

# PENSIONS THAT PAY OFF



## A Reference Manual for CEP Local Activists

Communications, Energy and Paperworkers Union of Canada  
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# INTRODUCTION

This manual is meant as a guide for CEP local bargaining committees, activists and members who share the union's goal of providing a decent living to retirees.

CEP members need people who understand the basics of pensions and can explain them to other members – people who know the different sources of pension revenue available, understand the kinds of expenditures retirees face, and can identify where improvements might be made in pension benefits.

Our members also need a solid understanding of these issues when dealing with employers at the bargaining table. As CEP has made improvements to pension plans, employers have been arguing that our pension plans cost too much. They want to reduce their costs at the expense of the retirement security of our members. In addition, government pensions such as OAS, CPP and QPP, have been under attack.

CEP has fought back against these demands, and with the help of local members who are educated and informed about pensions, we will continue to do so.

# SOURCES OF RETIREMENT INCOME

In Canada, retired workers have three main sources of potential income:

Government:

- Old Age Security (OAS)
- Guaranteed Income Supplement (GIS)
- Canada Pension Plan (CPP), or QPP in Québec
- Registered Retirement Savings Plans (RRSPs) and other private savings
- Workplace pension plans

## Government-funded retirement income

### Old Age Security (OAS)

#### **General**

The Old Age Security Program (OAS) is a monthly benefit available to Canadians and legal residents of Canada 65 years of age and older, regardless of employment history. The program is designed to provide a minimum income to those who meet the eligibility criteria. The OAS benefit does not come automatically. You must apply to receive it. Go to: [www.sdc.gc.ca/en/gateways/topics/ozs-gxr.shtml](http://www.sdc.gc.ca/en/gateways/topics/ozs-gxr.shtml)

For the period July to September 2005, the maximum monthly OAS benefit was \$476.97.

## Guaranteed Income Supplement

### **General**

The Guaranteed Income Supplement (GIS) provides additional income, on top of the Old Age Security pension, to those 65 or older who have little or no income. You must apply for the GIS each year.

### **Contact information (OAS, GIS)**

General Enquiries  
Social Development Canada  
Income Security Programs, Old Age Security  
355 River Road, Tower 'B'  
Vanier, Ontario  
K1A 0L1

**Phone:** 1 800 277-9914 (N. America)

**TTY device:** 1 800 255-4786

**Web:** [www.sdc.gc.ca/en/gateways/topics/ozs-gxr.shtml](http://www.sdc.gc.ca/en/gateways/topics/ozs-gxr.shtml)

## Canada Pension Plan

### **General**

The Canada Pension Plan (CPP) is a compulsory, government-sponsored, earnings-related program paid for by contributions from workers and employers. It provides worker contributors and their families with some protection against loss of income as a result of:

- retirement,
- disability, or
- death.

The CPP is designed to replace about 25 percent of the earnings on which your contributions were based.

The Canada Pension Plan provides:

- a monthly benefit
- paid for life
- indexed annually

You must apply to start receiving CPP. The government recommends you apply at least six months before you want to start receiving your CPP pension.

N.B. Workers in Quebec are covered by the Quebec Pension Plan (QPP), which is closely associated with the CPP and pays similar benefits.

### **Age you start to receive your CPP**

Your retirement pension normally starts the month after your 65<sup>th</sup> birthday. Your monthly payment is smaller if you begin receiving it before then, larger if you take it after. You can start as early as age 60 or any time up to 70.

CPP adjusts your pension by 0.5 percent for each month before or after your 65<sup>th</sup> birthday from the time you begin to receive your pension. The adjustment is permanent; if you choose to start your pension early, your benefit does **not** increase when you reach 65.

For example, if you start your pension at 60, your monthly payment is 30 percent **lower** than if you wait until 65. But, by starting it sooner, you will likely receive it for a longer time. If you start your pension at 70, your monthly payment is 30 percent **higher** than if you had taken it at 65. There is no financial benefit in delaying receiving your pension after the age of 70.

**Contact information (CPP)**

Enquiries Centre  
Social Development Canada  
Income Security Programs  
140, Promenade du Portage  
Gatineau, Québec  
K1A 0J9

**Phone:** 1 800 277-9914  
**TTY device:** 1 800 255-4786  
**Fax:** (819) 953-7260  
**Web:** [www.sdc.gc.ca](http://www.sdc.gc.ca)

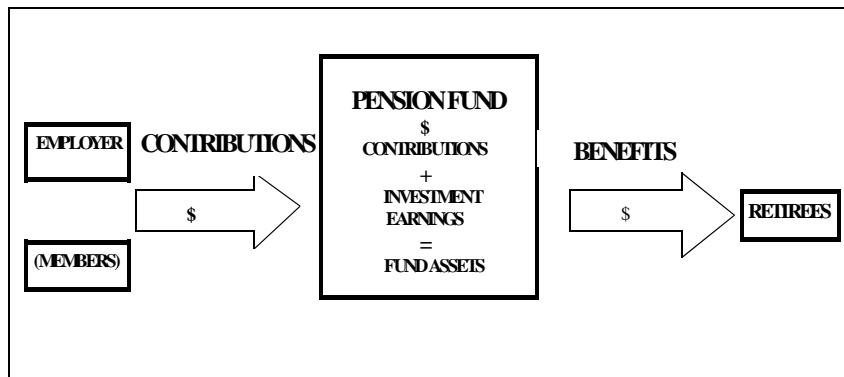
# Workplace pension plans

## Basic aspects

### The money in a pension plan

There are three types of money associated with a pension plan:

- **Pension contributions** (or premiums): the money that is paid into the fund
- **Pension fund:** the money that has been received in contributions, plus investment earnings, less money that has been paid out in benefits or used to administer the plan
- **Pension benefits:** the pension money that retired members receive



### Pension contributions

The employer, the plan members, or some combination of the two, pay pension plan contributions.

**Non-contributory plan.** A plan funded entirely by the employer, where the members do not contribute, is called a non-contributory plan.

N.B. While technically the members do not contribute to a non-contributory pension plan, in fact they do pay for their pensions. When the union negotiates a pension plan the workers give up some of their wages now, to pay for the money that goes into the pension fund. That's why pensions are sometimes called **deferred wages**.

A **wholly contributory pension plan** is one where the premiums are paid entirely by the pension plan members.

A **partial contributory pension plan** is one where both the employer and the plan members pay the contributions. The plan has rules about what contributions are paid by the plan member, who pays if the plan runs into a deficit and special payments have to be made, etc.

### **Pension fund**

The pension fund is the money that has accumulated in the pension plan. It consists of the money that has been received in contributions, plus investment earnings, less money that has been paid out in benefits or to administer the plan.

The idea behind a pension plan is to ensure enough money is paid into the fund now, so that there will be enough money available to pay out the required pensions to retirees in the future. Unfortunately, there are many variables that can affect these figures. It can be hard to predict.

For example, in a contributory plan (where the members pay contributions), the money flowing into the plan may decrease if there are layoffs, or may increase if new members join the plan.

Money in the fund is invested. But, we do not know what earnings the fund may generate. The economy may do well, the plan administrator may make good investment decisions, and a large amount of interest may accumulate. Or, poor returns may mean little or nothing is made.

### **Pension benefits**

Money is paid from the fund as pension benefits to retirees. But, we do not know how long individual retirees are going to live after retirement. So, we do not know exactly how much money we need for each individual. Some workers who are plan members do not even make it to retirement; they die when they are still young. Other workers may collect pension benefits for over 40 years.

But, an advantage of having a group plan is that while it is difficult to predict how long any individual will be drawing a pension, it is much easier to predict what averages will apply to a group as a whole. Actuaries, specialists who calculate statistics for pension plans, are quite accurate at predicting what these averages will be, based on statistics for the population as a whole.

### **A conflict between different interests**

The uncertainties associated with contributions, fund size and benefit payments lead to a conflict between different interests. Union members and other workers want to know, as precisely as possible, what pension benefits we will receive when we retire. We want to know how much we will have to live on when we stop receiving our employment income.

Employers usually want to know as precisely as possible, what they have to contribute to a pension plan. They prefer a predictable contribution amount. It makes budgeting easier. Generally speaking, workers prefer a defined benefit plan, whereas employers prefer a defined contribution plan.

### **The pension plan**

A pension plan is a written document that describes:

- Contributions: how contributions will be made, who will make them, what contributions will be made, etc.
- Fund: what happens to the money in the fund, who controls it, who makes decisions about how it will be invested, etc.
- Benefits: who is entitled to benefits, what type of benefits will be paid, what level of benefits will be paid, under what circumstances benefits will be paid, etc.

### **Important definitions and distinctions**

A **defined benefit plan** is one where the plan members know what benefits they will receive when they retire. A **defined contribution plan**, or **money-purchase plan**, is one where we know what contributions will be made to the fund, but we cannot know what any member's pension benefits will eventually be.

A **hybrid plan** contains elements of defined benefit and defined contribution plans. E.g. in a **target benefit plan** the employer makes a defined contribution, and benefits are paid out like a defined benefit plan on a years of service basis. But, the level of benefits is calculated by an actuary and is not guaranteed. If the actuary's estimate is off your benefit may be adjusted.

Most pension plans cover the employees of a single employer. But, **multi-employer plans** cover the employees of more than one employer, usually by agreement with one or more unions.

A **registered pension plan** is registered under the relevant provincial or federal pension legislation. Registered pension plans operate under rules that provide certain levels of protection to the plan members.

Some employers sponsor group **Registered Retirement Savings Plans** (RRSP). These plans are registered under the *Income Tax Act*, but are not considered workplace pension plans under provincial or federal pension legislation and are not registered under those acts.

## Types of plans

### **Defined benefit plan**

A defined benefit plan is one where the plan members know what benefits they will receive when they retire. Contributions vary with changes such as investment income fluctuations, increases in the number of members receiving pension benefits, etc., but a formula clearly sets out how to calculate the benefits each member will receive.

There are two kinds of defined benefit formula:

- Earnings related formulas
- Flat rate formulas

### **Earnings related formulas**

Every earnings related formula has three factors:

- Percentage
- Dollar amount (based on earnings)
- Years of service

These three factors are multiplied together to give the amount of pension benefit a member will receive.

For example:

$$2\% \times \$64,342.00 \times 27 = \$34,744.68$$

There are three types of earnings related formula:

- Best average earnings formula
- Final average earnings formula
- Career average earnings formula

### **Best average earnings formula**

CEP's model pension plan is based on a **best** average earnings formula.

A typical best average earnings formula is:

1.65% x average of best 3 years salary x years of pensionable service

The formula has three factors:

- Percentage
- Dollar amount based on your average earnings over your three best years
- Years of pensionable service

These three factors, multiplied together, give the amount of the pension benefit.

### **Final average earnings formula**

In a final average earnings formula the three factors are:

- A percentage
- A dollar amount based on your average earnings in your last years at work
- Years of pensionable service

The difference between the best average and final average earnings formulas is in the dollar amount in the calculations.

Some people do not make their highest wages in the last years they work. For example, they may work fewer hours in their last years, or take an easier job that pays less money. So, all other things being equal, a best average earnings formula is better than a final average earnings formula.

### **Career average earnings formula**

In a career average earnings formula the three factors are:

- A percentage
- A dollar amount based on your average annual earnings for all your years of service with the employer
- Years of pensionable service

The dollar amount in the career average earnings formula is lower than in the best average and final average earnings formulas. So, it provides the lowest pension benefits of the three, all other things being equal.

### **Flat benefit formulas**

A flat benefit formula is not based on earnings. It is only years of service that count.

The formula is very simple:

$$\begin{aligned} & \textit{Flat dollar amount} \times \textit{Years of pensionable service} \\ & = \textit{Pension benefit} \end{aligned}$$

### **Defined contribution plan**

A **defined contribution plan**, or **money-purchase plan**, is one where the formula for determining what amounts of money will go into the pension fund is clear (the contributions that the employer and the plan members will make are defined), but the benefits that the pension plan members will receive are not clear. We know what contributions will be made to the fund, but we cannot know what any member's pension benefits will eventually be.

### **Defined contribution formulas**

There are different defined contribution formulas:

Registered Pension Plan

- Cents per-hour formula
- Percentage of annual wages formula

Deferred Profit Sharing Plan<sup>1</sup>

- Percentage of profit formula

### **Benefits under a defined contribution plan**

A defined contribution plan may have a single pooled fund or be like a series of individual savings accounts. When you retire, you receive a lump sum based on your share of the pool or whatever money is in your individual account. You use this to purchase your retirement income, for example, through an annuity or a Life Income Fund.

