FINANCE C - WORKPLACE PLANS

HANDOUTS

HANDOUT # 12 – FACTORS AFFECTING HOW NEGOTIATED PLANS WORK

PENSIONS

Each pension plan is unique. Each pension within any plan is unique. To have accurate information about your own plan, consult your union pension expert and read the plan booklet.

Much of what seems complex about pensions relates to the terms used. We will de-mystify some of the terms and give you questions to guide you through your plan.

LAWS

Some pension plans come under federal law; others are governed by provincial laws. In a few cases, parts of both may apply.

VALUATION

Every pension plan must be evaluated at regular intervals, usually every three years. Most plans will do some type of evaluation annually. Stories in the media about valuations can be pretty scary. Understanding what influences a valuation will reduce some of the anxiety.

A valuation is a projection of the health of the plan over the long term, usually 70 to 75 years. Valuations are done by pension experts called actuaries.

Actuaries make various assumptions about factors that could affect the cost and funding of a pension plan. Actuarial assumptions are predictions of future conditions such as mortality rates, inflation, return on investments and wage growth.

Actuarial assumptions are invariably conservative, but they will differ from plan to plan. A different set of assumptions can result in a different view of the health of the plan.

PLAN HEALTH

The official valuation of a pension plan will result in a statement that the plan is:
In Surplus, Fully Funded or In Deficit.

In Surplus means that, under the actuarial assumptions used, there is more than enough income generated by the plan to pay out all the pension liabilities over the next 70 (or 75) years.

Fully Funded means that, under the actuarial assumptions used, there will be adequate income generated by the plan to pay out all the pension liabilities over the next 70 (or 75) years.

In Deficit means that, under the actuarial assumptions used, there is not enough income generated by the plan to pay out all the pension liabilities over the next 70 (or 75) years. It is important to know that the status of a plan can change from one valuation to the next. During a recession, rates of return on investments will usually be low, as has been the case recently, and hence the plan will appear to be less healthy than during times of strong economic growth.

COMMUTED VALUE

Some pension plans offer the choice to take a lump sum payment instead of a pension. This lump sum is the commuted value of your pension. Be very cautious; there are those who will earn a commission if they can invest your commuted value for you. Advice from such a person may not be in your best interest.

FACTORS THAT DETERMINE HOW MUCH PENSION YOU RECEIVE

The main factors that determine the size of your pension are:

- Earnings. These might be average lifetime earnings, earnings in the last 5 (or some other number) years, or earnings in your best 5 (or other) years
- Length of service. This is usually stated in years.
- Health of the plan. This normally applies to Defined Benefit plans.
- COLA. Your plan may have a full or partial cost of living adjustment.

FULL PENSION

Each pension plan will have conditions required to draw a 'full pension'. These conditions are usually a specific number of years worked under the plan, a specific age, a total of age plus years work or a combination of these. When you have fulfilled the conditions for your plan, you are said to have a full pension, regardless of how much it is. Even when you are entitled to draw a full pension, you may work longer and usually thereby increase the value of the pension to which you are entitled.

REDUCED PENSION

If you retire before meeting the criteria for a full pension, you may qualify for a reduced pension. In this case your pension will be reduced by a penalty. The penalty is usually a per cent of your pension earned multiplied by the number of years still required to receive a full pension.

STACKED OR INTEGRATED

Most negotiated plans include the value of CPP as part of the total benefit earned. These plans are called integrated. Some plans do not include CPP as part of the calculation. These plans are called stacked.

The following example demonstrates the factors involved. <u>You must do your own calculations based on your own years of service, etc.</u>

Example 1: Retirement at 65

Assume 30 years' participation in a plan that pays 2% for each year of service, and an average salary used for calculation of pension of $40,000.

Assume that at age 65, you would be eligible for $700 per month in CPP. (Note: you would likely have extra years' participation in CPP reflecting earlier employment or drop-off years for child rearing.)

With an integrated plan, you would receive a total pension of:

30 x 2% x $40,000 = $24,000.

You would receive $ 700 x 12 = $8,400 from CPP and $15,600 from employment based pension.

If the pension plan were stacked, you would receive: $24,000 plus $8,400 = $32,400.

Example 2: Early retirement

Assume your collective agreement includes an 85 factor, or some similar provision, that allows people with a high enough combination of age and years of service to take early retirement without a pension reduction.

Assume you qualify under this provision. (Check in your own case to see whether or not this would actually apply to you.)

Assume an average salary used for calculation of pension of $40,000.

If you were to retire at 60 years of age, your workplace pension would be $20,000 a year, based on 25 years' service. 25 x 2% x $40,000 = $20,000.

Your CPP, if you took it at 60, would be reduced for every month under 65. That rate was 0.5% in 2010 and rises to 0.6% in 2015. Thus if you take it at 60 in 2015, the reduction is 60 months x 0.6% = 36% of $700 or $252 per month. You would thus receive CPP of $448/month.

Most integrated plans assume you take CPP at 65. If you meet the qualifying criteria of age and years of service and you retire before 65, they usually pay you your entitled pension in its entirety. When you reach 65, the integrated plan deducts the value of your CPP at age 65 that you would have been entitled to, had you worked to 65.

