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NEWS FROM UWFA

EDITOR: DANIEL STONE

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President's Report

Members are encouraged to offer their opinions on a number of proposed changes to the Pension Plan.

The agreeable condition of the economy has produced a significant accumulated surplus in the Pension Fund. The Pension Committee has sought advice about possible changes to the Plan that could be financed out of this surplus.

Attached is a set of proposals that presently lies before the Pension Committee. UWFA has four representatives on the Committee: Alden Turner, Phil Cyrenne, Howard Mathieson and David Erbach. The Executive of UWFA has met once already to assess our response to these proposals. UWFA has set up a sub-committee of the above four names plus Geoff Scott and Ed Segstro. They will report to the Executive in time for final decisions and recommendations to be made in advance of the next meeting of the Pension Committee on April 27th.

In the meantime, I would invite comments and suggestions to any of the above members of the committee on the proposals contained in the attached report.

ALLEN MILLS

SPECIAL ISSUE
CHANGES TO THE PENSION PLAN

ECKLER PARTNERS LTD.
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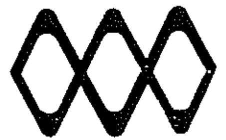
REPORT TO THE UNIVERSITY OF WINNIPEG PENSION COMMITTEE ON POSSIBLE IMPROVEMENTS TO THE PENSION PLAN

December 14, 1998



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SECTION 1 INTRODUCTION

The purpose of this report is to provide a description of various possible benefit improvements to the plan. In each case we provide our comments but not, at this stage, recommendations, which will be developed subsequent to the completion of the actuarial valuation report at December 31, 1998 and discussions with the Committee.

We also discuss the possible conversion of the plan to a defined contribution basis, as well as discussing the possibility of adding "flexible" provisions to the plan.

By way of introductory comment, the plan has generated a large surplus over the past few years because of very favourable economic circumstances. Thus the investment return of the fund over the 10 years ending December 31, 1997, net of expenses, has averaged 11.3% per annum during a period when inflation has averaged 2.6%. It seems highly unlikely that these circumstances will continue indefinitely. These conditions have meant that the "cost" of a defined benefit plan has been a lot less than originally estimated, and so the surplus has arisen. By the same token, when the economic situation returns to "normal", whatever that is, it follows that the cost of a defined benefit plan will increase from what it has been over the last few years. It is important to realize that in "normal" circumstances, the levels of contribution in this plan are barely adequate to provide the formula benefit. Any improvement which increases benefits in respect of future service will exacerbate this problem to some extent. Ideally, because of this any improvement should apply only to benefits in respect of service to December 31, 1998.

Some benefit improvements discussed below are in line with this criterion. However to implement others on a past-service-only basis would make the plan considerably more complex. For example, the current early retirement provision might be retained for future service benefits but that for past-service benefits might be changed to rule of 80 minimum 55. Such a provision, while awkward, is clearly possible.

Some benefit improvements described below provide corresponding increases for pensioners but many don't. For instance, the Income Tax Regulations would prohibit the provision of a bridge benefit for someone who is already over 65. However, the assets held in respect of pensioners have been a considerable contributor to the surplus. It is our view that the pensioners should continue to be included in any benefit improvement outcome.

Finally, many of the benefit increases described below will apply to all members but some, specifically, the early retirement and bridge benefit provision, only apply to those who take advantage of them - our preference is an increase which applies to everyone, or a package which provides a benefit improvement for each type or class of member.

We look forward to discussing this report with you at your convenience.

Respectfully submitted,

ECKLER PARTNERS LTD.

John Corp, FIA FCIA

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SECTION 2 EARLY RETIREMENT

(a) Current Provision

The current plan provision is for an unreduced pension on retirement when age plus service equals 85 or more, provided that the member is age 61 or more. On retirement prior to that date (and the earliest retirement age is 55), the pension is reduced by ¼% for each month by which the early retirement date precedes the first day that the member could have retired on an unreduced pension had he or she remained in employment. For a member hired prior to age 37, the first unreduced early retirement date would be age 61. For a member hired after age 45, it would be age 65. For others, it would be somewhere in-between.

