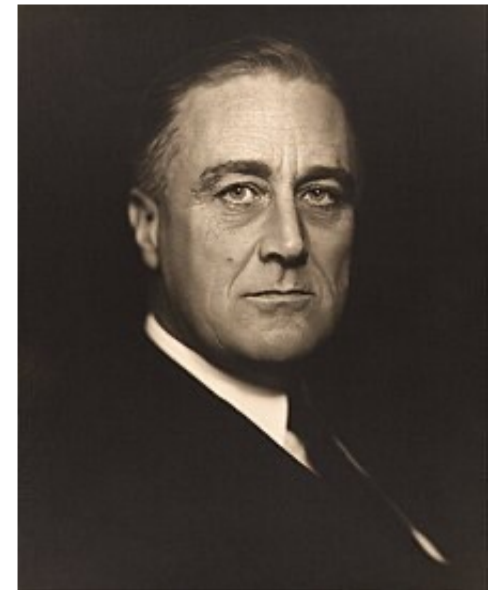


First Employer-sponsored Retirement Plan

1889 - Chancellor Otto von Bismarck

First Government-run Worker's Plan

1935 Franklin Roosevelt



Created US Social Security Pension

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A *Brief History* continued…

1965 – The Canada Pension Plan is created.

- *In part because of competitive pressures of Canada's Branch plant economy – the need to stay competitive with the US.*

- *Important sidenote – The US's social security has always been a pay as one goes program – there is no reserve investment for future payouts – And they are due to 'hit the wall' in about a decade when working American's contributions will not be enough to pay the pensions being collected – thus debt and ultimately, taxes will have to go up. A lot. More on this later…*

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A *Brief History* of the CPP

The contract:

- Law Creating it in 1965
- Began operation in 1966

  Under a Key difference between the US and Canada…
  - Pensions Are 100% provincial jurisdiction with one exception…
    - Private Nationally-incorporated firms
- It is a joint-operating agreement – not a unitary pension plan
- Nine provinces sign on while Quebec declines and sets up its own pension plan (QPP) that essentially mirrors the defined benefit that is paid

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A *Brief History* of the CPP continued…

Why not operate separately?

A typical mainframe computer in 1965 was over $1,000,000 - not including the building it would need to be housed in and the many people to operate it. The entire Newfoundland budget was 111 million.

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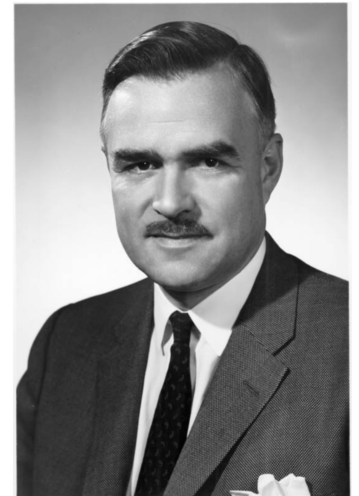
A *Brief History* of the CPP continued…

- It has been granted a monopoly on investment management of the funds for almost 60 years.
- Segregated accounts for each province from the very beginning
  - It was the reason the Social Insurance Number – A.K.A SIN - was created.
  - Tracked each individual's contributions AND what province they were working in when they made those contributions.
- Every participating province has the right to exit the CPP and create its own pension – multi-year process
  - Premier John Robarts of Ontario insisted on this. At the time Ontario was a rapidly-growing young province and was far and away the most significant province in the CPP.



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Exiting the CPP agreement…

- Retraction/Exit formula is **‘simple’** math:
  - Contributions + Growth on the Invested Contributions – Payments Made to contributors
  - There is NO ACTUARIAL calculation
- A note on Actuarial Science
  - Actuarial Calculations are **“complex”** math.
  - It requires modelling of data to estimate how much needs to be accumulated in funds to pay off future obligations.
  - Things like birth and immigration rates, life expectancy, disability rates, investment and inflation trends.
  - Very ‘Grey’ and very error-prone.

