



Pension Primer 101

Part 2 of a 3 Part Series



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Funding Ratio is the ratio of assets to liabilities. A ratio below 1 indicates that the pension is in danger of not being able to cover all obligated payments.

Pension Solvency relief is a 2 stage process resulting in additional time to amortize any pension plan deficits.

Pension Funding Crisis: How did we get here?

The University has provided a number of communications and public meeting to discuss the challenges of funding the pension plans of its employees. The University has described these challenges as the “**\$300 million dollar problem**”. The valuation for both pension plans has revealed that the funding ratio (specifically on a solvency or wind-up basis) would require additional payments. Together with the normal costs of the plan, these additional payments would amount to approximately \$300 million.

This is an attention grabbing way to describe the fact that **our plans do not have enough money in them to meet present and future funding requirements**. This newsletter attempts to provide Members with additional information and analysis on the financial health of our pension plan.

The UGFA is working with our own actuarial advisors and the University’s actuaries to better understand all of the methods and assumptions used by the University to arrive at its financial conclusions. In addition, the UGFA Pension & Benefits committee and the Negotiating Team have met with the University Administration to discuss the details of their solvency relief application to the Government filed in March. Follow the link below to view the official filing to the Province for pension solvency relief:

<http://www.uoguelph.ca/hr/total-compensation/pension-temporary-solvency-relief-application>

Pension Plan Funding



One common explanation put forward by both the provincial government and the University sector, through the Council of Ontario Universities (COU) and its advisors, is that **plan funding has simply been too low over the long-term life of pensions** to sustain the level of benefits paid to members. There are a number of reasons, which have been brought forward at various times, that can be linked to the current underfunded status of our pension plan: contribution holidays; low contribution rates; high expected investment returns; and poor fiscal management.

1) Contribution Holidays

The University has the sole authority under the current pension plan policy and legislation to unilaterally declare contribution holidays. Full contribution holidays (neither side paying contributions) were taken between the years 1998-2001. To adequately gauge the costs of lost contributions, we must assess the full cost of lost contributions during the past twenty years including a reasonable estimated rate of return on the lost investment:

- A. The cost of lost contributions while under 'mandatory holidays' for this period was \$29.2 million plus a further \$8.7 million for a total lost contribution of \$37.9 million (according to analysis from the University's actuaries). Using the professional pension plan's investment assumptions of a 4.5% rate of return compounded for 9 years (2002-2010), this amount would represent approximately \$56 million in plan assets. Taken as a percentage of the current pension deficit, the **lost contributions with income would equate to 18.8% of the current solvency deficit.**
- B. Alternatively we can look at the actual contributions (from both parties) compared to the 'normal cost' of the pension plan. Again, taking the University's own analysis of the past

A contribution holiday is a period of time when an employer does not make payments into the pension fund of its employees

Full contribution holidays were taken between the years 1998-2001

The '**normal cost**' of a pension plan is the actuarial present value of benefits attributed by the pension formula to employee service performed during the current year

Higher contribution rates would have led to even greater surpluses and therefore more pension holidays, unless a contingency account had been created.

Several improvements to our pension plan were made possible solely due to investment returns and the Federal surplus legislation

20 years, **the gap between the normal costs the Professional Plan and the actual contributions have totalled \$62.8 million** (including the mandatory contribution holidays noted above). While parts of these 'contributions not made' can be explained through the addition of plan improvements (i.e. early retirement provisions, CPI indexation of benefits) it is obvious that not making these contributions undermined the plan's ability to sustain a significant financial shock such as that resulting from the economic downturn of 2008-09.

Two critical points need to be made in relation to past contribution holidays. First, the UGFA would like to re-iterate the fact that both as an Association and as individual plan members, **we have collectively had no input, no say over, and certainly no control over pension plan surpluses**; e.g. the University at its sole discretion decided to take contribution holidays to handle its then short term budgetary problems. Second, it is true that Government legislation required some action to be taken on our pension plans (either contribution holidays or benefit improvements) once the funded status of the plan was in excess of 105%; however, there was a possibility (as noted by both the University of Toronto Faculty Association and OCUFA) that **pension plan sponsors could have redirected surplus**

funds into contingency accounts as a hedge against future downturns.

2) Contribution rates set too low OR expected investment returns set too high

This proposition was put forward specifically by Mr. Alan Shapira (Advisor to COU) in his presentations to the Board of Governors and to our Membership. Essentially, this position states that either sponsors and plan members (in most cases this means the employees who historically pay lower contribution rates) were not putting in enough money all along to keep the plan viable and/or the pension plan sponsors (the University) expected to fund too large a proportion of the plan through investment income.