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<sup>1</sup> A Deferred Profit Sharing plan cannot be registered under provincial or federal pension legislation.

Various factors can influence whether you will be able to buy adequate pension benefits.

**Amount of money contributed to the account**

If contributions to your account have been too small, if you do not have a large enough account, you will not have enough money to purchase adequate pension benefits when you retire.

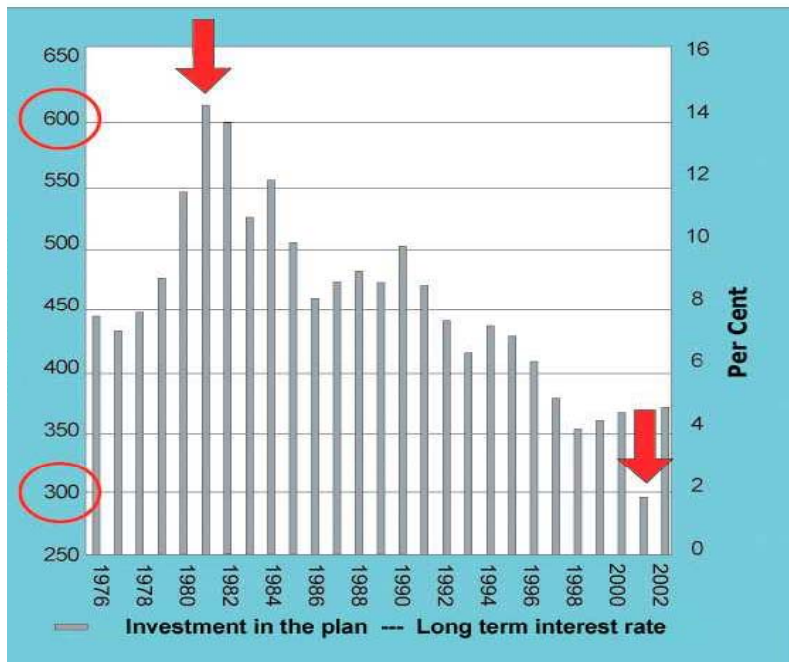
**Investment performance**

If the investment performance of your account has been poor, you will end up with less money to spend than someone who has enjoyed good investment performance.

**Timing of retirement**

Many workers with defined contribution pension plans have a tough decision to make about when to retire. One person who retires with a particular amount of money may be able to buy an adequate pension. But, with a change in the economy or an unlucky choice of investment, another person retiring six months later, with the same amount of money, may be forced to live in poverty the rest of their life.

As the table below shows, your timing, when you buy an annuity, has a considerable impact on how big a monthly allowance you will receive. \$50,000 in 1981 bought an annuity that paid a monthly allowance of more than \$600. But a \$50,000 annuity bought in 2001 paid a monthly allowance of less than half that, under \$300.



With a defined contribution pension plan, you try to avoid retiring at a time when the cost of purchasing retirement income is high.

**The pension you end up with is whatever the money in your account will buy when you retire. A defined contribution pension plan is a crapshoot.**

## Comparing defined benefit and defined contribution plans

If your employer is talking up the idea of converting your defined benefit (“DB”) pension plan to a defined contribution (“DC”) pension plan or an RRSP, chances are the switch is being presented as a “win-win” for everyone involved.

Your employer wins, because it gets “cost certainty” out of the deal. The employer knows exactly what its pension obligations are because in a defined contribution pension plan, the employer’s only obligation is to make a fixed contribution to the plan. The employer has no responsibility for the retirement benefit that the plan eventually pays.

You win, according to the pitch, because you get control of your own pension money. You get to decide how it is invested. You get to decide how and when the money in your plan is paid out. And you can take it with you if you quit.

Defined contribution conversion is often presented as a kind of pension magic that’s sure to make everybody a pension millionaire.

**But there’s no magic in retirement savings. And there’s a lot more at stake for you in conversion than just getting control over your money.**

Your retirement income depends on three things: how much is contributed to the retirement fund; what rate of return is earned on the money while it is in the fund; and who bears the risks when you convert your savings into a retirement income when you stop working.

And in each of these three areas, **defined benefit plans have a clear advantage.**

**Defined benefit pension plans generally earn higher investment returns than defined contribution plans, and substantially higher returns than RRSPs.**

- Because all of the risk in a defined contribution plan is borne by plan members at the point where retirement income is actually paid, defined contribution funds and RRSPs tend to be invested more conservatively than defined benefit funds.
- Because defined benefit pension funds are generally larger than defined contribution funds, and much larger than individual RRSPs, the investment management fees they pay are much lower.
- These differences add up. A typical return differential of 1% increases the cost of providing a given retirement income by about 30%. And if the investment management fees are 1% higher than a defined benefit plan's fees – a low estimate of the differential -- that means about a quarter of your retirement savings are going to pay the investment manager rather than to provide a pension for you.

**Defined benefit pension plans take the risk out of retirement.** The benefit is guaranteed. The plan, and ultimately the employer, bears all of the risk. In a defined contribution plan, the risk is yours, and it affects both your retirement income and its security. For example, in the past 20 years, the monthly pension you can buy with \$50,000 has been as high as \$629 and as low as \$331. And what you get depends entirely on when you have to make the conversion.

**In a defined contribution plan, you are forced to play an interest rate lottery when you retire.**

**In a defined contribution plan, you also have to think about what happens if you run out of money in your retirement fund before you die.**

- You can bear the risk yourself – imagine not carrying any fire insurance on your house;  
or
- You can pay an insurance company -- out of your retirement savings – to bear it for you.

**The bottom line? You get more for your money with a Defined Benefit plan than with a Defined Contribution plan: more pension; more options; and more security.**

## Issues in your retirement income: a quick comparison of DB and DC plans

<i>Issue</i>	<i>Defined Benefit</i>	<i>Defined Contribution</i>	<i>RRSP</i>
Investment risk before retirement	Borne by employer	Borne by plan members as a group or as individuals	Borne by individual employee
Investment risk after retirement	Borne by employer	Borne by individual plan members	Borne by individual employee
Life expectancy risk	Borne by employer	Borne by individual plan members	Borne by individual employee
Expected investment returns before retirement	Highest, both long-term risk and timing risk spread out over plan membership and backed by employer	Moderate, long-term risk may be spread over membership, but timing risk is borne by individual	Lowest, all risks borne by individual employee
Expected investment returns after retirement	Highest, risks shared by all plan members --active and retired -- backed by employer	Lowest, all risks borne by the individual	Lowest, all risks borne by the individual
Risk and return: Benefits provided relative to contributions	Most favourable relationship between contributions and benefits	Less favourable relationship between contribution and benefits: i.e. to match a DB benefit, contributions must be higher	Least favourable relationship between contributions and benefits. i.e. to match a DB benefit, contributions must be substantially higher

<i>Issue</i>	<i>Defined Benefit</i>	<i>Defined Contribution</i>	<i>RRSP</i>
Design: Unreduced Early retirement	A common feature of defined benefit plans	Early retirement only on self-funded and reduced basis	Early retirement only on self-funded and reduced basis
Design: Indexing	Some plans provide automatic indexing; many plans provide “ad hoc” cost of living adjustments	Cannot be provided	Cannot be provided
Plan Design: Integration with disability benefits	A common feature of defined benefit plans	Cannot be provided	Cannot be provided
Termination benefits and portability	Minimum termination benefit is commuted value of pension. Lower values for younger workers; higher for older. Higher termination benefits can be negotiated.	Terminating member generally receives contributions plus interest as termination benefit.	Terminating member automatically receives contributions plus interest as termination benefit
Retirement planning	Guarantees a specific benefit around which retirement can be planned	Forecasting pension requires forecasting stock market returns and interest rates	Forecasting pension requires forecasting stock market returns and interest rates
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## How long will your retirement money have to last?

### **Defined benefit pensions (fully indexed)**

Defined benefit pension plans that are fully indexed to inflation (just like the Canada Pension Plan and Old Age Security) pay pension money until death. Many even pay money after death through survivor benefits.

Because they are fully indexed (again like the CPP and the OAS) it is simple. You calculate what your entitlement will be at your expected retirement date and can be sure that you will receive the same amount, plus adjustments for inflation, until you die.

### **Defined benefit pensions (not fully indexed)**

Defined benefit pension plans that are not indexed or are only partially indexed, also pay pension money until death, but the actual value will drop over time. You can calculate what you will receive when you retire, but you have to guess what impact inflation will have. With a fully indexed pension, you know that you will be able to buy the same basket of goods and services in your 15<sup>th</sup> year of retirement as at the start of your retirement. With an un-indexed or partially indexed pension, it is much more difficult to predict how much the value of your pension will fall and what you will be able to afford.

### **Defined contribution plans and personal savings**

However, it is much more difficult when you are trying to work things out under a defined contribution plan or for retirement income from personal savings.

In these cases, you have to budget your money, based on how long you expect to live and on what different income sources you may have at different stages in your retirement. All this is further complicated by the need to invest your savings and to try to guess what returns, if any, different types of investment might yield.

Your retirement income might come from investments such as annuities, Registered Retirement Income Funds (RRIFs), Life Income Funds (LIFs), and Life Retirement Income Funds (LRIFs)

First, we'll consider life expectancy, the number of years you can expect to live. Then we'll look at changes in income at different stages of your retirement.

**How long am I going to live?**

No one can know for sure how many more years they have left to live. The following page gives recent life expectancy statistics that will go some way towards helping you calculate how long a retirement you will need to finance.

## Life expectancy statistics

Source: Statistics Canada

Chart 1: Life expectancy (in years) at birth, by sex and by province

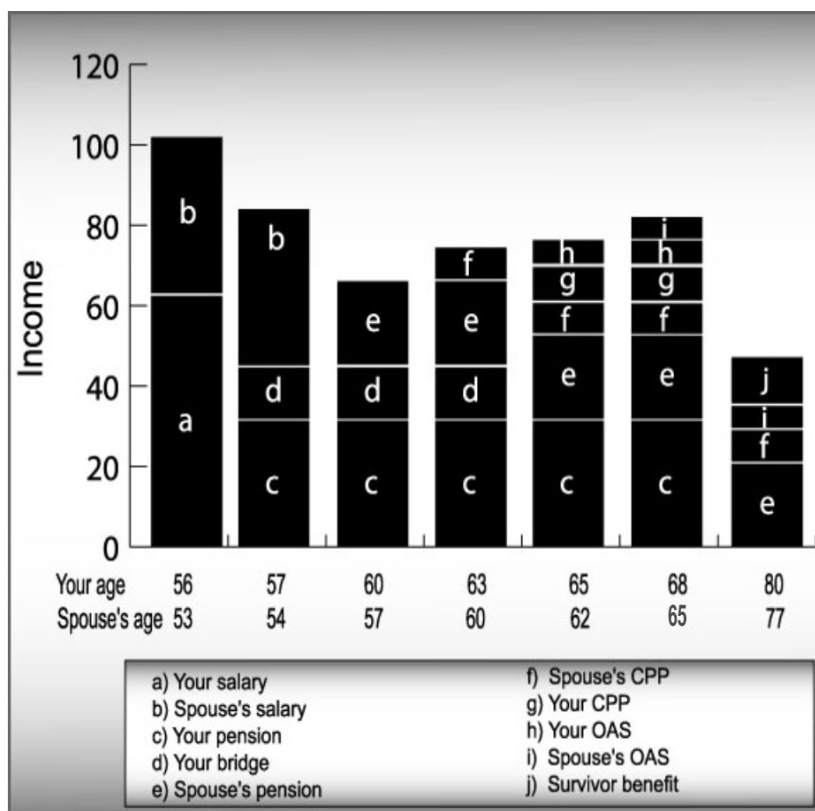
	<b>Males</b>	<b>Females</b>
<b>1990-92</b>		
<b>Newfoundland and Labrador</b>	<b>74</b>	<b>80</b>
<b>Prince Edward Island</b>	<b>73</b>	<b>81</b>
<b>Nova Scotia</b>	<b>74</b>	<b>80</b>
<b>New Brunswick</b>	<b>74</b>	<b>81</b>
<b>Quebec</b>	<b>74</b>	<b>81</b>
<b>Ontario</b>	<b>75</b>	<b>81</b>
<b>Manitoba</b>	<b>75</b>	<b>81</b>
<b>Saskatchewan</b>	<b>75</b>	<b>82</b>
<b>Alberta</b>	<b>75</b>	<b>81</b>
<b>British Columbia</b>	<b>75</b>	<b>81</b>

### **Retirement income changes**

Your family income will probably change during the course of your retirement.