The Retraction Exit Formula

- According to several sources, were the APP to be created the transfer from the CPP would be approximately 50% of the fund.
  - According to the CCPIB the Fund value is $570 billion (September 2023)
  - IF that is the fund value the transfer would be about 285 billion*
  - Note – the process would take several years – as that is part of the CPP contract, AND
  - The transfer won't just be a 'check' for that amount but rather a transfer of assets*

* more on both later…

Back to the Actuarial discussion…

- Simply put the more contributors one has compared to those receiving benefits the less contributions are required and the lower the reserve fund needs to be.
- The CPP has been pooling all provincial funds and making required contribution and reserve calculations based on the Demographics of The 9 provinces in the CPP COMBINED.
- But Alberta is far younger and has far more contributions coming and far fewer funds paid out than any other province.
- Thus, Actuarially Alberta needs far less contributions and reserve funds than it owns in the CPP fund.
    - It has a very large actuarial fund surplus and Albertans have been paying a much higher income deduction into the fund than is required.
- IOW Aggregated nationally it has meant a transfer – into the billions of dollars from Alberta to eastern provinces – and has been for decades.

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Actuarial Discussion continued…

- Meanwhile other provinces – Newfoundland and Labrador and PEI and others have the exact opposite situation –
  - they have a significant actuarial **deficit**

- The reality is: Albertans have been subsidizing other province's CPP programs.

- The troubling thing is that many many Albertans have contributed far more into the CPP than they needed to.
  - The Difference between the severed amount and the Actuarial required amount - an amount possibly above 100 billion dollars…
  - Is money that **should have been paid** to Albertans or not taken from Albertans.
  - *Including many thousands of Albertans who have passed on*.

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Actuarial Discussion continued…

Going forward, **because of this actuarial surplus** in an APP two things would need to happen:

- Contribution rates would have to be decrease for those not yet receiving a pension.
- The amount being paid to those already receiving a pension would have to be increased – a refund of overpayments they made when they were working.
    - The exact numbers obviously need to be calculated, but they are not insignificant changes in either case.
  - A reduction of the combined Employee and Employer contribution rate by 4% does not sound unreasonable.
    - This would be the case regardless of the actuarial surplus
  - And an immediate increase in Pension payments of 10% also seems manageable and sustainable.
    - probably for several decades before the actuarial surplus would be refunded.

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Back to US Social Security…

- Operated very differently…
- No investment element – Meant to be a pay as you go system – contributions have to be at least as much as what is being paid out.
- What has happened is the contribution levels stayed flat –
  - causing a surplus in early years –
  - but now and for several years it has been running a deficit and in less than a decade the benefit will have to be paid not just from contributions
  - but also from government revenues (Increasing the deficit and debt even further) AKA an unfunded liability.

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The CPP Contribution Rate…

- The CPP was in similar difficulties - had an unfunded future liability – and wasn't taking in enough contributions. That was corrected starting in 1986 by increasing the deduction by about 300% from 3.6% to 10%.
- Effective in 2024 that rate is now 12%

Side bar/FYI – The contribution is 50% paid via the Employer and 50% by the Employee – and the deductions are remitted to the CPP directly by the Employer 'as-earned'.

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The CPP Contribution Rate Continued…

- The increase to 12% is being done to…
  - “finance the expanded pensions and maintain the soundness of the plan, contributions to the CPP from workers and their employers will each rise 1 per cent from current levels, to 5.95 per cent over the existing band of covered earnings.
  - This increase will be phased in over 5 years, starting in 2019.
  - The increase to the earnings threshold will be phased in over 2 years, starting in 2024”

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The CPP Contribution Rate Continued…

“The primary CPP benefit is the monthly retirement pension.

- Currently, (pre 2024) this is equal to **25 per cent** of the average earnings on which CPP contributions were made over the entire working life of a contributor from age 18 to 65 in constant dollars.
- The earnings upon which contributions are made are subject to an annual limit, which, in 2020, is $58,700.
- However, under changes being phased in by 2025, the pension benefit will rise to **33.33 per cent** of earnings on which contributions were made,
- and the maximum amount of income covered by the CPP will rise by 14 percent from the projected 2025 limit of $69,700 to $79,400.”

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The CPP Contribution Rate Continued...

Some consider these changes a good thing…

Others do not.