Low Contribution Rates

There is much evidence within our own plan that funding has been mostly equal between employer and employees over the longer-term life of the pension. While it is true that the contribution ratios for the last 3-4 years have been on the order of 2:1 (employer to employee), the University's own analysis shows the long term 20 year average is closer to a 50/50 split of plan funding (when the impact of all contribution holidays is fully factored in). **Having the employees pay more contributions during the last**

20 years would not adequately explain the current financial problems

as higher contribution rates would have inevitably led to even greater plan surpluses (and presumably even more frequent contribution holidays taken by our Administration).

Moreover, if the government's stated aim through its legislation is to move towards a more equal 50/50 cost sharing of contributions between employers and employees to the goal of reducing the employer's costs, then the net effect is not increase to stabilize plan funding but rather to simply to realign costs between sponsors (employer) and members (employees).

High Expected Investment Returns

On the expectations of how much plan funding should be derived from investments, it can only be said that our plan had within in its investment goals (Statement of Investments Principles) and plan funding documents, similar assumptions to industry standards for such items as asset class mix and risk levels. Such assumptions were entirely rational given the market

situations of the day, with alternating periods of high investment growth and high interest rate returns, each of which in turn have beneficial impacts on pension plans.

Indeed, several improvements to our pension plan (current CPI inflation protection formula in 1989, the addition of the 'Rule of 85' in the early 1990s) were made possible solely because of investment returns AND because federal pension funding legislation required adjustments to either plan benefits or contribution rates when funding ratios exceeded 105%.

It is therefore an anachronistic and unrealistic claim to assert that plan funding (including contribution rates) could have been adjusted upward in any significant way prior to the economic downturn of the past few years without perpetuating plan overfunding and the resulting contribution holidays.

3) Poor Fiscal Management of the Plans

Another hypothesis that has been made with regard to the current financial problem has been the allegation that **poor financial**

management of pension investments or lack of proper oversight by the Board of Governors Investment Management Committee may have played a role in creating the financial problems of our pension plan.

The COU undertook a sector wide study of pension plans (the UGFA will be lobbying to have this study released to its Members for their information) that analyzed the performance of major pension plans. To look at the information provided by the University as to its recent returns on pension plan, and to judge these returns against either the Ontario University sector or other DB pension plans in the Ontario public sector, it is reasonably apparent that the rates of returns, asset mix and overall investment decisions were and remain in line with other similar plans across Ontario. While losses may have been avoided, **recent reports as to the University's investments indicate that most of the losses realized during the significant downturn have been recovered** (essentially setting us back to zero, but not having made any investment income gains during the past 2.5 years).

The Impact of the Economic Downturn

Many commentators of the funding crisis in pension plans across North America have spoken at length about the impact of the economy, through both the fall in stock market investments and the fall in long-term interest rates. While many of our own Members would be far better equipped to discuss the causes and implications of the Economic Crisis on the economy and our society, there are some basic facts about the larger economic climate that impact directly on our pension problem.

The loss in equity markets has directly affected our

{...the lower the long term interest rate the more expensive the annuity is to purchase...}

pension plan assets and eroded the ability of our plan to pay out all the funds that are required under our plan. Also, the fall in long-term interest rates has caused a very pronounced funding problem with regard to the

funding status of our pension plan on a solvency basis. To recap, the solvency test of a pension plan assumes that the whole plan is wound up and anyone who is owed anything must be paid out. When calculating solvency for pension plans, one of the assumptions (among many) is that annuities (an

{The loss in equity markets has deflated the value of investments}

investment that pays a monthly income for a set period of time) are purchased for many current and retired employees. The lower the long term interest rate, the more expensive the annuity is to purchase. So, a large portion of the problems associated with the University's pension funding problem is tied to the actuarial calculation that is dependent on long-term interest rates.

The University of Guelph is not alone in grappling with a significant pension-funding problem owing to losses in equity markets and increased costs (particularly in solvency costing). This situation is beyond our control. It will take time (this

is why the solvency relief process is considered so important) for plan assets to recover and for long-term interest rates to return to 'normal'.

The Provincial Government's metrics that it has used to judge pension plans in the University sector under its

solvency relief program have been designed to distinguish between plans that have specific and ongoing funding problems prior to the economic downturn (which would show up in lower funding ratios prior to the 2008/09 crisis) and those plans that have experienced a funding shock because of specific economic events (and that are closer to being 90% funded for the 'normal costs' of the pension plan). A quick analysis of the University's Solvency application reveals that the 'Going Concern' costs of the pension plan over the last four filings has averaged 96% and the solvency funding ratio has been 87.4%. 90% is the cut-off figure where plan is considered 'funded'.