For example, imagine you are a married male CEP member, with early retirement provisions in your union-negotiated, defined benefit pension plan. Your wife is three years younger than you and has a workplace pension, but no bridging.

The diagram below illustrates typical changes you may expect in your family income over the course of your retirement.



If you decide to take early retirement at 57, and your spouse is still working, your family income at the start of your retirement will consist of your pension, plus bridging, plus your wife's salary.

If, after three years, your wife retires too, the family income will drop by the difference between her former salary and her workplace pension. Because she has no bridging, your wife may choose to receive a reduced CPP, starting at age 60. This will increase the family income again.

When you hit 65, you will start to collect CPP and OAS. But, the increase in your income as a result of these government pensions will be offset by the loss of your bridging.

When your wife turns 65, she will be able to collect OAS.

If one of you dies before the other, the survivor will experience a drop in family income, but may be entitled to survivor benefits.

## **Workplace pension plan funding**

### **Unions work for proper funding**

As union activists, we work in various important ways to ensure our pensions are properly funded:

- We work politically to pass laws that protect workers' pensions
- We negotiate pensions with stable funding
- We work for union involvement in the control of our pension plans
- We educate our members on the basics of pensions, including funding

### **Funding issues**

With defined contribution plans, the employer simply pays the agreed amount into the fund. So long as the employer pays the agreed amount, he is off the hook when it comes to funding issues. Any funding shortfall must be addressed by the plan members themselves, not by the employer (unless something specific has been negotiated.) The employer, of course, does not worry about what level of benefit their contributions will eventually pay for. That's a worry for the workers, the members of the plan.

With defined benefit plans, regular calculations and adjustments are made to ensure that enough money is going into the fund to pay for all current and future liabilities. The funding issues and the worry that goes along with them belong to the employer and others who ensure the funding, rather than with the plan member and the retiree.

### **Two key funding questions**

We need to answer two key questions when we consider pension funding:

- **Question 1** How much money will the plan need to pay your pension when you eventually retire?
- **Question 2** How much money should be paid into the fund now, to ensure enough money is available to pay the benefits to which you will be entitled when you do retire?

These answers apply to two different pension costs:

- **Current service cost** The cost of providing you a pension for the service you earn this year.
- **Past service cost** The cost of providing pension improvements or new pensions for previous years.

### **These calculations can be used in other circumstances**

The calculations on the next pages are related to funding for defined benefit pension plans. But the principles apply to other situations too.

If you are relying on a defined contribution pension plan or on personal savings such as RRSPs you can apply these principles when you do calculations on how much an annuity will pay, and how much you will have to save each month to accumulate enough money to buy a particular annuity.

## How to calculate current service costs

### Assumptions

Let's assume:

- We are doing the calculation for a male plan member
- The member joined the plan at age 35. He will have 30 year's service if he retires at 65.
- At 65, the member's final average earnings will be \$50,000
- Pension is calculated based on the formula: 2% per year of service
- This member has a life expectancy of 17 years at age 65. (It would be higher for a woman: around 21 years)
- No indexation

**Question 1** How much money will the plan need to pay your pension when you retire?

### Without investment earnings

If the fund did not earn returns on its investments, you would need \$30,000 in the fund to pay for the member's pension each year.

$$\$50,000 \times 2\% \times 30 \text{ years service} = \$30,000$$

If the member lived for 17 years after retirement, assuming the fund earned no investment earnings, you would need \$510,000 in the fund to pay the member's pension until he died:

$$\$30,000 \times 17 \text{ years} = \$510,000$$

But, pension funds do earn returns on their investments. So, you need less than \$510,000 in the fund when the member starts retirement to cover the total costs of his pension.<sup>2</sup>

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<sup>2</sup> A more complete explanation

If, when the member retired, you had the full \$510,000 in the fund to cover the pension costs, only \$30,000 would be paid out the first year to the retiree. With no investment earnings, this would leave \$480,000 in the fund.

$$\$510,000 - \$30,000 = \$480,000$$

But, we can expect that the rest of the money would be making making investment returns. So, instead of having only \$480,000 left in the fund, you would have \$480,000 plus these investment earnings. The actual figures might be:

$$\$510,000 - \$30,000 + 3\% \text{ investment earnings} = \$480,000 + \$14,400 = \$494,400$$

Interest would continue to be added on the reduced amount every year. So, to cover the costs of a pension, you need less in the fund when the retirement starts than the total amount that eventually will be paid out. In our example, you can have less than \$510,000, and still be covered.

### With investment earnings<sup>3</sup>

If you do not need the full \$510,000 in the fund when the member retires, how much do you need?

The answer depends on the interest rate and what you can expect to earn on your investments. The amount you would require in the fund to pay \$2,500 per month over 17 years is:

Return on investment	Amount in the fund at the start of retirement
10%	\$244,807.52
7%	\$297,739.33
5%	\$343,097.77
3%	\$399,122.12

At 3% return, over 20% of the payments would come from returns earned by the fund during the period of retirement. With a return of 7%, more than 40% of the retirement payments would come from these accrued investment earnings.

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<sup>3</sup> There are several programs available to make these calculations, some on the internet.

If you have Microsoft Excel:

1. click on **Paste Function**, or on the icon: **fx**
2. under function category select **Financial**
3. under function name select **PV**
4. Insert your **Rate**. In our first example, the rate is 7%, and we are talking about 12 monthly payments a year, so type in: **7%/12**
5. Insert your **Nper** (Total number of payments). This is **204** (17 years x 12 months a year)
6. Insert your **Pmt** (Payment): **2,500** (\$30,000 per year = \$2,500 per month)
7. The formula result provides the amount you will require in your fund at the start of the retirement to cover the full amount.

N.B. You can use this feature to calculate how much annuity you must buy, at different rates of interest, to return a particular payment every month.

*N.B. When markets are in a downturn, everyone can expect to make lower returns on average. But, as a general rule, professionally managed, large pension funds can expect to make relatively higher rates of return than small investor individuals at any point in the business cycle. Individuals investing their own money, because of less expertise, a smaller fund and a lower capacity to take a loss can expect to make relatively lower returns on their investments.*

**Question 2** How much money should be paid into the fund now, to ensure enough money is available to pay the benefits to which you will be entitled when you do retire?

Let's assume the plan will need \$297,739.33 in your pension fund when you retire at 65 to pay for your 17 years of retirement. The amount that needs to be invested each month to reach this total depends on:

- How long you have until you retire, and
- How much the money will earn as it is contributed to the fund (the rate of return on the contributions)

If you are 35 and a new member of the plan, the plan will have 30 years to accumulate this total of \$297,739.33. The table<sup>4</sup> below shows how much money has to be contributed each month over the next thirty years to accumulate this total, assuming different rates of return.

Rate of return	Monthly contributions
10%	\$132.71
7%	\$244.05
5%	\$357.75
3%	\$510.93

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<sup>4</sup> Use Microsoft Excel function PMT to do these calculations.

As we saw with our calculations to answer Question 1, a significant proportion of the final total will come from returns on investment earned by the fund.

If the rate of return is 7%, monthly contributions will total \$87,858.00 ( $\$244.05 \times 360$ ). This represents less than 30% of the \$297,739.33 that will be in the fund in thirty years time. The other 70% comes from investment earnings.

With a 7% rate of return, the current service cost for this member this year is:

$$\$2,928.60 \quad (\$244.05 \times 12)$$

### **Costing for the whole plan**

By performing these calculations for all the plan members, an actuary can have a good idea about how much money will be needed in the fund at given times to cover all the expected future benefits.

### **Additional assumptions**

#### **Life expectancy**

In our example, we assumed a life expectancy for our member of 17 years after retirement. Of course, we cannot know for sure how many years any one individual will live. Some people will live exactly as long as the life expectancy tables predict, some will die sooner, some will die later.

But, the total effect of these early and late deaths means we can assume for any one person that the life expectancy from the life expectancy tables is more or less correct. The larger the group, the closer to the actuarial life expectations we can expect our assumptions to be. This is one of the advantages of a group pension plan; individual differences tend to even out statistically.

### **Indexing**

Gloria Swanson had a neat take on inflation: “Americans are getting stronger” she said. “Twenty years ago, it took two people to carry ten dollars’ worth of groceries. Today, a five-year-old can do it.” We all know she must have said that a while ago, because you don’t get many groceries for ten dollars these days. Prices are rising all the time

An additional calculation will have to be made if the plan has full or partial indexation of benefits, to allow for the increase in price of groceries and other essentials.

We do not know how much the cost of living will rise in any future year. So, if your pension is indexed (as the best pensions are), assumptions are made in the costing about what the cost of living increase will be.

### **How to calculate past service costs**

Past service costs (also known as previous service or prior service) are calculated when we negotiate an improvement in pension benefits.

If we negotiate an improvement in the formula, e.g. from 1.65% to 1.7%, the pension you are entitled to may be increased for all your past years of service. The difference in this example (1.65% to 1.7%) is 0.5%.

If you have been in the pension plan ten years, the difference of 0.5% will be applied to the ten years you already have in the plan.

Extra money will have to be set aside for everyone in the plan to cover this increase of:

$$0.5\% \times \text{pensionable years to date} \times \text{final average earnings}$$

This represents the increase in costs to cover past service liability.

The past service cost is a one shot cost (unlike an increase in current service cost that has to be paid every year in the future).

Sometimes this one-shot cost can be paid for out of a fund's surplus. Where there is no surplus, special payments will be needed to cover the past service cost. Because the past service cost can be large, these payments are often spread over a period of time, usually 15 years. It is like paying the mortgage on a house.

Until the special payments have all been paid, the fund will have an unfunded past service liability.

With past service costs as with current service costs, assumptions have to be made about life expectancy, additional costs to cover indexation, etc.

## Workplace pension plan administration

### Levels of pension plan administration

Different pension funds are administered in different ways. The options are defined in legislation, which varies across the country, depending on jurisdiction. There are three levels of pension plan administration:

Function	Responsible	Explanation
Governance	Plan administrator	<p>The plan administrator, on top of the hierarchy, is ultimately responsible for all major decisions.</p> <p>The plan administrator is responsible for plan administration, drafting the plan text and amendments, planning the trust agreement and amendments.</p> <p>The plan administrator could be an employer, board of trustees, pension committee, insurance company, union or another body set up according to the law's requirements.</p>
Management	Pension committee Staff	<p>The people at this level:</p> <ul style="list-style-type: none"><li>•advise the plan administrator on what to include in the investment plan</li><li>•implement the investment plan provisions.</li></ul> <p>Larger plans have investment managers.</p>

<b>Function</b>	<b>Responsible</b>	<b>Explanation</b>
Operations	Staff Service providers	Staff members do the day to day work of the plan: keep records, answer plan members' questions, etc. Service providers such as actuaries, investment advisors, investment managers, custodians, legal counsel, etc. provide actuarial, investment, insurance or legal advice and services.

### **Plan administrator**

The plan administrator must:

- Act in the best interests of all plan members and other beneficiaries
- Establish governance objectives for the oversight, management and administration of the plan
- Ensure the plan is administered according to its provisions
- Ensure compliance with statutory requirements (Registered pension plans must report to Revenue Canada and the Office of the Superintendent of Financial Institutions (OSFI) or provincial authority)
- Ensure contributions are paid on a timely basis
- Provide for the establishment of performance measures
- Ensure that participants who have decision-making authority in the governance process are monitored
- Establish an internal control framework to address the plan's risks
- Protect personal information
- Guard against the misappropriation of funds

- Educate the plan members about their retirement options and the associated risks.

### **Actuaries**

Actuaries are statisticians who work in the pension industry. They play an important role in advising the plan administrator.

### **Actuarial assumptions**

Actuaries make predictions about what will happen to the pension plan in the future. These predictions are based on actuarial assumptions.

Actuaries make assumptions about variables such as: the age at which plan members will retire, future interest rates, the life expectancy of members, the life expectancy of spouses (when calculating the costs of survivor benefits), etc.

These actuarial assumptions are educated guesses. For example, actuaries use mortality tables that give life expectancy statistics for the whole country, to make educated guesses about how long members of a particular pension plan will live.