(b) Best Possible Provision

The Income Tax Regulations (ITR) specify that an unreduced pension can be provided at the earliest of

(i) attainment of age 60
(ii) completion of 30 years' service
(iii) the date when age plus service totals 80.

Retirement prior to that date requires a ¼% per month reduction.

(c) Our Comments

Early retirement is a very expensive provision - members make contributions to the plan for a shorter time while the benefits are payable for a longer time. For this reason, we would suggest that the availability of unreduced early retirement benefits be limited to age 55 + over even where the ITR would permit earlier retirement.

It is also a discriminatory provision in that it only benefits those who take advantage of it - it does nothing for those who stay until 65. Other improvements that we discuss later provide something for everyone. It is apparent that, based on the results to date of the current early retirement windows, the benefit is a lot more attractive to support staff than it is to academic staff.

SECTION 3 BRIDGE BENEFIT

A bridge benefit is a temporary pension payable from early retirement date for a period of time but no later than age 65.

(a) **Current Provision**

There is no current bridge benefit except for the temporary arrangement under ERO III, which provides for a bridge benefit of $600 per month payable for five years but not past age 65.

(b) **Best Possible Provision**

The ITR provides that the maximum bridge benefit is the sum of

(i) the estimated OAS benefit (currently $410.82 per month)
(ii) the estimated CPP pension (the current maximum is $744.79 per month).

For a member earning less than the CPP earnings ceiling, the estimated CPP pension is based on the ratio of the member's earnings in the last 3 years to the CPP earnings ceiling in these 3 years.

The bridge benefit so calculated is reduced by ¼% for each month the member is less than age 60 at retirement and by 10% for each month by which the member's service is less than 10.

Finally, there is another restriction which limits the bridge benefit where a member is at or near the maximum pension. Essentially that says that the maximum total payment to a member prior to age 65 is

$$(A \times B) + (.25 \times C \times \frac{D}{35})$$

where A is the defined benefit limit for the year (currently $1,722.22)
B is pensionable service
C is the average of the CPP earnings ceiling in the year of retirement and the 2 preceding years
D is pensionable service to a maximum of 35 years.

Thus a member with 30 years of service, who was at the maximum pension would, if he or she retired this year, be limited to a bridge benefit of

$$.25 \times \frac{30}{35} \times \frac{1}{3}\left[36{,}900 + 35{,}800 + 35{,}400\right] \div 12$$

$$= \$643 \text{ per month.}$$

(c) Our Comments

Our comments applicable to the early retirement provision apply equally well to the bridge benefit provision i.e. they only apply to those who take advantage of them and if implemented, it will probably be necessary to also provide other benefit improvements which apply to those who do not take advantage of the early retirement/bridge benefit provisions. In addition, if such a benefit were to be introduced, we would recommend that it be subject to a reasonable service qualification, so as to avoid the situation where a member with 10 years service was entitled to the full bridge at age 60.

One relatively common type of bridge benefit is provided by delaying the application of the integration in the pension formula until age 65. Thus the current pension formula is 1.4%/2.0% per year of service so that the benefit on retirement prior to age 65 would be 2% per year of service to age 65 and 1.4%/2.0% after age 65. In your case, because the 2.0% pension formula was "stacked" for service prior to December 31, 1987, this will not produce much of a bridge benefit for those retiring in the next few years.

SECTION 4 SURVIVOR BENEFITS AFTER RETIREMENT

(a) Current Provision

The current plan provision is for a "normal form" of pension payable for the lifetime of the member (a "single life" pension) with a 5-year guarantee i.e. if the member dies within the first 5 years, payments continue until the end of the 5 year period. Alternative forms are available including a longer guarantee period (up to 15 years) and/or a joint and survivor pension (up to 100% survivor) where the pension is payable for the life of the pensioner and on his or her death, continues for the lifetime of the spouse but, in that case, the initial pension is reduced so that its actuarial present value is equal to the actuarial present value in the normal form. The Pension Benefits Act requires that a member with a spouse must elect a joint and 2/3 survivor pension unless the spouse waives the right to the survivor pension.

