8.

EDUCATION AND CULTURE - TEACHERS' SALARY CONTINUATION PLAN

BACKGROUND

8.1 Section 143(1) of the Education Act includes the following:

> "*The payments made by the Minister or a school board for all or a portion of the cost of any policy of insurance or any other benefits plan provided to teachers including, without limiting the generality of the foregoing, life insurance, accidental death or dismemberment insurance or medical and dental plans are financial assistance for the purpose of the Auditor General Act and subject to audit by the Auditor General.*"

8.2 In our 1996 Annual Report (page 53), we included the results of an audit of the Teachers' Group Insurance Plans. That audit included a finding with respect to the Teachers' Salary Continuation (long-term disability) Plan which was summarized as follows:

> The Salary Continuation Plan generated approximately $5 million of dividends from 1978 to 1995. School boards fund approximately 24% of the premiums for the Salary Continuation Plan. The school boards and the Nova Scotia Teachers Union Group Insurance Trustees should reach an agreement regarding disposition of these dividends.

8.3 In our 1997 Report (page 121), we reported that on October 20, 1997 the Nova Scotia School Boards Association requested our office to undertake an audit of the Salary Continuation Plan to determine changes in the Plan subsequent to our 1996 audit including the current existence of surplus funds identified in our 1996 Report.

8.4 The requested audit was conducted during 1998 and on August 28, 1998, we issued our audit report to the Executive Director of the Nova Scotia School Boards Association. This Chapter summarizes the major points of that report.

8.5 The Nova Scotia Teachers Union (NSTU) Group Insurance Fund Trustees offer insurance plans to teachers in the Province including a Salary Continuation (long-term disability) Plan. The Trustees are appointed by the Executive of the NSTU under the provisions of a Trust Deed dated 1965. The Trustees receive premiums and make arrangements with Plan administrators and insurance carriers for salary continuation insurance coverage.

8.6 The Salary Continuation Plan was established in 1965. Enrollment in the Plan is voluntary for eligible teachers. Approximately 6,000 teachers (60% of eligible teachers) are enrolled. At the time of our audit, the premiums were set at 1% of gross monthly income. In some cases, members' premiums are cost-shared by school boards under the provisions of local collective agreements. There are currently 12 (pre-amalgamation) boards making contributions ranging from 20% to 70% of premiums. Total premiums for 1997 were $2.8 million. New local agreements between the NSTU and amalgamated boards are currently being negotiated.

8.7 Johnson Incorporated administers the Salary Continuation Plan and the current insurance carrier is Manulife Financial. Johnson Incorporated has been the administrator since the Plan was established. The carrier was Citadel General Assurance from establishment of the Plan until 1991.

In 1991, Confederation Life became the carrier and in 1994 Manulife Financial assumed that responsibility when Confederation Life went into liquidation.

RESULTS IN BRIEF

8.8 The following are the principal findings resulting from our review.

- As at December 31, 1997 the Salary Continuation Plan had an accumulated deficit of $3.6 million which originated in the period from 1995 to 1997. Although the Plan is an experience-rated insurance plan and the insurer is responsible for any deficit upon plan termination, the NSTU Trustees have indicated it is not their present intention to force Manulife to absorb any existing deficit by terminating the Plan.

- The NSTU Trustees and Manulife negotiated a Guaranteed Deficit Reimbursement Agreement signed in May 1998 which includes provisions whereby the NSTU has absorbed some of the Plan risk upon termination which was previously the responsibility of Manulife. The Trustees will have to pay the insurer $1.2 million at Plan termination if the Plan is still in a deficit position and they also agreed to raise premiums by 20% in September 1998. The Trustees have set aside $1.2 million of the NSTU Group Insurance Trust Fund in a dedicated reserve to cover the costs of the Guaranteed Deficit Reimbursement Agreement.

- Insurance plans should be reviewed by actuaries every three years to establish the adequacy of reserves, however the Plan has not been reviewed by actuaries since 1991.

- The prior years' dividends of $5 million plus accumulated interest, as reported in our 1996 Report, form part of the NSTU Group Insurance Fund and have not been specifically segregated from other funds of the Trustees. The school boards should seek legal advice with respect to entitlement to prior years' dividends. The Trustees and school boards should negotiate an agreement regarding ownership of any future Plan surpluses or dividends.