Actuaries are experts at estimating what will happen in the future, but their estimates are rarely, if ever, exact. Actual costs end up being different from estimated costs.

### **Key actuarial assumptions**

The four most important actuarial assumptions in connection with a pension plan are:

- The rate of return on the fund's assets
- The age at which members retire
- The rate of inflation
- Wage increases

Registered pension plans must be evaluated by an actuary at least once every three years. When they prepare their actuarial valuation report, actuaries usually compare the assumptions they used for their previous actuarial valuation with what actually happened since then.

For example, they will report their assumed rate of return on the fund's assets and compare it with the actual rate of return on the fund's assets. How much they predicted the fund would make, compared with how much it actually made.

Changes in assumptions can make an enormous difference. For example, a one per cent increase in the rate of return assumption represents a change in the required contribution of around 20%.

### **Aggressive or conservative assumptions**

Assumptions can be aggressive, conservative, or fall somewhere between the two. Larger plans can afford to be more aggressive in their assumptions and in their investment strategies than smaller plans, because they have a larger pot, so they can invest more broadly, and there are more people to spread any potential losses over.

### **Experience gains and experience losses**

An **experience gain** occurs when actual costs are lower than predicted. An **experience loss** occurs when actual costs are higher than expected.

If experience gains are made, the money can be used in one of three ways:

- To pay improved benefits

- To offset current service costs or past service costs
- To accumulate in the fund and eventually create a surplus

### **Systematic under-funding or over-funding**

If aggressive return on investment assumptions are made for the plan on a regular basis, it may be viewed as a systematic strategy to lower regular contributions and make them up, if need be, by periodic special payments. Regular use of conservative assumptions can be expected to lead to surpluses, which can then be used for benefit improvements, or to give the employer a contributions holiday.

### **Actuarial valuation reports**

Under pension legislation across the country, a pension plan must be evaluated by a professional actuary at least once every three years. The time between actuarial evaluations is called an actuarial cycle.

### **Balance sheets: two sets of calculations**

Registered pension plans must make two calculations:

- Going concern calculations (which assumes the plan will continue forever)
- Solvency calculations (which assumes the plan will be wound up on the date of the valuation)

These two sets of calculations indicate how well (or badly) the fund is doing, and in particular indicate any under-funding or over-funding.

The actuary examines these documents and others to assess how the plan has done in the last actuarial cycle and predict what might happen in the future.

### **Actuarial valuation report**

The actuary prepares a report (an actuarial valuation report) which:

- Estimates what contributions are required over the next actuarial cycle
- Compares the assumptions that were used in the last evaluation against what actually happened over the last cycle
- If necessary, recommends adjustments needed to contributions or benefits

### **Surpluses**

A surplus in the plan might be used to:

- Finance improvements in benefits
- Pay past service costs
- Subsidize a reduction in employer contributions, or even a contributions holiday
- Finance other activities of the sponsor (surplus withdrawal)

The specifics of pension legislation vary across the country, but there are rules about when employers can withdraw surpluses:

Usually employers must prove they are entitled to withdraw a surplus

The employer must follow rules about notifying plan members

There are limits on how much money can be withdrawn.

Employers cannot make changes that reduce the rights of the plan members without the members' consent.

### **Actuary's recommendations**

The recommendations in the actuarial valuation report usually provide the basis for decisions affecting the plan over the next period.

## A CEP model pension plan

On the following pages you will find the details of a model pension plan. This model plan is based on pension bargaining objectives set for CEP's Eastern Canada pulp and paper negotiations and may be used as a guide when you formulate pension proposals.

The model plan contains all the major elements of a good workplace pension plan:

- Inclusive membership
- Adequate employer funding
- Union participation in fund supervision
- Early retirement provisions with bridging
- Adequate lifetime defined benefits
- Indexation of benefits
- Death benefit
- Survivor benefit
- Termination benefit
- Disability benefit

## **Model Pension Plan**

### **Membership**

All members of the Communications, Energy and Paperworkers Union of Canada (CEP) employed by a company that has entered into a collective agreement with the CEP shall participate in a pension plan as described hereafter.

### **Funding**

Premiums shall be fully funded by employer contributions and by returns on investments of the plan.

Regular and special employer-funded premiums shall be determined by statutory actuarial valuations and, according to applicable laws, shall provide sufficient funding for the premiums of former and present members as well as for reasonable expenses necessary for the administration of the plan.

Should an actuarial valuation reveal a deficit in the plan, special employer contributions will absorb the deficit over the period prescribed by the applicable legislation.

If an actuarial valuation determines that the plan has a surplus or a profit, such surplus or gain shall be used, following an agreement with the CEP Local, solely for the purpose of improving members' benefits. Accordingly, this surplus or gain shall not, at any time, be used to reduce regular or special employer contributions, unless the applicable legislation provides for an opposite prohibition.

## **Supervision**

A pension committee composed of representatives of the members as well as representatives of the employer shall supervise the plan. The number of representatives of the members shall be at least equal to the number of representatives of the employer. Supervision involves the financial management as well as the administration of the plan.

The representatives of the members shall be granted sufficient resources and paid time-off as required to perform the tasks associated with their role as trustees as well as any necessary professional support provided by the CEP. Such professional support shall be funded by the plan.

## **Benefits**

The pension plan shall provide the following benefits:

### **1. Pension benefit:**

A member may retire and receive an unreduced pension as long as one of the three following criteria is met:

- the member has reached the age of 58;
- 30 years of pensionable service have been completed;
- the age of the member plus the years of pensionable service total 80.

A member may also opt for an early retirement. In such a case, the amount of pension payable shall be reduced permanently by 0.25% multiplied by the number of months from the date of retirement to the first date on which the member would have met one of the three criteria above.

A member's pension shall consist in two parts: the lifetime benefit and the bridging benefit. The lifetime benefit shall be payable until the death of the member and shall be equal to, for each year of pensionable service, 2% of the best final average wage of the member over a period of 36 consecutive months. The bridging benefit, established on the day of retirement, shall be payable until the age of 65 and equal to, for each year of pensionable service, 1/30 of the sum of the maximum benefit of the Canada Pension Plan or the Quebec Pension Plan and the basic amount of Old Age Security.

Benefits payable to a member or a spouse shall be automatically increased on January 1<sup>st</sup> of every year by an adequate amount to fully compensate for the loss of purchasing power caused by inflation, according to the Consumer Price Index of the previous year.

A member's pensionable service shall be equal to the number of years since the date the member was last employed by the employer. Furthermore, pensionable service provided to a previous employer is included as long as severance pay was transferred into the plan.

## **2. Death benefit:**

If the death of a member occurs before retirement, the spouse, or in the absence thereof, the legal heirs shall receive, prorated with the number of completed years of service, a benefit equal to the pension which the member would have received had he or she completed 30 years of pensionable service without exceeding the age of 65, taking into account the wage increases the member would have received.

If the death of a member occurs after retirement, the spouse shall receive for life  $66\frac{2}{3}\%$  of the member's pension, effective on the date of the member's death. In the absence of a spouse, the member's legal heirs shall receive 100% of the member's pension, effective on the date of the member's death, until a total of 180 monthly payments have been issued since the date of retirement.

### **3. Termination Benefit:**

A member whose employment ends before retirement shall receive, prorated with the number of completed years of service, a benefit equal to the pension which the member would have received had he or she completed 30 years of pensionable service without exceeding the age of 65, taking into account the wage increases the member would have received.

### **4. Disability Benefit:**

A member who is disabled before retirement shall continue, throughout the period of disability, to accumulate entitlement to pension benefits, death benefits and termination benefits in the same manner as if he or she had continued to work, and until the day on which he or she would have completed 30 years of pensionable service.

## Registered Retirement Savings Plans

The federal government has set up tax incentives to encourage Canadians to save for their retirement. A registered retirement savings plan<sup>5</sup> (RRSP) allows you to save for your retirement and defer paying taxes on the money you save. You, your spouse or common law partner can contribute.

You can invest in RRSP's until 31 December of the year of your 69<sup>th</sup> birthday. If your spouse has not yet reached 69 you can continue to invest in his or her RRSPs.

### Possible options

#### **RRSPs and tax reduction**

You can use deductible RRSP contributions to reduce your tax. Income earned in an RRSP is also usually exempt from tax while the funds remain in the plan. But, you can expect to pay tax when you cash in or receive payments from the plan.

#### **For retirement and other uses**

RRSP money is not just available for your retirement. You can use it to buy a home for yourself or for a relative who is disabled. You can use RRSP money to pay for training or education for yourself, your spouse or your common law partner.

#### **Income from RRSPs**

RRSPs generate income in three ways:

Withdraw money

Buy an annuity

Convert into a RRIF

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<sup>5</sup> For more information on RRSP's, check out:  
<http://www.cra-arc.gc.ca/tax/individuals/topics/rrsp/menu-e.html>

### 1. Withdraw money from your plan

You can cash in all or part of your RRSP at any time. The money will be added to your income for that year and you will pay tax at the appropriate rate.

### 2. Buy an annuity

You can use your RRSP to buy a **life annuity** or an **annuity certain**.

**Life annuity:** A life annuity pays an amount regularly (e.g. each month) for the rest of your life.

**Annuity certain:** An annuity certain pays for a pre-set period, e.g. until you reach 85.

The amount you receive from an annuity depends on how much you paid for it, rates at the time of purchase, your life expectancy, the expected rate of return and your age when the annuity starts to pay. The payments are taxed.

### 3. Convert your RRSP into a RRIF

A Registered Retirement Income Fund (RRIF) is the post-retirement equivalent of an RRSP. You can convert your RRSP into a RRIF. The deadline is 31 December of the year you turn 69.

You must withdraw a minimum annual income out of your RRIF, but no maximum is set. Income from a RRIF is subject to income tax.

## **Group RRSPs**

Some employers have set up Group RRSP schemes. The employer administers a series of individual RRSPs for employees in the plan. Often contributions are made on a matching formula. The employer will match the worker's contribution, up to a certain limit.

Group RRSPs are an exceedingly poor substitute for a negotiated pension plan. CEP's goal is always to negotiate pensions, not RRSPs.

## **Investment experience**

When part of your retirement income is from a Defined Contribution Plan or RRSPs, you have to make investment decisions.

Some people make their own investment decisions without help from others. Some handle their own self-controlled RRSPs as part of a pre-retirement savings strategy. Some play the stock market. However, the majority of working Canadians have not had the interest or the time or the confidence to control our own investments (if we've had any) without outside advice.

Author Monica Townson, speaking of individual savings accounts, says: "the amount of any pension will ... depend on financial markets and individual investment expertise. Lower pensions would ... result for individuals who made poor investment decisions: if the stock market dropped so that the rate of return on their investment was much lower than ...anticipated, or if interest rates were low when they retired and used their funds to buy an annuity. Fees and commissions also reduce the

proportion of the individuals' contribution that will actually generate a pension.

“The pooling of risk is a central characteristic of a pension plan. It does not even exist in a system of individual accounts, which – by definition – are based on the individual investor bearing the entire risk.”<sup>6</sup>

So, many workers who depend on individual accounts under a Defined Contribution plan or personal savings plan, seek financial counseling. However, as Diana Salomaa and Henry Dembicki point out: “Much of the retirement financial advice we get comes from investment advisors, mutual fund salespeople, insurance agents and stockbrokers. Typically, when you are sitting in a bank or mutual fund office, the person giving you advice is a salesman.”<sup>7</sup>

Often the advisors we seek advice from are not completely unbiased. Free financial counseling is almost always advice from a person who makes their living, at least in part, from commissions on the financial products they sell.

Objective, unbiased advice usually has to be paid for. Consultations with an independent financial advisor, who is not making money by selling you particular financial products, can cost several hundred dollars per session.

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<sup>6</sup> Monica Towson. *Pensions under attack. What's behind the push to privatize public pensions*. CCPA, James Lorimer. 2001.

<sup>7</sup> Diana Salomaa and Henry Dembicki. *Why swim with the sharks?: an unconventional guide to early retirement*. Fine Print Press, May 2005.

# NEGOTIATING A WORKPLACE PENSION PLAN

## Motivating the members

If you have no workplace pension plan, it is crucial that you get the members on side. They must be willing to put pensions at the top of the priority list for your next round of bargaining. Without the support of a significant majority in the bargaining unit, it will be very difficult to put a pension plan in place.

At every stage in your program to negotiate pension benefits into your collective agreement, do everything you can to keep the members motivated.