(b) Best Possible Provision

The ITR provide that the longest guarantee period for a single life pension is 15 years. Alternatively, the plan can provide a joint and 2/3 survivor pension with a 5 year guarantee with no reduction in the initial pension. Survivor benefits of up to 100% with guarantee periods up to 15 years are permitted, but they must be accompanied by a reduction in pension, from a "normal" form of joint and 2/3 survivor with a 5 year guarantee.

(c) Our Comments

A normal form of joint and 2/3 survivor for a member with a spouse makes a good deal of sense since it will mean that the minimum survivor pension under the provincial legislation can be provided with no reduction in pension. For a member without a spouse, the normal form could be improved to life guaranteed 10 or life guaranteed 15.

An alternative might be to provide everyone with a normal form of pension of life guaranteed 15 years, say. In this way, a member retiring with a spouse and who elected a joint and survivor pension would still suffer a reduction in pension but nowhere near as much as from the life guaranteed 5 year pension.

Finally, it should be noted that where the normal form was joint and survivor or life guaranteed 15, the member could not elect a single life pension with five year guarantee and get a larger pension - the ITR excludes that possibility. On the other hand, the ITR allows for such a possibility if the normal form is life guaranteed 10.

SECTION 5 SURVIVOR BENEFITS PRIOR TO RETIREMENT

(a) Current Provision

The current pre-retirement survivor benefit is the sum of

(i) member contributions to December 31, 1984 plus interest, and
(ii) the Commuted Value of benefits earned after December 31, 1984.

(b) Best Possible Provision

The Income Tax Regulations provide that the maximum survivor pension payable to a spouse or former spouse is 2/3 of the member's accrued and future pension where the future pension is determined on the basis that the member would have retired at 65 and that the final average earnings would have been the same as the accrued earnings. The survivor pension is limited to a benefit of 150% of the CPP earnings ceiling in the year of retirement i.e. the maximum survivor benefit would be $4,612.50 per month in 1998.

Alternatively, the plan could provide for a minimum death benefit of the Commuted Value of all benefits or two times the member's contributions with interest.

(c) Our Comments

The ITR provisions allow for much higher survivor benefits on the death of a young member than the plan currently provides but our view is that coverage for such an individual is best provided through the group insurance plan where the premiums at such ages are relatively low and the benefits are non-taxable.

SECTION 6 TERMINATION BENEFITS

(a) Current Provision

The current provision is for the member to receive the Commuted Value of his or her accrued pension.

(b) Best Possible Provision

The ITR provides that the benefit payable to a member could be equal to two times contributions with interest. Alternatively, it provides that the Commuted Value of the member's benefit could be determined by allowing for pre- and post-retirement indexing of the accrued benefit.

(c) Our Comments

In many ways, the termination benefit is the least attractive feature of the University of Winnipeg plan. It should be noted that a change to a termination benefit of two times contributions with interest does not, by itself, make the plan a defined contribution plan but this will be discussed later. Clearly the two times contribution plus interest benefit is the simplest way to go but an alternative which would also increase the current benefit would be to determine the commuted value taking into account the current early retirement provisions of the plan. Currently the plan provides that on termination of employment prior to 55, the entitlement is to a deferred pension payable from 65. The plan could instead provide that the deferred pension could start from age 61 provides that the member would satisfy the rule of 85 if he or she continued in employment to age 61 - a so-called "grow-in" provision. Extending the early retirement provisions to those who terminate prior to age 55 enhances the benefit and also the Commuted Value of the benefit.

SECTION 7 INDEXING

(a) **Current Provision**

The current plan provision is for indexing after retirement based on the 4 year average earnings on the fund in excess of 6% i.e. if the average earnings are 10%, the pension is increased by 4%. This method is known as an excess interest method. The pension increase is limited to the increase in the CPI and there is a catch-up provision whereby if the excess interest cannot provide full CPI in a year but is more than adequate in a subsequent year, the shortfall can be made up at that time.