- The claims experience for this Plan is currently about 44 claims per 1,000 insured teachers which is very high. The Trustees and other stakeholders, including school boards, should analyze the root causes of the Plan's negative experience and take action to resolve whatever problems are indicated.

- A Joint Committee, comprised of representatives of the Trustees, insurer and plan administrator, is actively monitoring the Plan and making worthwhile recommendations. The school boards should have representation on the Joint Committee.

- The NSTU and school boards should work together to ensure that there is a regular exchange of information about teachers who are potential candidates for Salary Continuation Plan benefits to facilitate early intervention particularly in alleviating situational stress.

- The Trustees and school boards should meet to discuss appropriate governance for the Salary Continuation Plan which would ensure that the school boards' interests are adequately represented in the decision-making process, and that the boards have sufficient, appropriate information to enable them to contribute meaningfully to the decision-making process.

AUDIT SCOPE

8.9 The objectives of the audit were to review the existence, ownership and valuation of any accumulated reserves, surpluses or deficits related to the Salary Continuation Plan, and to determine whether school board contributions to the Plan have been expended in compliance with the agreements and with due regard for economy and efficiency.

8.10 Our audit approach included discussions with management of the NSTU Group Insurance Fund Trustees, the Plan administrator (Johnson Incorporated), and the insurance carrier (Manulife Financial.) We also reviewed related documentation including financial reports, audited financial statements, the insurance policy and underwriting agreement. Our audit did not include a review of files related to individual claims.

PRINCIPAL FINDINGS

Responsibility for Deficits and Surpluses

8.11 The Salary Continuation Plan is fully experience-rated. Any deficit in the Plan upon termination of the policy is the responsibilty of the insurer. This has been confirmed in our discussions with the NSTU Trustees, Johnson Incorporated and Manulife. Any surplus in the Plan would be returned to the Trustees.

8.12 If the Plan is not terminated, Manulife wishes to break even over a reasonable period of time. This can be accomplished through changes to the Plan (e.g., increasing premiums or reducing benefits).

8.13 As of December 31, 1997, the Salary Continuation Plan had an accumulated deficit of $3.6 million which originated in the period from 1995 to 1997. Although the NSTU Trustees are not legally obligated to fund deficits, they have indicated it is not their present intention to force Manulife to absorb any existing deficit by terminating the Plan. The NSTU, in a letter to our Office, indicated the following.

> "*The NSTU maintains that the deficit/surplus relationship must be viewed in its entirety. That is, under a Surplus Refund Contract such as that which exists between the parties, the insured cannot act on a day-to-day basis in a manner that holds the insurer is totally responsible for deficits. To do so would mean chaos, with widely fluctuating premiums that would drive away voluntary participation.*"

Guaranteed Deficit Reimbursement Agreement

8.14 During the fall of 1997 and the early part of 1998, the NSTU Trustees and Manulife attempted to negotiate a solution to the deficit problem which would keep premium increases to a minimum. Various alternatives were examined and the two parties reached a Guaranteed Deficit Reimbursement Agreement which was signed by the Trustees in May 1998. The Agreement is significant because the NSTU will absorb some of the risk of the Plan which was previously the responsibility of Manulife. This risk transfer is in the form of a Special Payment of $950,000 at Plan termination which the Trustees will make if the Plan still has a deficit.

8.15 Although Manulife was seeking a larger increase, the Agreement included a premium increase of 17% effective January 1, 1998 but the Trustees subsidized the full amount of the increase until August 31, 1998 at a cost of $250,000 which will be payable at Plan termination. In addition, the Trustees agreed to adjust rates and/or benefits effective September 1, 1998 to offset a 20% increase in premiums.

8.16 The Trustees set aside $1.2 million of the Group Insurance Trust Fund in a dedicated reserve to cover the costs of the Guaranteed Deficit Reimbursement Agreement.

8.17 We have recommended that agreements which transfer significant risk from the insurer to Plan members and/or school boards should not be signed by the NSTU without consultation with the stakeholders in the Plan.