### **Research**

Find out all you need to know about pensions.

Research what pension benefits (if any) workers have in:

- Companies similar to yours
- Your industry
- Companies of your size
- Companies in your community

Research the demographics of your potential pension plan members. Two pieces of information are vital:

- How old are they?
- When might they be expected to retire?

### **Educate**

Use handouts, special courses, general membership meetings, special membership meetings, your web page, your newsletter, word of mouth, your steward network, etc. to educate the members about:

- The importance of pensions
- Different sources of retirement income
- Different types of pension plan
- Options you could aim for during negotiations

### **Prepare**

- Prepare a long-term plan for the kind of pension plan you would ultimately like to have. (e.g., the model plan)
- Prepare your demands carefully, within the context of this plan.
- You will likely not get the ideal plan when you bargain your first pension. The important thing may be to get a foot in the door.
- Aim to set up a firm foundation that can be built upon, rather than negotiating an inadequate base that might have to be knocked down in the future.

### **Bargaining improvements to an existing plan**

If you already have a plan in place, you may want to improve the provisions. Below you will find some ideas on where improvements can be made:

### **Average earnings formula**

The average earnings formula has three factors:

- Percentage
- Dollar amount based on average earnings
- Years of pensionable service

Examine each of these factors to see where improvements might be made.

**Percentage**

The maximum percentage allowed by law is 2%. If your formula has a percentage below 2, here is a place where there is room for improvement.

**Average earnings**

If the formula uses career average earnings or final average earnings, move to best average earnings.

How many years are used in the calculation? If you have to average your five best years, an improvement would be to reduce this to your three best years.

Do your best years have to be continuous? If your current formula reads “over a period of 36 continuous months” try to change it to: “best three years”. It likely won’t make a difference to many people, but it will be an improvement.

What is the definition of annual earnings? If the definition is limited to basic hourly pay received, try to expand it, e.g. to include vacation bonus pay.

**Note:** Unionists generally are not in favour of including overtime earnings as part of average earnings, however they are calculated. We do not want to place workers who are in their final years at work under pressure to work overtime to improve their retirement pension. CEP is the shorter work hours union, and unionists generally want to reduce the number of overtime hours we work. Certainly we do not want people to work large numbers of overtime hours in the years immediately before they retire. This is when they should be slowing down. There are far better ways to improve our pension benefits.

### **Years of pensionable service**

The definition of years of service for seniority purposes may not be the same as the years of pensionable service definition. If there is a waiting period before people become eligible to join the pension plan, try to reduce or eliminate it.

In some pension plans, only years of uninterrupted service are counted. Try to have leaves such as sick leave and parental leave included in the calculations and if people are away for a while, but then return, allow for all service to be included, not just continuous service.

### **Indexation**

If you have no indexation, or only partial indexation, try to move to full indexation.

### **Retirement health and medical benefits**

Negotiating retirement health and medical benefits for retirees may not be an improvement to the pension plan itself, but will mean that your pension benefits go further.

A major expense you can expect in retirement is health and medical costs. If you are able to negotiate a benefits package that includes retirees, you will make an important positive impact on the financial stability of most of your retired members. There is also the psychological advantage they all will feel as a result of not having to worry about how they will pay for health costs not covered by government programs.

### **Disability benefit**

A disability benefit brings peace of mind to all members of a pension plan, although very few plan members end up receiving it. If you do not have a disability benefit provision, try to include one in your pension plan. For those, thankfully few, members who need to use it, it is vital.

One problem some people with disabilities encounter concerns when they stop receiving the disability benefit and start to receive their retirement pension. Some employers, to save themselves money, force workers off their disability benefit and onto their retirement pension. This might make the difference between living above or below the poverty line to a disabled member.

Try to include in your collective agreement a provision that allows the member to decide when to start their retirement pension, rather than being told by the employer.

### **Survivor benefit**

Sometimes spouses are asked to sign a waiver to give up survivor benefits in return for a guaranteed monthly pension (at a higher rate) for a guaranteed, but limited period of time.

Instead of getting full survivor benefits they might receive a 10-15 year guarantee. This means the monthly pension received could be vastly increased, but if the pension member spouse dies early, the survivor could be left with no more benefits in their final years.

### **Plan administration**

An important area for improvements in most pension plans is plan administration.

As union members and workers, we benefit in the long term if there is union input into the administration of our pension plan. These provisions can be negotiated into the collective agreement.

### **Other improvements**

To identify other areas where improvements can be made, examine your existing plan, and see how your plan compares with the provisions of the model plan.

### **Costing our proposals and the employer's offers**

Whenever we negotiate, costing the demands and the final provisions is important. It helps us to decide amongst priorities. It helps us evaluate which of various alternatives is best for us and (not necessarily the same) best for the employer.

Almost all improvements to the pension plan are going to cost money. (Exceptions might be changes to the composition of the Board of trustees.)

We need to have a good idea about, not only how the benefit we are demanding at the bargaining table will affect various segments of our membership, but also what the actual costs will be to the employer.

There can be a large difference between the cost of a demand to the employer and the value of the benefit to the worker.

### **Current and past service costs**

We have already seen how the returns that pension funds earn on their investments reduce the amount of money an employer must contribute to cover pension fund liabilities.

We have also seen that the one shot expense of covering past service costs can be spread over several years.

**So, the cost of funding a pension plan is lower than the total benefits that the members will receive. Let's examine some other considerations.**

### **Costing considerations**

When costing a benefit, ask:

- What will be the size of the benefit?
- How many plan members will enjoy the benefit?

If we calculate the size of the benefit to a member, its value, and compare it with the anticipated cost to the employer of providing the benefit, we have a better idea of which benefits are most worthwhile to go for.

Knowing how many members will enjoy a particular benefit is also important. With early retirement improvements, for example, the demographics of your workforce will determine how many people are likely to actually enjoy the benefit. A benefit that only exists on paper for most plan members is not the same as a benefit that most plan members will actually receive.

On the other hand, just because only a few people will likely ever receive a particular benefit is not necessarily a sufficient reason to put it at the bottom of our priority list. The disability benefit, we hope, will only be paid to a minority of our members. But it should be a high priority because of the incredible difference it makes to those who do actually need it.

## Early retirement options

The table below compares pension benefits an individual might receive for three different ages of retirement:

- 55: reduced early retirement
- 58: unreduced pension early retirement
- 65: normal retirement

### **Assumptions**

Joined plan at age 25

Formula: 1.7% x final average salary x pensionable years

Actuarial reduction for early retirement: 6% per year

Wage increases of \$1,500.00 per year

Bridge of \$11,000 per year

	<b>Early retirement at age 55</b>	<b>Early retirement at age 58</b>	<b>Normal retirement age 65</b>
Years in the plan	30	33	40
x 1.7%	51%	56.1%	68%
Final average salary	\$50,000	\$54,500	\$65,000
Annual pension	\$25,500.00	\$30,574.50	\$44,200.00
Actuarial reduction 6%	18%		
	\$4,590		
Reduced annual pension	\$20,910		
Life expectancy	25 years	22 years	15 years
Total pension received	\$522,750	\$672,639	663,000
Bridge	\$11,000	\$11,000	N/A
Years receiving bridge	10	7	
Total bridge	\$110,000	\$77,000	
Total retirement pay (total pension + total bridge)	\$632,750	\$749,639	\$663,000
Total retirement pay per year of service	\$21,091.66	22,716.33	16,575

Examine the next to last line in the table. If the person retires at 65, he will receive a total retirement pay of \$663,000, compared with \$749,639 for a retirement that starts at age 58. That's \$86,639 more for the person who retires early.

The last line shows how much retirement pay a worker receives for each year of pensionable service. If he retires at 65, the worker receives \$16,575 per year of service ( $\$663,000 \div 40$ ). But, even with an actuarial reduction, if he retires at age 55, he receives \$21,091.66 in pension benefits for each year of pensionable service ( $\$632,750 \div 30$ ).

### Costing early retirement

Early retirement costs pension funds in various ways:

- A pension is paid for that much longer
- Contributions to the fund on behalf of the early retiree end sooner
- Investment earnings on unpaid contributions are lost

If life expectancy is 80 years:

- a person who retires at 65 can expect 15 years' pension
- a person who retires at 58 can expect 22 years' pension.

The difference is seven extra years of pension payments.

A person in the plan from 35 to 65 has 30 years of contributions paid into the plan on his or her behalf. Someone who joins at 35 but takes early retirement at 58 only has 23 years contributions paid into the plan. The difference is seven years of lost contributions.

Not only are seven years' worth of contributions lost, all the investment earnings on those contributions are lost too. Roughly speaking, it costs a plan up to 8% more for each year someone retires ahead of the normal retirement date

### **Actuarial reduction**

Because of these costs to the pension fund, early retirement sometimes comes with a penalty. There is an actuarial reduction in the pension the person taking early retirement actually receives. A typical actuarial reduction would range from 3% to 7% per year. A 6% actuarial reduction means your pension is reduced by 0.5% for each month you take early retirement before the age at which an unreduced pension is paid. (The unreduced benefit age might be e.g., 58, 60 or 65)

### **Impact of early retirement provisions on the decision of when to retire**

Changing the age at which workers can take an unreduced early retirement has an impact on when people decide to retire.

Imagine you are working full time and clearing \$15.00 an hour after taxes and work related expenses. You do the calculations and realize that if you retired, you would still be clearing the equivalent of \$13.00 an hour. You might say to yourself: "Why am I working full time for an extra two bucks an hour, when I could be retired?"

Making unreduced early retirement available to younger people can be expected to increase the number of workers who retire young. There will be associated cost consequences for the pension fund.

### **Other cost factors in early retirement**

Other factors such as bridging and salary increases have to be considered. The table on the next page helps to illustrate how these factors play out.

### **Bargaining history of one CEP pension plan**

Once you have a pension plan in place, the idea is to try to negotiate improvements until you have reached a pension plan with the provisions contained in your model pension plan.

In 1982 the CEP's predecessor union in the paper sector, the Canadian Paperworkers Union (CPU) set targets for pensions in the industry. These targets are outlined in the model plan we examined earlier.

The following "Bargaining History Case Study", outlined by Local 242, Corner Brook, Newfoundland, represents the history of the CEP pension plan in the Eastern Canada pulp and paper sector. The case study allows us to see what improvements were made over the years as part of the long-term plan to arrive at the model plan.

- 1982** - Temporary Formula introduced.  
1.65% (5-year final average salary) X years of pensionable service minus  
1/35 X CPP X YEARS IN CPP SINCE 1966
- Bridging Benefit Introduced  
Age 61 to 64 \$16 monthly (1982 to 1984)

\$18 monthly (after 1984)  
-5% Temporary Inflation Adjustment

**1987** - Temporary formula renewed  
- CPP offset reduced to 21/35  
- Retirement age lowered to 58  
- Bridging Benefits  
Up to age 60  
\$22 monthly (1987 to 1990)  
\$24 monthly (after 1990)  
Age 60 to 64  
\$15 monthly  
- 50% of Consumer Price Index temporary adjustment formula

**1993** - Temporary formula renewed (1993 to 1995)  
- Permanent formula to be adopted by January 1<sup>st</sup> 1996.  
Some exceptions based on financial positions  
- CPP offset reduced to 14/35  
- Bridging Benefits  
Up to age 60: \$28 monthly (1994 to 1996), \$30 monthly (after 1996)  
Age 60 to 64: \$15 monthly  
- Early retirement at age 55 with reductions  
Life Annuity (Pension Formula) 6% / year  
Bridging Benefits 8% / year  
- Increase in members contributions  
3.5% up to YMPE (Maximum Pensionable Earnings under CPP)  
5.0% of excess earnings

**1998** - Temporary formula renewed (1998 to 2004)  
- CPP offset reduced to 7/35 (1998 to 2001)  
- CPP offset eliminated (2001 to 2004)

- Bridging Benefits
  - Up to age 60: \$32 monthly (1998 to 2001), \$33 monthly (2001 to 2004)
  - Age 60 to 64: \$16 monthly
- Increase in members contributions
  - 4.5% up to YMPE (Maximum Pensionable Earnings under CPP)
  - 6.0% of excess earnings

Locally Negotiated Improvements 1998

- Pension Credit for time loss due to illness
- Member on long term no longer required to retire
- Member on LTD to have either best 5 years or 5 years at mill labour rate used in final average earnings calculation.