It means:

- More government control – less flexibility in how one saves for retirement
- More incentive for Employees and business owners to ”opt out” via contracting and getting ‘paid’ via dividends

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A critique of the CPP

Four huge issues:

- The CPP is expensive
- The CPP fund has become unwieldy – unable to efficiently play in the market system
- Liquidity – lack of transparency.
- It is not accountable.

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The CPP is expensive

- They employ over 2000 people (as per their own annual reports)
- An all-in annual operating cost of well over 2 billion – likely over 3 billion – per year.

Translated to terms investors are familiar with – that's over a 0.5% Management Expense Ratio (MER)

  - Considering the size of the fund under management and the economy of scale that that should deliver, along with almost half of the current fund being in non-trading assets – real estate and private equity where the transaction costs are absorbed by the seller and the assets are intended to be held for the very long term, **0.5% is a very high MER**.

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The CPP is expensive continued…

- There should be no marketing costs for the CPP – All wage-earning Canadians by law are required to contribute
  - Yet they spend approximately 40 million per year on advertising

- They are not burdened by annual reporting and other mailings to be done and the myriad other service demands individual investment clients require that the CPP does not have to do.

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The CPP is expensive continued…

- By comparison, a person can buy $1000 of a Vanguard *managed* balanced fund with a 0.41% MER. Index-linked funds can have an MER as low as 0.05% (!!).

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The CPP is expensive continued…

Fund Name/Share Class	1YR	3YR	5YR	Inception	MER
Vanguard Canadian Long-Term Bond Index ETF	+ 9.21%	– 6.72%	+ 0.36%	+ 1.35%	0.17%
Vanguard Canadian Government Bond Index ETF	+ 6.09%	– 3.60%	+ 0.63%	+ 0.99%	0.17%
Vanguard Canadian Corporate Bond Index ETF	+ 7.89%	– 1.07%	+ 2.34%	+ 2.10%	0.17%
Vanguard FTSE Canada All Cap Index ETF	+ 12.20%	+ 9.93%	+ 11.20%	+ 8.01%	0.05%
Vanguard FTSE Canada Index ETF	+ 12.29%	+ 11.07%	+ 11.91%	+ 8.20%	0.06%
Vanguard FTSE Canadian Capped REIT Index ETF	+ 9.24%	+ 4.59%	+ 4.02%	+ 5.22%	0.40%
Vanguard FTSE Canadian High Dividend Yield Index ETF	+ 8.36%	+ 13.93%	+ 12.10%	+ 9.03%	0.22%

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The CPP fund has become unwieldy

- Due to its sheer size, it is unable to efficiently play in the market system.
- Portfolios that have too many individual ownership positions dilute their ability to capture growth.
- But buying only a manageable number of publicly-traded stocks or bonds means simply by acquiring or selling into a position distorts the market
- Essentially they buy high and sell low

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The CPP fund has become unwieldy continued…

- This has, along with some accounting and actuarial rule changes, incentivized the CPP to move away from publicly-traded assets and into Private Placements, Real Estate and Infrastructure.
- More on that next…

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Liquidity – lack of transparency.

There have been several accounting and actuarial reserve rule changes brought on by several market upheavals that have happened over the past 30+ years:

- Hurricane Andrew and the ‘scandalous’ collapse of Girling Re
- Enron and other accounting scandals –early 2000s
- The sub-prime crisis 2008

- One of the primary outcomes for insurance and pension managers was that investments had to be “marked to market” on a daily basis.

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Liquidity – lack of transparency continued...

- This caused a lot of volatility and "strain" on the actuarial requirements and literally the values of the companies themselves
  - Some very smart people say that it was the M2M requirements that precipitated the financial market collapse of 2008.

- It created a huge incentive to move away from publicly-traded assets to ones that are not. This eliminates the "mark to market" issue.

- This also made **accurate** valuations of these pension funds **impossible**.

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Liquidity – lack of transparency continued...

Here is what the CPP stated in its 2003 Annual report:

"Private Equities - While private equities are a small component of total CPP assets, they can contribute exceptional returns over the long term for the extra risk involved. However, these specialized investments need time to deliver full value. Our ultimate goal is **to invest as much as 10 percent** of CPP assets in private equities, subject to the availability of opportunities with acceptable risk/return profiles." (Emphasis mine.)

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Liquidity – lack of transparency continued...