8.18 In a letter to our Office, the Trustees indicated that they disagree with this recommendation and made the following comments.

> "*The governance of the Plan is the jurisdiction of the Trustees. The Boards do not carry any fiduciary burden to protect the Plan members. During each round of regional bargaining the Boards are at liberty to cease their contributions - which they do on a regular basis whether the premiums go up or down.*
>
> *No other actions, taken in recent years more properly reflect the fiduciary role of the Trustees than their move to secure the Plan. This Plan was developed by teachers for the protection of teachers without any help, cooperation or encouragement from School Boards. This was, and continues to be, viewed as a necessary interim measure until the Plan stabilizes.*"

Disabled Life Reserves

8.19 Disability insurance companies are required by regulation to hold disabled life reserves. These reserves represent the actuarial cost of providing benefits to approved claimants until age 65. At the time a claimant is approved for benefits, the insurance company creates a disabled life reserve sufficient to pay benefits until age 65 and the amount (calculated by actuaries) is charged as an expense against annual premiums received during the year. The insurer currently holds disabled life reserves which are expected to be sufficient to fund the cost of future disability payments for approved claimants.

8.20 The amount of required disabled life reserve is calculated by actuaries employed by the insurance company. The Trustees have not had an actuarial review of the Plan performed by independent actuaries since 1991. Such a review would give the Trustees assurance with respect to the financial position of the Plan and the adequacy of the disabled life reserve. We have recommended that the Trustees engage an independent actuary with disability plan experience to perform an actuarial review of the Salary Continuation Plan every three years.

Prior Years' Dividends

8.21 As noted in our 1996 Annual Report (see paragraph 8.2 above) dividends of $5 million relating to the Salary Continuation Plan were received by the Trustees from a previous insurer (Citadel General) in the 1978-79 to 1994-95 time period. These funds are still being held by the Trustees and form part of the NSTU Group Insurance Fund. The funds have not been specifically segregated from other funds of the Trustees.

8.22 There are no formal agreements between the Trustees and the school boards relating to the Salary Continuation Plan and therefore, there is no agreed-upon methodology to disperse these dividends even though school boards contributed to the plans. Since the question of ownership of prior dividends raises legal questions which are outside the scope of this audit, we have recommended that the school boards seek legal advice on this matter. As well, the Trustees and school boards should negotiate an agreement regarding ownership of any future Plan surpluses.

Increase in Number of Claims

8.23 The claims experience for this Plan is about 44 claims per 1,000 insured teachers which is high. The number of approved claimants has almost doubled between 1994 and 1997. Various reasons for the high claims experience were put forward by those we interviewed during the course of the audit.

8.24 We believe the Trustees should have a detailed analysis performed by the insurer, Plan administrator and/or insurance consultants to identify the root causes of the Plan's negative experience. In conjunction with other stakeholders, including school boards, an action plan should be developed to resolve any problems identified.

Rehabilitation of Claimants

8.25 Economical operation of the Plan depends on getting claimants back to work as soon as possible. Early intervention is critical in reaching this goal. We were told that the probability of returning to work decreases as the length of the claim increases.

8.26 The Salary Continuation Plan is experiencing difficulty in getting claimants back to work. There are several reasons for this difficulty:

- *Length of time before intervention takes place* - Salary Continuation does not commence until after sick leave expires which may be a year after the disability was incurred. The Salary Continuation Plan receives no information from/about future claimants until sick leave is about to expire which means that the Plan suffers from a lack of information in the early stages of the disability.

- *Teachers' Pension Disability* - There is a separate process for approving eligibility for Teachers' Pension Disability which has been described to us as less rigorous than the Salary Continuation approval process. The existence of a separate decision-making authority with little, or any, interaction with the Plan leads to inconsistent decision-making and pressure for Salary Continuation to accept claimants who have been approved by Teachers' Pension.

- *Lack of employer participation in the process* - Many claimants are deemed to be suffering from *situational stress* which may be able to be remedied through cooperation of the school board in changing factors such as the school or grade level of the disabled teacher. Currently, school boards are not formally involved in the rehabilitation process and there is little communication between the Trustees and the boards.