(b) **Best Possible Provision**

The plan could be modified to provide guaranteed full CPI indexing. Alternatively, it could provide excess interest indexing without the CPI limit except that the pension payable in any subsequent year is limited to the maximum pension permitted at retirement increased to that subsequent year by increases in the CPI. The maximum pension at retirement for this purpose is the lesser of

(i) $1,722.22 times years of service

(ii) 2% of the member's best 3 year average earnings multiplied by years of service.

(c) **Our Comments**

The rationale behind the excess interest approach was that, to the extent that the fund earned more than the interest rate assumed in the valuation, the first call on the surplus generated by that return would be for pension increases. In "normal" circumstances, it would be unusual for the investment return over 6% to provide for full CPI indexing but the economic circumstances of the last few years - high investment returns, low inflation - have meant that this approach has been more than adequate to provide full indexing. We don't expect that this situation can continue indefinitely, either returns will drop so that no indexing can be provided, or inflation will return. We don't believe that, in the long-term, the plan can afford full CPI indexing. The excess interest approach without the CPI limit would, in a period of very low inflation, ensure that more of the investment gains are paid to the pensioners.

SECTION 8 DE-INTEGRATION OF BENEFITS

(a) **Current Provision**

The current provision is that the pension formula is 2% of final average earnings for each year of service prior to January 1, 1988 but the formula after that date is integrated with the Canada Pension Plan by providing a benefit of 1.4% up to the CPP earnings ceiling and 2% in excess.

(b) **Best Possible Provision**

The best possible provision is 2% for each year of service.

(c) **Our comments**

The plan, as it is currently structured, could not afford such an increase for future service but the adjustment could be made in respect of service up to December 31, 1998. However this presents a serious tax related problem. From January 1, 1990 on, the University has been reporting Pension Adjustments (PA) to Revenue Canada. These PA's are derived from the plan formula and the fact that the plan was integrated with CPP, meant that the PA's were lower than they would have been if a flat 2% formula had been used. In turn, this meant that members could make higher RRSP contributions. If the plan formula is now retroactively changed for service from January 1, 1990 - the University will be required to report Past Service Pension Adjustments (PSPAs). This would have the effect of reducing RRSP contribution room - and for a member who has earned in excess of the CPP earnings ceiling and maximised RRSPs since 1990, his or her RRSP contribution room would have a negative balance at the end of 1998 of $16,300. There are no immediate consequences of this, but it will mean that that member will not be able to make any RRSP contributions until the negative balance has been reduced which will take about 8 years. At the same time, there are a number of members who are at or near the maximum pension who will receive no benefit increase as a result of this change.

In summary, then, any modification of the plan formula should probably be limited to the 2 years 1988 and 1989 which would not entail any PSPA reporting.

SECTION 9 REDUCTION IN AVERAGING PERIOD

(a) **Current Provision**

The current provision is for a pension based on the average of the best 5 years earnings.

(b) **Best Possible Provision**

The best possible provision is for a 3-year averaging period.

(c) **Our Comments**

This is a very important feature in a situation where salaries are escalating rapidly but in the current environment this change would not have much effect on pensions paid from the plan.

SECTION 10 FLEXIBLE PENSION PLAN

This is a modification to the plan which should be considered even without any consideration of the plan surplus. Revenue Canada has now indicated that it will accept the concept of a "flexible pension plan" although, as yet, the Pension Commission has not made its position clear.

Under a flexible pension plan, a member is allowed to make "optional ancillary contributions" (OACs) over and above the regular contributions. These contributions are tax deductible but they do not affect the member's available RRSP contribution room.

These contributions accumulate at the rate of return earned by the fund and, at retirement (or an earlier death or termination of employment), must be used to enhance the defined benefit in some respect.

For example, a member who was retiring and who had a spouse, might have to suffer a reduction in pension of 12% to provide the mandatory joint and survivor pension. But, if that member had made optional ancillary contributions, the balance in that account at retirement could be used to reduce or even eliminate the reduction.

The level of OAC that could be made to the plan is a function of the member's salary and the earnings ceiling under the Canada Pension Plan. In 1998, the maximum available contributions are

Salary	Contribution
$30,000	$1,377
40,000	1,801
50,000	2,101
60,000	2,401
70,000	2,701
80,000	3,001
90,000	3,301

There are some very important restrictions

(i) these contributions can only be used to enhance the benefits when these benefits become payable - they cannot be cashed out.