And Again in 2003…

- “Real Estate and Infrastructure Assets - The final component of our asset diversification strategy to date is real estate. Coupled with infrastructure assets, **they may comprise as much as five percent** of total CPP assets in the future.” *(page 15)*

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Liquidity – lack of transparency continued...

Currently (circa spring 2023) the Fund's reported holdings are:

9% in real estate and Private Equity holdings are **33% (!!)**. **That's over three times more Private Equity than they considered responsible exposure 20 years ago.**

Coupled with infrastructure investments of 9%, **today 51% of the CPP's holdings are not publicly-traded and by definition are illiquid.**

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Liquidity – lack of transparency continued...

They are also valued very opaquely:

- The only valuations have been done by third parties being **paid by the CPP to conduct the valuations** – hardly true arm's length.
  - (page 11 of the 2023 annual report)

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It is not accountable.

There are many who consider this to be a very risky option for these kind of funds as the managers are highly unlikely to be held to account for any mistakes or failings in these investments as they may not fail for decades to come.

It is not accountable.

Who are some of these many?

- **Warren Buffett: Private Equity Firms Are Typically Very Dishonest**
  - https://www.youtube.com/watch?v=r3_41Whvr1I

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It is not accountable.

The results of private equity in pensions can be disastrous for pensioners:

- Nebraska state auditor finds more than $1.4 billion in retirement funds for Omaha Public Schools mismanaged
  - https://www.ketv.com/article/nebraska-state-auditor-retirement-funds-omaha-public-schools-mismanaged/44301799

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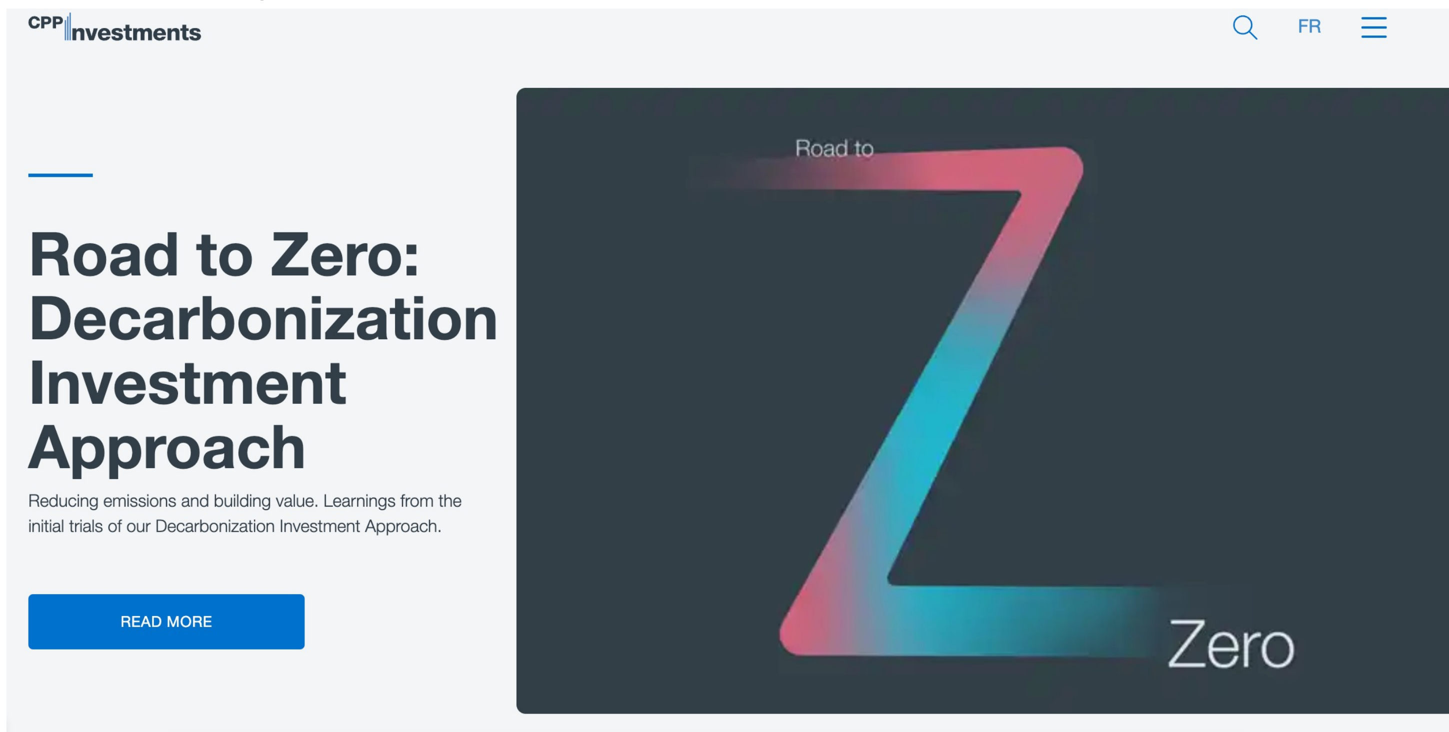
It is not accountable.