8.27 An Employee Benefits Facilitator was hired in early 1998 with the hope that such a position will result in net cost savings for the Plan. The role of the Employee Benefits Facilitator is to be a liaison between the claimant and the Plan and to make recommendations which result in putting claimants back to work.

8.28 We have recommended that the NSTU and school boards work together to ensure that there is a regular exchange of information about teachers who are potential candidates for Salary Continuation Plan benefits to facilitate early intervention. Also, the NSTU and school boards should work together to ensure that situational stress is relieved to the maximum possible extent by employer participation in efforts to reduce such stress.

Monitoring of Plan

8.29 There is a Joint Claims Review Committee which monitors the Plan and is responsible for bringing forth recommendations for problem remediation to the Trustees. It is comprised of representation from the NSTU Trustees, the Plan administrator (i.e., Johnson Incorporated) and the insurance company, but it does not include a representative from the school boards. The Trustees' representative on the Committee prepares an annual review and report for the Trustees. Our review of the Report indicates the Joint Committee is actively monitoring the Plan and making worthwhile recommendations. In our opinion, a school board representative would help the Committee to fulfill its mandate especially in relation to problem remediation.

Plan Governance

8.30 The Trustees are responsible for governance of the Salary Continuation Plan which includes responsibility for setting premiums. School boards do not receive information relating to the financial position and performance of the Plan nor are they involved in any of the decision making processes. The Trustees noted the school boards have never requested involvement in Plan governance or additional information about the Plan.

8.31 We believe the Trustees and school boards should meet to discuss appropriate governance for the Salary Continuation Plan. The boards' interests should be adequately represented in the decision-making process and the boards should have sufficient, appropriate information to enable them to contribute meaningfully to the decision-making process since the boards bear a significant portion of the costs associated with the Plan.

Other Recommendations

8.32 We made several recommendations related to other aspects of the Plan. The more significant of these are summarized below:

- The Trustees and school boards should consider whether the Salary Continuation Plan should be a mandatory Plan for all teachers. This would help to diversify risk and improve Plan experience.

- Open enrollment periods (times when teachers can join without medical evidence of insurability) should not be held without specific direction from Plan members and school boards as they have a negative impact on Plan experience and increase the costs to those who pay the Plan premiums.

- The premiums for the Salary Continuation Plan should be set at the level recommended by insurance carriers/actuaries to cover the projected costs of the Plan. In the past, premiums have been kept below the level recommended by the insurer to maintain or increase enrollment levels.

- The Trustees should review the benefits provided under the Plan to determine if changes should be made to increase the economy and equity of the Plan. Examples of changes which should be considered are decreasing the 70% benefit when it is non-taxable in the hands of the recipient, and mandatory retirement at some age prior to 65.

- A disabled teacher with more than two years of service also collects disability benefits under Sections 24 and 25 of the Teachers Pension Act. The benefit is 2% per year of service. The 70% benefit payable under Salary Continuation Plan is reduced by benefits under Teachers Pension, Canada Pension and Disability benefits. The disabled person does not accumulate pensionable service under the Teachers Pension Act while collecting Salary Continuation Plan benefits. Disability benefits under the Teachers Pension Act and their relationship to the Salary Continuation Plan should also be reviewed by the NSTU and school boards, and recommendations should be made to the appropriate authority for modification of those benefits if required.

Concluding Remarks

8.33 There are no agreements between school boards and the Trustees covering the disposition and ownership of Plan dividends received by the NSTU Trustees in prior years and related interest which would have accumulated over the years. The question of ownership of prior dividends raises legal questions which are outside the scope of this audit.

8.34 The NSTU Salary Continuation Plan provides a valuable benefit to Plan members and school boards by ensuring that disabled teachers do not suffer financially because of their disabilities. It is important that the Plan be financially sustainable over the long-term.

8.35 There are a number of fundamental issues affecting the Salary Continuation Plan such as benefit levels; premiums; sharing of costs, dividends and risks; and governance. These issues can only be resolved by open dialogue between the stakeholders. In order to ensure that teachers return to productive employment as soon as they are able, employer flexibility and intervention may be required. For this reason, it is especially important that employers be involved in plan governance and the monitoring work of the Joint Committee.