Government Legislation



There are a host of other specific factors that have been raised in various quarters that have been identified as having a role in creating funding problems for defined benefit pension plan. The most commonly cited among this group are legislation and the regulatory environment of DB pensions. The two most often cited as negatively impacting DB pension plan funding are:

1) Federal Government rules on pension funding, whereby **no contributions can be made to a plan where the funded ratio is in excess of 105%**. This rule was put in place to prevent employers from tax sheltering monies through transfers to pension plans. It is this rule in particular that has enabled universities to take contribution holidays. Connected to this legislation, it has further been suggested that Government policy or actions in Ontario encouraged and condoned short sighted decision making on the funding of plans within the broader public sector by employers encourage (either directly or indirectly) to take advantage of the funding flexibility presented by pension surpluses.

2) Provincial Rules enacted in 1987 that mandated that **employers needed to examine and account for the financial health of their pension plan on a solvency or wind-up basis**. Prior to 1987 in Ontario, only the going concern costs were required to be evaluated and funded. Based on concerns pertaining mainly to private sector employers going bankrupt and leaving underfunded or unfunded pension plans, the Government moved to ensure a higher degree of financial health among all defined benefit pension plans, and hence even the broader public sector (including universities) were included within this rule.

The requirement for solvency valuations of pension plans was removed in a number of other provincial jurisdictions in Canada to address the kinds of funding challenges our plan currently is under. Sustained efforts dating back to 2007/08 on the part of COU to realize the same exemption for universities in Ontario have not been successful. Given the low probability of change on the legislative front, **it is safe to assume that these issues (and others) will remain part of the legislative framework that our plan operates within** and, hence, are beyond the control of either the University or the UGFA to directly affect and change.

Legislation requires adjustments to plan benefits or contribution rates when funding exceeds 105%

The going concern cost is the normal ongoing expected costs of the pension plan based on past experience

Our Observations



From the preceding analysis, the UGFA believes that there is no single causative explanation that would suffice to explain the current underfunded status of our plan. Rather, the causes are several and interdependent. Many of these causes (particularly asset losses due to market downturn and the legislative environment) are beyond the direct control of both the University and the UGFA. However, several observations can be drawn from our analysis of pension funding:

- Financial aspects of plan (contribution rates, funding, management of plan) are in line (or at least not out of line) with industry standards for public sector DB plans such as ours
- Long term health of plan and stability of benefits appears to be markedly better (based on the University's Solvency Relief Application) than the most recent valuation (August 2010)
- Funding of the going concern (normal costs of the plan) appears manageable and sustainable over the long term (possibly with some minor adjustments). This data leads the UGFA P&B Committee to believe that one reasonable response to the current situation would be to look at temporary measures aimed at meeting the Province's regulations to tackle our solvency deficit
- UGFA Member's have not had a true and equal say in how the plan has been designed and administered such that

asking our Members to assume the costs associated with the past risks of the plan are neither equitable nor logical – this is especially true when the 'lost funding' of past contribution holidays is factored into the equation

- UGFA needs to understand, advocate, and have meaningful input into the assumptions and methods used to value the pension plan in order to ensure that the most accurate financial picture is presented to our Members and to the Government before we move collectively to longer term 'fixes' to our pension plan
- To satisfy and qualify for the Government's solvency relief process (which will allow time to pay off the current solvency deficit problem) some changes will have to be made to the pension plan – However, such changes must be negotiated in good faith within the collective bargaining environment in a spirit of mutual cooperation
- Where changes are made to the pension plan (the University has identified member contribution rates, early retirement provisions and discussion of Jointly Sponsored plans), such changes need to be closely examined in light of approved UGFA Member Principles and the actual usage and benefit of plan provisions for Members



UGFA Updates and Events:

1. General Meeting – MacKinnon 115

Monday, May 16, 2011, 4:00 – 5:30 pm

2. OVC General Meeting – Room 1810

Wednesday, May 18, 2011, 8:00 – 9:30 am

Cancelled



UGFA Executive and Office Staff:

Executive:

Judy Sheeshka,
President

Ed Carter,
Vice President

Scott Colwell,
Treasurer

Jim Mahone,
Collective Agreement Chair

Bill Cormack,
Academic Freedom Chair

Èva Nagy,
Grievance Officer

Herb Kunze,
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Joseph Yankulov,
Health & Safety Chair

Mary DeCoste,
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