(ii) the degree to which benefits can be improved are limited to those benefits permitted under the Income Tax Regulations - for example, since the best early retirement rule under the Regulations is rule of 80, flexible contributions could not be used to provide a rule of 75.

(iii) a member who is unable to use up all his or her flexible contributions for benefit improvements will lose the unused balance (i.e. they will stay in the plan to benefit other members). However this may not be as serious as it looks if it was provided that, in a situation where this occurred, the University would pay the difference directly to the individual concerned and then reduce its next contribution to the pension plan by a corresponding amount. It is our understanding that such a strategy would be permitted by Revenue Canada.

We think that this is the ideal approach to enhance certain benefits eg. early retirement. Essentially those who want it, will be able to make additional contributions to provide for it.

SECTION 11 CONTRIBUTION HOLIDAYS

The Income Tax Act provides that if the surplus gets too big, the University must stop contributing, but there is no corresponding requirement for the plan members to stop contributing.

However since, in this plan, there is a long history of matching contributions and the plan calls for matching contributions, it seems logical that any full or partial contribution holiday should equally benefit the contributing members.

We do see some problems with this, however. Any such contribution holiday for members will not mean that they can contribute the savings to an RRSP - they are still accruing benefits under the pension plan so that their RRSP contribution room is not affected. There is also an equity issue - a contribution holiday for active members does nothing for members who have already retired even though they were contributors to the surplus, while new members would get a benefit from a surplus to which they have made no contributions. We don't believe that it would be possible to fix the latter problem i.e. if there were a contribution holiday for active members, it would have to apply to all active members, including new ones. If there were a contribution holiday for the active members, we would envisage that some offsetting benefit improvement for the retirees only would be part of the package.

In summary, while a contribution holiday for the University alone or for the University and the active members is a legitimate use of surplus, it is not one which we could enthusiastically endorse.

SECTION 12 CONVERSION TO A DEFINED CONTRIBUTION BASIS

In recent years, many defined benefit pension plans have converted to a defined contribution basis. The economic conditions which have created the existing surplus have been a driving force with defined benefit plans being seen by many employees as a bad deal. Coupled with this have been pension legislation which makes the administration of a defined benefit plan complex and expensive, a tax system which favoured defined contribution plans (although the introduction of Pension Adjustment Reversals and flexible plans help to restore the balance) and litigation over the use of surplus and the legitimacy of contribution holidays. Finally the new options at retirement have encouraged defined contribution plans - the only option used to be the purchase of an annuity but now there are Life Income Funds and Locked-In Retirement Income Funds.

In the University environment, many plans are already on a pure defined contribution basis and it is very likely that if the University of Winnipeg were establishing a plan at this time, it would be a pure defined contribution plan.

We would assume that the contribution to any such plan would be the same as for the current plan and we would also assume that members would be able to choose their own investment mix. The key question is the conversion of existing defined benefits into a money-purchase equivalent.

We would envisage that plan members would be given the option of transferring to the money-purchase plan or remaining in the existing plan - so that the defined benefit plan would continue for the next several years. It may be possible to limit this option to those who are, say, age 45 and more with 10 years service and the basis for conversion would depend to some extent on the valuation results. Presumably someone converting would be entitled to a benefit equal to the value of his or her existing defined benefit, plus an allowance for surplus.

For the older members, say 50 and over, such a transfer value could be higher than the maximum amount permitted to be transferred from a defined benefit plan to a defined contribution plan. In that situation, the excess would have to be paid in cash to them and would then be fully taxable. In particular, if the transfer value of an individual were determined by accumulating his or her contributions to the plan at the historic investment return on the fund and then adding an equal amount in respect of the University, that is still a transfer from a defined benefit plan, and subject to the above mentioned limitation.

In summary, then, we think that such a conversion could be attractive to many of the members, especially the younger ones. However in any such conversion there are complex issues of equity and tax efficiency, issues which are far beyond the scope of this report.