Pension Calculation:

1.65% X 5-year Final Average Salary

Up to age 60: Add Calculated Bridging Benefit

Up to age 65: Add Reduced Bridging

**Update**

In 2005 CEP negotiated a new pattern for the Eastern Canada pulp and paper sector with Abitibi-Consolidated. The company wanted to abandon the defined benefit approach and introduce a defined contribution plan. The union fought back and not only held on to the defined benefit plan, but made, on balance, important improvements.

Indexation adjustments, which had been made every year, now happen every other year. But, this was more than offset by improved formulas for the calculation of the pension benefit:

2005	1.7%
2009	1.75%

The agreement also included an improvement to the early retirement provisions. Starting in 2009, employees with 20 years or more continuous service can retire at 57 (subject to the Rule of 80 under the *Income Tax Act*).

# THE UNION'S ROLE

## **The importance of union involvement in pension plan decisions**

Because there are differences in the interests of the employer and the interests of the workers who are pension plan members, it is important to press for effective union representation at the plan administrator level.

Union members have two important issues to consider when we discuss how our pension fund money is to be invested. We want to:

- ensure a reasonable return on our investments, while protecting our pension benefits
- use our pension fund money to further labour's social, economic and environmental agenda.

### **Involving union members in decision-making**

All union members have a responsibility to “read the fine print” of their pension plans. But there is much more for us to do than that.

We can only have a say in how our pension money is invested if we have active union members involved in the decision-making.

This means we need union representatives on boards of pension trustees, actively involved in making the key investment decisions. Members of the local executive, and grass-roots members, have an important role as well.

### **Trustees**

### **The newly appointed pension trustee**

A newly appointed union pension plan trustee should ask questions, plenty of questions. It is not reasonable for anyone to expect that you know what is going on at first. It is reasonable for them to expect that you will educate yourself on pensions in general and your plan in particular. It is much better to ask questions than to pretend you know what is going on and remain in the dark.

### **Basics the pension trustee should know**

What are the legal requirements that apply to your plan, and what responsibilities do you as a trustee have under the law?

How is the pension plan administered?

Who are the people involved? What roles do they play?

Who contributes to the fund? What are the rules around these contributions, special payments, etc.?

What are the details of the plan's investments?

What are the details of the benefits paid out to plan members?

### **Documents that should be made available to you**

Ask for the following documentation and, if you need it, help in reading and understanding them.

- The pension statute and regulations that apply to your plan
- Trust agreements
- Certificate of registration
- Plan rules and regulations, including amendments
- Actuarial valuation reports
- Pension fund reports
- Statement of investment policies and procedures
- Information returns, as required under provincial and federal legislation

- Minutes from Board of Trustees or Pension Committee meetings
- Annual statement to plan members
- Current pension benefits (the plan booklet)
- Insurance contracts
- Any other relevant documents, e.g. minutes, service provider contracts, etc.

### **What you want from the employer**

You should expect the employer to provide you with:

- Full cooperation as you learn your job
- Access to all the documents you need to build up a picture of the plan
- Access to any staff, service providers or experts attached to your plan
- Adequate time to fulfill all your responsibilities

### **What you owe to your union and other plan members**

Your union brothers and sisters have shown great confidence in you by selecting you to represent them on the board of pension trustees. This is very important work and they have showed their trust in you.

You owe it to them to do the job to the best of your ability and to keep the union and the membership involved and informed.

- Consult with members and the executive on a regular basis.
- Distribute written reports and other documents. (But remember, some of the information you are given and some reports you receive are confidential. Do not distribute confidential information or reports.)
- Make regular reports to membership meetings

- Make sure there are mechanisms in place so that all plan members can have their pension questions answered by you or by some other competent person
- Inform members of any changes to the plan, including changes in benefits
- Advise the executive and the negotiating committee on any changes that need to be made, or on the possible impact of proposed changes

There is a danger, as there is with any joint union-management committee, that you start to identify with the needs and values of the company, rather than the needs and values of your fellow workers. Keep in touch with your members and this will not happen to you.

### **The experienced pension trustee**

Once you know the ropes, you can start to play a more activist role.

You will read all documents as they are supplied and attend the trustees' meetings. Continue to ask questions, but now be prepared to make suggestions.

Of particular interest are the assumptions upon which the investment plan is based, the details of the investment plan, decisions about how the investments can be used to further labour's goals, decisions about how to respond to surpluses or unfunded liabilities, decisions about the level of benefits that can be supported. Make sure that the investment decision reflects labour values.

## Local executive

- Ensure the union is properly represented on pension committees, boards of trustees, etc.
- Ensure the employer provides the union and the plan members with all the documents they require, e.g.:
  - Actuarial valuation reports
  - Pension fund reports
  - Information Returns, as required under provincial and federal legislation
  - Current pension benefits
  - Trust agreements
  - Insurance contracts
- Ensure the membership is educated on pensions, including
  - the provisions of their own pension plan,
  - areas where improvements could be made,
  - major decisions about the plan, including investment strategies
- Ensure trustees are appointed
- Ensure union trustees are given the support they need to do an effective job
- Ensure members are kept up to date
- Negotiate pension improvements

## Grass roots member

The grass roots member has two kinds of pension responsibility. He or she is:

- Responsible for keeping informed about his or her own pension

- Responsible for ensuring that the pension committee, the trustees, the plan administrator and the executive fulfill all their pension responsibilities.

Ask to see the details of the pension plan

Ask to see the regular reports on the fund which the trustees are required to produce

## **Investing to ensure a reasonable return**

### **Investment earnings play an important role in building up our pension fund**

Getting a reasonable return, while protecting our benefits, is an important investment goal for pension plan members.

We depend upon making a reasonable return on our investment to help pay current and past service costs before we retire. We also need investment returns to bring enough extra money into the fund to pay for all our pension benefits once each plan member does retire.

High-risk investments have the potential of bringing high returns. Unfortunately, they also have the potential for high losses. Low risk investments have a lower potential for losses, but returns may be so low that contributions have to be high.

Pension fund investment approaches often illustrate the different conflicting interests of employers and workers.

### **Aggressive assumptions**

With aggressive return on investment assumptions, lower contributions are required, and higher returns are possible, but more aggressive, high-risk investments have to be made. The hope is that high returns on investment will balance out the low contributions.

But, the higher the risk, the higher the possible losses too. What if the fund's investments take a hit, if there are losses? The fund may adopt even more aggressive investment strategies and make even higher risk investments in an attempt to avoid experience losses and unfunded liabilities. The more the fund loses, the more it will need to win back if the balance sheets are to continue to look good.

If a fund has unfunded liabilities our future benefits are put in jeopardy. Even if the situation looks good on the Going Concern balance sheet, it may not be good in the short term on the Solvency balance sheet. This represents a threat to our future benefits.

### **Systematic under-funding**

To keep their contributions to the fund low, some employers systematically make aggressive assumptions. They hope the returns on investments will be high enough to make up for their low contributions. If returns are low, and the fund ends up with unfunded liabilities, they make special payments.

However, these special payments may be stretched over several years. During this time the fund will be under-funded. This may put our benefits in jeopardy if the fund folds. Systematic under-funding may be good for the employer, but it is not good for the plan members.

### **Systematic under-funding and bargaining**

An employer who is facing special payments has to find the money to pay them. This may affect bargaining strategy. The employer may try to reduce the total compensation package elsewhere, e.g. by keeping salary increases to a minimum, lowering wage and salary offers, postponing or dropping other benefits. If they succeed, they can use the money saved to make the special payments.

Even an employer who is not actually facing special payments (but, because of a systematic under-funding approach, wants to keep a contingency fund in case special payments are needed) may adopt this bargaining strategy.

### **Systematic over-funding**

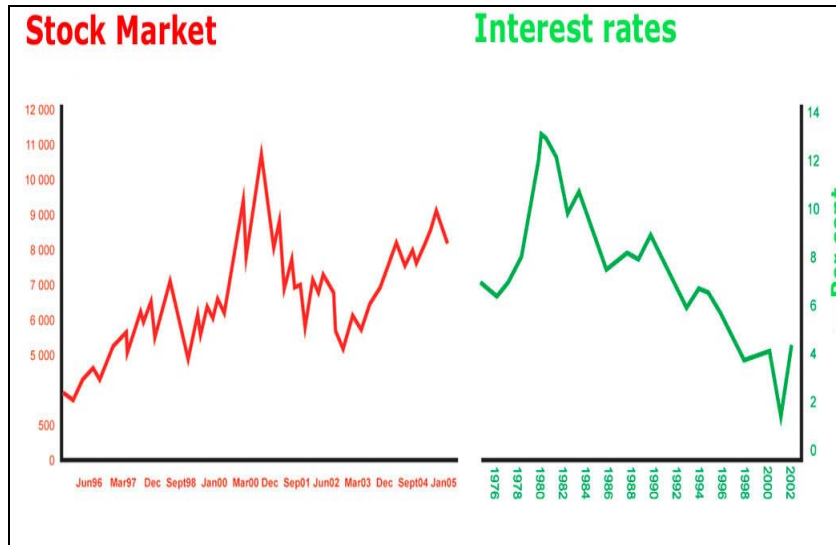
Some employers take an opposite approach. For example, in a pension plan where the members pay part of the contributions, the employer may adopt a policy of systematic over-funding. If a surplus accumulates in the fund, the employer may then take a contribution holiday, or even withdraw part of the surplus for other purposes.

In effect, the employer is using the plan members' own contributions and deferred wages to fund other company activities. Clearly, this is not in the best interests of the pension plan members. Contribution holidays can cause other problems too.

### **Contribution holidays may lead to under-funding**

Financial markets were flourishing in the 80s and 90s. This generated surpluses in defined benefit pension funds. Some employers used these surpluses to treat themselves to contribution holidays.

As unions had warned, the financial good times did not last forever; the stock market dropped, interest rates went down. The employers' contribution holidays, as a recent study by the Shareholder Association for Research and Education (SHARE) shows, were an important reason why several defined benefit plans then found themselves under-funded.



**Under-funding as an excuse to get out of defined benefit plans**

At the turn of the new century, some employers started to use the under-funding their contribution holidays had caused as an argument against defined benefit plans.

They said that because they were under-funded (they didn't mention why), defined benefit plans (which are good for the workers) should be abandoned in favour of defined contribution plans (which are good for the employers).

Other employers used the under-funding to argue for increased contributions from plan members in contributory plans. In other words, the workers were asked to pay for the contribution holidays the employers had given themselves.

If abuses like systematic under-funding and over-funding are to be avoided, the union has to be able to affect pension fund investment decisions. Another reason why union involvement in pension plan decisions is so essential, is the importance of using pension fund money to promote labour's social, economic and environmental goals.

### **Labour-friendly investment strategies**

#### **The ethical investment of workers' pension funds**

CEP policy promotes the investment of pension funds in labour-friendly ways. Our pension fund money should be invested in ethical ways, to promote the social, economic and environmental interests of working people and their families.

Currently, much of our pension fund money is being invested without any input from plan members, often in ways that go against our core values and interests.

#### **The power of pension fund money**

##### **5.5 million workers in workplace pension plans**

5.5 million workers were in workplace pension plans (including 4.5 million in trustee plans), on 1 January 2003<sup>8</sup>. About five out of six were in a defined benefit pension plan and one out of six in a defined contribution plan.

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<sup>8</sup> Figures in this section are mainly from the Canadian Labour Congress (CLC) and Shareholders Association for Research and Education (SHARE)

81% of unionized workers have a workplace pension. Only 39% of non-union workers are pension plan members.

### **More than \$650 billion in assets**

Trusteed pension plans currently have assets of more than \$650 billion. This is the second largest pool of investment capital in the country (after chartered banks). It is our money. It is our deferred wages. It represents significant financial power. It is in the interests of working people and their families for us to become more involved in deciding how it is invested.

### **What workers want**

Naturally we are interested in this money because our retirement income depends on it. But, it makes sense for us as workers to take an interest in where and how this money is invested too. We want it to be invested in ways that benefit us as working people, our families, including retirees, our communities and our environment.

We can invest our pension fund money to earn reasonable returns and to advance our social, economic and environmental objectives.

### **The voting rights of shareholders**

When we invest our money in particular companies, we should take advantage of our power as shareholders to influence corporate policy.