Mission Creep:



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It is not accountable continued…

Mission Creep:

From the link under the “Read More” button:

“At CPP Investments, we have committed to attaining net-zero greenhouse gas (GHG) emissions across all scopes[1] in our operations and portfolio by 2050. We seek to do this while fulfilling our mandate of maximizing returns without undue risk of loss, taking into account the factors that may affect the funding of the Canada Pension Plan and its ability to meet its financial obligations.”

Bluntly - that is an express dilution of their mandate.

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How an Alberta Pension Plan should be managed

- Protect APP from political interference
  - No DIA or ESG mandates for example…
  - Or “Road to Zero” investment directives…
  - No direct investing in Alberta
  - Cannot/Should not be an Alberta economic development fund
  - Arms length investment managers

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How an APP should be managed continued…

The mandate of the fund managers is simple and should be inviolable:

Maximize returns without undue risk of loss.

(From the CPP Annual Report…)

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How an APP should be managed continued…

Complete Transparency:

- Mandate that only publicly-traded entities that are not single asset purchases (IOW no individual stock or bond purchases)
- Primarily Exchange Traded Index Funds and Index Funds (aka ETFs)
  - Always can be marked to market
  - Very low cost
  - Acquiring or disposing of them will not distort the market
  - Potential for corruption is nil.

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How an APP should be managed continued…

Third party managers only:

Contract a group pension fund managers – 3 to 5 perhaps.

- Review their performance every 3 to 5 years
- and fire those that underperform.

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How an APP should be managed continued…

Who are these potential fund managers?

Top managers of defined benefit assets

(Assets in billions)

#	Name	2021	2020	Percent change
1	**BlackRock**	$708.2	$692.2	2.3%
2	**State Street Global**	$470.3	$424.1	10.9%
3	**NISA Investment**	$292.5	$216.2	35.3%
4	**BNY Mellon**	$270.9	$241.9	5.4%
5	**Prudential Financial**	$222.1	$210.8	5.4%

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How an APP should be managed continued…

Who are these potential fund managers?

…And Private Canadian Pension managers like Sunlife, Manulife and Canada Life

How an APP should be managed continued…

Realtime reporting in assets would be possible.

In the future pension payout options could be introduced:

- Conversion to an individual Locked-In Retirement Accounts (LIRA) with maximum annual payouts but the remaining balance can be part of one's estate.
- Make it possible for Self-employed/contract Albertan workers to contribute or purchase their way into an APP
- Mirror Funds – the APP managed accounts could themselves become ETFs

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APP Advantages

- Lower Contribution rates; higher pensions paid
- Transparency
- Accountability
- Not a monopoly on management
- Alberta becomes a less expensive place to work and run a business
- Exposure of CPP practices will make it more accountable and ultimately a better, safer manager of people's pensions
- One less thorn in the side – of Alberta Re; this confederation

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A review…

- A brief history of Public Pensions and the CPP
- What is Alberta's – and Albertan's – share of the CPP Fund
- What are the implications of that Share compared to the actuarial need.
- And what would an APP mean for Albertans - working and retired - and those who employ them.
- The CPP and how it is managed
- The concerns Canadians should have about the CPP
- How an Alberta Pension Plan should be managed
- Benefits of an APP for Albertans, Alberta and Canada

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Thank you for your time…

and patience…