Canadian pensions are invested as follows:

<b>Type of security</b>	<b>Percentage</b>
Stocks	40.4%
Bonds	35.2%
Short term	5.2%
Real Estate	5.1%
Mortgages	1.6%
Other	12.5%

# PENSION LEGISLATION IN CANADA

## The history of pensions

### **Military pensions**

Among the first pensions ever were military pensions. Joining the armed forces was potentially very dangerous and armies had recruitment problems. One solution was to offer military pensions. People were willing to take a chance in the military because, if they survived, the military pension would mean they had financial security for the rest of their lives, once they left the service.

### **Public service pensions**

Before the development of a professional, unionized civil service, government jobs were not particularly well paid. But many workers envied those with government jobs because they came with a pension, when few other workers enjoyed this benefit.

The public service pension allowed the government as employer to pay lower wages and to maintain the loyalty of their employees. The government workers, as a stated or unstated condition of their continued employment and eventual receipt of a pension, would give political support to the government.

### **Government paid, public pensions**

The first government paid, public pensions, were introduced by the right-wing government of German Chancellor Otto von Bismarck in 1889. They were part of the world's first welfare program, designed to reduce the likelihood of revolution.

The government was afraid that if working people were destitute, they might rise up against the government. Pensions were introduced to make sure older workers, 70 and up, who could no longer make a living by working, would receive a minimum income.

### **Welfare state**

Although the first welfare programs were sponsored by the right wing, they were soon adopted as policy and adapted by progressive politicians for more humanitarian reasons. Pensions for seniors were seen as a way to:

- Reduce poverty: seniors themselves benefit, as do their families and relief agencies who might otherwise have to support them.
- Redistribute wealth: share the country's resources a little more fairly.
- Provide work opportunities for young people: allow older people to stop working and free up jobs for younger workers.

### **Pensions in Canada**

In Canada, the introduction of public pension plans and most major improvements to these plans resulted from pressure from progressive parties (the NDP and its predecessors) on minority Liberal governments.

### **Political action: legislation to protect pensions**

The federal government and all the provinces except Prince Edward Island have pension benefits legislation. The federal statute is the Federal Pension Benefits Standards Act (PBSA). The governments of Saskatchewan, Manitoba and Ontario have adopted the provisions of the federal PBSA. In British Columbia, Alberta, Nova Scotia and Newfoundland Labrador

investment regulations are similar to those in the federal PBSA. New Brunswick and Quebec have distinctive provisions.

Québec pension law is the most worker-friendly. In all Quebec pension plans the administrator must be a committee with a voting member and a non-voting member representing the active plan members and a voting member representing the retirees.

This is not required in other jurisdictions, where it is very common for the employer alone to be the administrator. Where the employer is the plan administrator, the employer also usually selects the actuary who recommends the level of contributions and the fund manager who implements the investment plan.

### **Split jurisdictions**

What happens if a plan covers people in more than one jurisdiction?

The federal government and the provinces have agreed a plan is registered in the jurisdiction where the largest number of plan members work. But, the benefit standards, e.g. vesting and survivor benefits, are set by the jurisdiction where the individual works. So, in these cases, the regulator of the jurisdiction of registration applies the law of the other jurisdiction.

Take, for example, a pension plan that covers the employees of a company with workers in Quebec and New Brunswick. If the majority of the workers are in Quebec, the plan is registered in Quebec. But, when the Quebec regulator decides how a New Brunswick plan member is to be treated, they apply the New Brunswick rules.

### **What the law says**

Pension law differs from jurisdiction to jurisdiction, but there are principles and rules common to all. For example:

- Whoever sponsors a workplace pension plan must create a fund that operates “at arm’s length” from the sponsor’s other activities
- The pension plan’s assets must be separate from the assets of the sponsoring company
- There must be enough money in the fund to pay all the benefits
- In fully funded plans, the contributions each year are linked to an estimate of the value of the benefits
- The plan’s assets should equal the estimated liabilities. But, plan sponsors are allowed to make up unfunded liabilities over a period of time.
- A professional actuary must prepare an actuarial valuation report at least every three years
- Rules are established about what can or cannot be done with surpluses
- The *Income Tax Act* limits the ability of plans to accumulate surpluses to protect against future adverse conditions
- A pension fund must have an explicit investment policy

### **Problems can happen**

The problem is that current legislation is not strong enough. Problems still happen.

For example, a full funding plan might not have enough assets to cover its pension liabilities when the company goes bankrupt if:

- It has experienced losses

- Benefits have been improved, but not enough funds have been put aside to cover past service costs

The St. Anne Nackawic mill in New Brunswick shut down and went bankrupt in September 2004. The workers' pension fund was short \$20 to \$30 million. The shortfall meant plan members under 55 lost all their pension benefits, regardless of how many years service they had. Workers over 55 saw their pension benefits reduced by 10 to 25 per cent.

### **Union proposals for beefing up pension legislation**

The CLC and its affiliated unions such as CEP have been taking political action to eliminate various problems that workers face in the pension area.

Some of the improvements unions have been pressing for:

- All jurisdictions should adopt the Quebec policy of requiring member involvement in plan management
- Provide adequate protection for workers' pension benefits when a company goes bankrupt. There should be a policy of paying the workers first, before other creditors. Ensure that the unfunded liabilities of workplace pension plans are treated as the second claim on a corporation's assets, right after unpaid wages (broadly defined)
- Establish a Pension Benefits Guarantee Corporation to provide a back-up pension and wage protection fund

- Improve rules governing the financing of defined benefit workplace pension plans. This is urgent as outdated rules make portability difficult, joint management unlikely and accountability weak.
- Tighten legislation on how surpluses may be used
- End contribution holidays at the employer's sole discretion
- Pension legislation should be clear that pension funds can be used to further non-financial interests of the plan members
- Labour, environmental, ethical, human rights and social considerations should be explicitly included in statements of investment policies
- Transparency in pension fund investment decision-making. Pension funds should divulge all their holdings at least quarterly

## GLOSSARY OF PENSION TERMS

### **Accumulated:**

Built up over time.

### **Accrued benefit:**

Benefits earned under the plan up to a particular point in time

### **Accrued pension:**

Amount of pension credited to a plan member according to service, earnings, etc., up to a given time.

### **Actuarial assumptions:**

In an **actuarial valuation**, a set of estimates of future developments affecting the cost of benefits to be provided under a pension plan (e.g., mortality, salary increases, investment return, employee turnover, retirement ages).

### **Actuarial equivalent:**

Result of a calculation used to reduce or increase the amount of monthly pension payments when taken in a form other than the **normal form of benefit** – at a different age, or with different survivor conditions, etc., - but representing the same total value over the entire term of the expected payments. For example, a life pension commencing at age 60 may be a lower monthly amount than the starting at age 65 because a greater number of monthly payments are expected; it is said to be the actuarial equivalent of the age 65 pension when the **present value** is the same.

**Actuarial liabilities:**

Amount of money needed today to pay for the pension benefits that have been earned.

**Actuarial reduction**

An actuarial reduction is the amount a pension benefit is lowered to cover the extra costs associated with early retirement.

**Actuarial report:**

Report prepared by an actuary stating the plan's assets, liabilities and how much money has to be contributed to a pension plan every year.

**Actuarial valuation:**

Examination of a pension plan by an actuary to assess the solvency of the plan and determine the level of contributions required to maintain its solvency.

**Actuary:**

A professionally trained specialist in pensions and insurance. In Canada, full professional recognition requires membership in the Canadian Institute of Actuaries.

**Ad hoc adjustment:**

Amount added to a pension after retirement, on an irregular basis and not as a result of a prior commitment or contract. To be distinguished from **indexing**.

**Annual information return:**

Official document filed by the administrator of a pension plan with the Pension Commission.

**Annuity:**

A life annuity pays an amount regularly (e.g. each month) for the rest of your life. An annuity certain pays for a pre-set period, e.g. until you reach 85.

**Assets:**

Money in the pension fund.

**Balance sheet:**

A document that shows the assets, liabilities and surplus or unfounded liabilities in a plan.

**Beneficiary:**

In a pension plan, a person who, on the death of a plan member or pensioner, may become entitled to a benefit under the plan. (See Survivor benefits, Death benefits).

**Benefit:**

Generally, any form of payment to which a person may become entitled under the terms of a plan; often refers specifically to the **normal** pension provided by the plan formula.

**Benefit formula:**

Provision in a pension plan for calculating a member's **defined benefit** according to years of service, earnings (career or final average), a fixed dollar amount, etc.

**Best earnings formula:**

A defined benefit formula which applies the unit of benefit credited for each year of service to the member's average earnings for a specified period of highest earnings (e.g., best five of the last ten years of service).

**(CPP/QPP):**

A compulsory government sponsored pension plan funded through contributions by workers and employers.

**Book value:**

The value of the assets of pension plan when they were bought.

**Bridge benefit:**

A pension benefit you only receive between your early retirement date and age 65.

**Career average formula:**

A defined benefit formula which applies the unit of benefit to earnings of the member in each year of service, and not to final or final average earnings.

**Cash withdrawal:**

A return of personal pension contributions to a member whose employment is terminated.

**Clawback:**

A requirement to pay back some or all of a government benefit when your income is above certain level.

**Commutated valued:**

Amount of an immediate lump-sum payment estimated to be equal in value to a future series of payments.

**Compounded Interest:**

Interest earned on your interest.

**Compulsory plan:**

A pension plan which eligible employees must join as a condition of employment.

**Compulsory retirement:**

Provision in a pension plan, collective agreement or employer's rules requiring that employee must retire at a certain age or under other specified conditions.

**Consumer Price Index (CPI):**

Monthly report from Statistics Canada about changes in the prices of goods and services in the country.

**Continuous service:**

Period during which an employee is continuously employed by the same employer; may be defined in a pension plan (or by law) so as to include certain periods of absence, and service with an associated or predecessor employer. To be distinguished from **Credited service**.

**Contribution:**

Payment by employer (sometimes also the member) into the pension plan.

**Contribution integration:**

Provision for reducing the required contributions to a pension plan by contributions prescribed in the Canada Pension plan (or QPP). To be distinguished from treatment of contributions in **Step-rate integration**.

**Contributory plan:**

A pension plan which requires the employee to make contributions by payroll deduction in order to qualify for benefits under the plan.

**Credited service:**

Periods of employment counted in calculating amount of pension; may also be a basis for qualifying for a particular type of benefit. See also: **Continuous service**.

**Current service:**

Period of service of an employee after becoming a member of a pension plan. **Current service cost** usually refers to the cost to benefits credited to members of a plan in a given year.

**Death benefit:**

A lump sum (usually), payable from a pension plan to the beneficiary or estate of a member who dies before retirement. May refer to a payment on death after retirement.

**Deferred Profit Sharing Plan (DPSP):**

Type of profit sharing plan defined in the Income Tax Act, often used as a **defined contribution** pension plan. Employee contributions are not deductible from income for tax purposes.

**Deferred vested pension (Annuity):**

A specified pension determined at the time of termination of employment or termination of a plan but not payable until some later date, usually normal retirement age. (**See Vesting**).

**Defined benefit plan:**

A plan which defines the pension to be provided (based on service, average earnings, etc.) but not the total contributions. If plan is contributory, the rate of employee contributions may be specified, with the employer paying the balance of cost. To be distinguished from **defined contribution plan**.

**Defined contribution (money-purchase) plan:**

Plan which defines contributions to be made by employer and employee, but not the benefit formula. Accumulated contributions and interest are used to purchase an **annuity** for the member. To be distinguished from **Defined benefit plan**.

**Dependent child's benefit:**

Under the Canada Pension Plan (or QPP), a monthly amount payable to each dependent child of a disability pensioner or deceased contributor.

**Disability pension:**

Pension payable to an employee permanently incapacitated due to physical or mental disability.

**Disclosure of information:**

Duty of the employer to share information with the union and the members.

**Division of pension credits:**

Also known as "credited splitting", a provision in the Canada Pension Plan (and QPP) whereby one spouse, on dissolution of marriage, may obtain an equal division of pension credits earned by one or both partners during the period of marriage.

**Early retirement:**

Provision in a pension plan for a worker to start to collect a pension before the normal pension age. The pension may be reduced or unreduced, depending on whether specified service conditions have been met.

**Earnings:**

Money received for doing a job, or from interest.

**Earnings-related plan:**

Any plan with a benefit formula based on earnings (as opposed to a **Flat benefit plan**). Includes **Career average** and **Final average** plans.

**Earning test:**

A form of **retirement test** in which eligibility for a specified pension or supplement is determined on the basis of a person's earnings during a certain period.

**Eligibility requirement:**

A condition such as age or length of service that must be met before an employee is permitted or required to join a pension plan. (Term may refer to eligibility for certain benefits).

**Employee-pay-all-plan:**

Any pension or retirement savings plan that is organized for or by a group of employees but is not financed by an employer.

**Estate:**

A person's assets at death

**Excess earnings:**

In discussion of inflation, earnings from investments of a pension fund in excess of an assumed or expected rate of return.

**Experience deficiency:**

An unfunded liability, revealed by an actuarial review of a pension plan, resulting from a difference between actual experience (investment earnings, salary levels, etc.) and assumptions made at the time of a previous valuation.

**Experience gains:**

When the fund's investment rate of return is greater than expected.

**Experience losses:**

When the fund's investment rate of return is less than expected.

**Final average (earnings) formula:**

A defined benefit formula which applies the unit of benefit credited for each year of service to the member's average earnings for a specified number of years just before retirement.

**Final earnings formula:**

A defined benefit formula which applies the unit of benefit credited for each year of service to the member's final salary rate or annual earnings immediately before retirement.

**Final pay plan:**

Term commonly used for any pension plan whose benefits are based on earnings in a member's last years of service.

**Flat benefit formula:**

A defined benefit formula which specifies a dollar amount of pension to be credited for each year of service. Term should be distinguished from **Flat rate pension**.

**Flat rate pension:**

A defined benefit expressed as a dollar amount of monthly pension, not related to service or earnings, but paid on retirement after meeting certain qualifying conditions. See for example, **Old Age Security**.

**Fully funded:**

A **fully funded plan** is one that, at any given time, has plan assets equal to or greater than plan liabilities. There are sufficient assets to cover all pensions and other benefits in respect of service up to that date.

**Funding:**

Funding is the systematic payments to a pension fund which, with investment earnings, are expected to cover all pensions and other benefits as they become payable.

**Future value:**

The value in the future of an amount of today's dollars.

**Going concern basis:**

Refers to the assumption, when making an actuarial valuation, that the pension plan will continue in operation indefinitely.

**Grow-in provision:**

A grow-in provision gives the members of a wound-up pension plan the benefits they would have been entitled to if the plan had continued. For example, in a jurisdiction with a grow-in provision a member of a plan that is wound up may enjoy the benefits they earn up to wind-up, plus the early retirement benefits they would have "grown into" had their job and pension plan not been wound up.

**Guaranteed Investment (Interest) Certificate (GIC):**

A Guaranteed Investment Certificate is an investment security sold by Canadian banks and trust companies. They are often bought for retirement plans because they provide a low-risk fixed rate of return.

**Guaranteed Income Supplement (GIS):**

A monthly payment under the federal Old Age Security Act to needy recipients of the OAS pension, based on a guaranteed minimum income amount. See: **Old Age Security; Spouse's allowance.**

**Hybrid plan:**

A hybrid plan contains elements of the defined benefit and the defined contribution plans.

**Indexing:**

Provision for periodically adjusting a benefit amount (usually after retirement) according to a formula based on a recognized index of price or wage levels, e.g., the Consumer Price Index. To be distinguished from **Ad hoc adjustment.**

**Inflation:**

An increase in prices of goods and services.

**Income supplement:**

A regular payment made to a person, usually on the basis of need or other special circumstances, in addition to other income such as earnings or pensions.

**Injured worker:**

Worker hurt doing his or her job.

**Integration:**

Provision in a pension plan which relates plan contributions and/or benefits to those of a government pension program, e.g., Canada Pension Plan. Not to be confused with **Level income option.**

**Investment policy:**

Decisions about where and how money can be invested.

**Investment returns:**

Profit gained from investing.

**Joint administration:**

Provision for a union-management committee or board to assume supervisory functions relating to a pension plan. May include provisions for final and binding settlement of disputes.

**Joint and survivor annuity:**

An annuity payable until the death of the retired employee, and continuing thereafter to the surviving widow or widower until that person's death. Commonly provided as an option at the time of retirement; may be available as a level amount or with reduction when one annuitant dies. See also: **Survivor benefit**.

**Level income option:**

Also referred to as a "notched" option: provision for employee, at time of retirement, to elect an increased pension, subject to a reduction by a specified amount when the retiree becomes eligible for pension under a government program. To be distinguished from **integration**.

**Life Income Fund (LIF):**

A Life Income Fund is a restricted registered fund that provides retirement income for life.

**Locked-In Retirement Income Fund (LIF):**

A Locked-In Retirement Income Fund is a registered fund that provides retirement income for life. It is more volatile than a LIF because the amount you can take out any year depends on investment earnings from the previous year.

**Locking-in:**

Requirement under legislation that pension contributions made after a certain date cannot be withdrawn or otherwise forfeited if the employee on termination of employment has attained a certain age or has completed a certain period of service or plan membership. See **Vesting**.

**LTD:**

Long term disability.

**Market value:**

The value of the assets of a pension fund if you sell them.

**Means test:**

A way of determining whether or not you have a small enough income to be eligible for a benefit. A means tested benefit is available only to those who are found to have an income below a certain minimum.

**Mortality Rates:**

A table showing the expected length of the life of individuals of different ages.

**Monsanto decision:**

In a partial wind-up, if the plan has an actuarial surplus, a portion of the surplus must be paid out of the plan. Supreme Court of Canada decision, 29 July 2004.

**Multi-employer plan:**

A multi-employer pension plan covers employees of more than one employer, usually by agreement with a union or group of unions.

**Non-contributory plan:**

A pension plan in which all required contributions are made by the employer.

**Normal Retirement age:**

Usually 65 years old.

**Offset:**

Generally, the amount of one type of benefit used to reduce the amount of another benefit payable to a person, e.g., a disability pension where disability insurance benefits are provided by the same employer. For reference to government pension programs, see **Offset integration**.

**Offset integration:**

Provision in a pension plan for directly reducing a plan benefit by all or a portion of pensions payable to the individual from a government program. See also: **Step-rate integration; Contribution integration**.

**Old Age Security (OAS):**

A pension provided by the federal government to almost all Canadians over 65.

**Past service:**

Number of years that a member has belonged to a pension plan.

**Pay-as-you-go plan:**

Term used for benefits that are not funded except as and when they are paid to individuals, i.e., payment is made from current revenue or other sources outside the plan as such.

**Pension adjustment:**

The value of a person's pension benefit accumulated.

**Pensionable earnings:**

Defined portion of an individual's total earnings, used in calculating pension entitlement (e.g., excluding certain bonuses).

**Pension benefits legislation:**

Laws and regulations under which employment pension plans must be registered and meet prescribed standards relating to vesting, solvency, investments, etc.

**Pension board (Committee):**

Group of persons designated according to the terms of a pension plan to oversee various administrative functions. Members may be **trustees** of the plan.

**Pension credits:**

Benefits earned by a member of a pension plan.

**Pension commission:**

Commission responsible for administering the Pension Benefits Act.

**Plan sponsors:**

The organization responsible for the funding of the pension plan.

**Plan termination:**

Discontinuance of an employment pension plan, voluntary or involuntary (e.g., as in bankruptcy); wind-up procedure regulated by pension benefits legislation.

**Portability:**

Extent to which an individual is provided on retirement with pension income which recognizes all periods of employment with various employers. See also: **Vesting**.

**Pre-Retirement and Post-Retirement Death Benefits:**

Benefits for a pension plan member's survivor.

**Present value:**

The value, in today's dollars, of a future fund or benefit.

**Priorities (plan termination):**

A set of rules, in an employment pension plan or legislation, under which the assets of a plan that is discontinued are allocated among members and beneficiaries to provide as far as possible for all accrued benefits.

**Private sector plan:**

An employment pension plan offered by an employer or by employers and unions (multi-employer plan) in the private sector.

**Provisionally funded:**

In pension benefits legislation, term used to describe a pension plan that is not fully funded but is "solvent" i.e., current service costs are being met year by year, and special payments are being made to amortize all unfunded liabilities.

**Public pension program (plan):**

Also referred to as "government program". A legislative program providing pension benefits from the government in its role as a government rather than its role as an employer; e.g., Old Age Security, Canada Pension Plan. To be distinguished from **Public sector plan**.

**Public sector plan:**

An employment pension plan offered by an employer in the public sector, covering civil servants, teachers, municipal employees, etc.

**Registered Retirement Income Fund (RRIF):**

A Registered Retirement Income Fund is a personal retirement income fund. The RRIF is to retirement income what the RRSP is to retirement savings. A minimum income must be withdrawn each year, but there is no maximum.

**Registered pension plan:**

An employment pension plan registered under applicable pension benefits legislation.

**Registered Retirement Income Fund (RRIF):**

Form of investment vehicle permitted under the Income Tax Act for funds an individual has accumulated in a Retirement Savings Plan that has “matured”.

**Registered Retirement Savings Plan (RRSP):**

A personal retirement savings plan, defined in the Income Tax Act, under which tax is deferred on contributions and investment income until received as annuity payments.

**Reserve fund:**

Amount of money or assets to be kept on hand.

**Revenue:**

Total income.

**Spouse:**

A person of the same or opposite sex living in a conjugal relationship with another person.

**Successor rights:**

The right of a trade union to continue to represent workers after a change of ownership of a company.

**Surplus:**

Occurs when total assets exceeds total liabilities.

**Surviving spouse's pension:**

A monthly benefit payable under a pension plan to the surviving spouse of a deceased employee or pensioner; usually refers to a benefit other than payments under a guaranteed annuity or joint and survivor annuity.

**Survivor benefit:**

Generally, any benefit payable under a pension plan to the surviving spouse or dependent of a plan member who dies before or after retirement.

**Tax credit:**

Provision for a reduction of income tax payable (not a deduction from taxable income), by an amount of other taxes payable or a portion of housing or other expenses of the taxpayer; e.g., Ontario Tax Credits. Tax credit is said to be "refundable" if it is payable to a person with no taxable income.

**Tax-deductible:**

Refers to a type or amount of income which may be deducted from a person's total income in computing net or taxable income; e.g., registered pension plan contributions; pension income (up to \$1,000 per year).

**Tax deferral:**

Provision in the Income Tax Act whereby certain pension and similar contributions are tax-deductible and employer contributions and investment income are not included in a member's current taxable income; but benefit payments are considered income for tax purposes in the year in which they are received.

**Tax shelter:**

Generally, any savings arrangement entitled to **tax deferral** and therefore involving the probability that payments when received by the individual will be taxable at a lower rate than would apply in the year the income was first received or credited.

**Termination of employment:**

Severance of the employment relationship for any reason other than death or retirement.

**Trustee:**

A pension trustee is a person or a member of a board with the power to administer a pension plan.

**Trusteed pension plan:**

An employment pension plan whose funds are held and invested by trustees, and the plan sponsor is responsible for making sufficient contributions to maintain the plan's solvency. Benefits are not insured except to the extent annuities are purchased.

**Unfunded liability (unfunded actuarial liability):**

Generally, any amount by which the assets a pension plan are less than the liabilities. An **initial unfunded liability** exists when benefits are created in respect of prior service (e.g.) and not provided for in current service contributions.

**Union pension plan:**

Plan sponsored by a trade union; usually refers to a **dues-paid plan** (see definition) but may mean a plan financed by employer contributions (see **Multi-employer plan**).

**Union benefit formula:**

Any defined benefit formula providing a benefit credit expressed as a percentage of a member's earnings for each year of service. (To be distinguished from flat benefit formula).

**Variable annuity:**

A pension whose amount varies according to the market value of the fund, usually invested in common stocks. In theory, this feature may compensate the retiree for the effects of inflation.

**Vesting:**

The right of an employee, on termination of employment, to part or all of his or her accrued pension; usually requires **Locking-in** of employee's contributions. Vesting is usually in the form of a deferred annuity commencing at retirement age. Vesting is said to be **contingent** or **conditional** if employee has the option of cash withdrawal. **Statutory vesting** occurs when employee meets the age and/or service conditions set out in pension benefits legislation. **Cash vesting** is a return of both employer and employee contributions if not restricted by statutory vesting.

**Waiting period:**

Period of service with an employer before an employer fulfills eligibility requirements for membership in a pension plan.

**Year's Maximum Pensionable Earnings (YMPE):**

Term used in Canada Pension, often referred to as the **earnings ceiling**: the maximum amount of annual earnings from employment on which CPP contributions and benefits are calculated. YMPE is changed each year according to a formula based on average wage levels.