In this example, with either an integrated or a stacked pension plan, you would receive between 60 and 65, an annual payment of

CPP payment of $448 per month x 12 =	$5,376
Workplace plan of	$20,000
Total annual income	$25,376

At age 65, with a stacked plan, you would continue to receive the above amount ($25,376) plus Old Age Security (which is $6,480 in 2012), for a total of $31,856.

$25,376 + $6,480 = $31,856

At age 65, with an integrated plan, you would continue to receive CPP of $5,376. But, the company portion of your pension would no longer be $20,000. It would be reduced by the value of CPP taken at 65 ($8,400) and only amount to $11,600.

$20,000 – $8,400 = $11,600

Your total annual income would be:

$5,376 (CPP) + $11,600 (Company pension) + $6,480 (OAS) = $23,456

This example illustrates how the options can affect you. You must consult your union and financial advisor to know your exact situation.

TYPES OF PENSION PLAN

It is commonly believed that pension plans fall into one of two categories, Defined Benefit or Defined Contribution. In fact, there is at least one plan that is a hybrid of these. A targeted pension plan is a multi-employer or jointly sponsored pension plan, such as many of those run by the building trades. Legally it can call itself a Defined Benefit plan. However, when you read the terms, you will discover that the benefits are defined only so long as the plan is not 'in deficit'. Should that occur, it essentially becomes a defined contribution plan.

DEFINED BENEFIT PLAN

In a defined benefit plan, your pension benefit (payment) is determined by a simple formula. A common formula is 2% of earnings times the number of years worked. The other important number is the salary used for the calculation of pension. It can range from life time average earnings with this employer to best 5 years or some other number of years.

The result of the formula for your plan is the amount that you will receive each payment period. It does not depend on the value of the plan's investments. Your pension might increase if there is a cost-of-living clause.

With a defined benefit plan, any risk to the plan is the responsibility of the plan. Such risk will be addressed by the employer or a combination of employer and current employees. This might mean an increase of premiums for current contributors and/or a negotiated change in the benefit to **future** pensioners.

DEFINED CONTRIBUTION PLAN

In a defined contribution plan, it is the contribution that is set by the plan. The benefit is not. The value of the investments of the plan and the value of ongoing contributions will determine the benefit you will receive upon retirement. As we have seen in recent recessions, the value of investments and rates of interest can vary dramatically. Because of these variables, you can only estimate what your pension benefit might be. Your pension benefit might vary over time as the market and interest rates change.
In a defined contribution plan the employees assume all the risk.

QUESTIONS YOU NEED TO FIND THE ANSWER TO IF YOU HAVE A DEFINED BENEFIT PLAN:

1. Does my workplace pension entitlement include what I get from CPP or is it separate from it?
If it is included, it will likely be based on the assumption that I would have drawn the amount that I would be entitled to if I waited to 65 to apply.

2. If I retire before 65, should I apply for CPP?
Note: The CPP you get will be less than what you would have received at age 65. The reduction will be increasing from 0.5% per month in 2011 to 0.6% per month in 2016.

3. If I retire before 65, will my negotiated plan be reduced and if so by how much? Is it reduced when I reach 65?
If you took your CPP before 65, the drop will likely be greater than the CPP benefit you are actually receiving because you will collect it longer.

4. What are the conditions (usually minimum age combined with years of service) for retiring without a penalty to my negotiated plan?

5. Is there a maximum number of contributory years for calculating my workplace pension?

6. Is my workplace pension based on:
Last five years? Best five years? Average earnings?

7. a) What do I gain in my workplace pension by working beyond age 65?
b) What do I lose in my workplace pension by retiring before age 65?

8. a) What do I gain in my workplace pension by working more than 35 years?
b) What do I lose in my workplace pension by working less than 35 years?

IF YOU HAVE A DEFINED CONTRIBUTION PLAN, WHAT SHOULD YOU WATCH OUT FOR:

- If the employer invests your money for you, find out where it is invested and how well they have invested other people's pensions in the past.
- If you choose your own investments, you should talk with at least one adviser. Your employer should also give you some information and worksheets to fill out that will help you make investment choices. They will also keep you updated about how your savings grow. Track your investments to be sure they will give you enough income when you retire.

A COUPLE OF WEB SITES TO GO TO:
from http://www.getsmarteraboutmoney.ca/managing-your-money/investing/pensions/Pages/defined-contribution-pension-plan.aspx

Further information:
http://www.canadianfundwatch.com/modules.php?name=News&file=article&sid=28

HANDOUT # 13 - Severance Pay, Retirement Allowance, Termination Pay and Bridging

Severance pay, retirement allowance and termination pay
Severance pay, retirement allowance and termination pay are all very similar. At times the terms are used interchangeably. All of these are treated as income in the year in which they are paid and are subject to statutory deductions such as income tax, E.I and CPP/QPP unless sheltered. Such payments can increase your year's income sufficiently to result in a higher rate of tax.

A portion of these payments, if transferred directly to an RRSP or an RRIF, can avoid these deductions. The transfer amounts include:

$2,000 for each year of service before 1996, and

an additional $1,500 for each year of service prior to 1989, in which the employer's contributions to a company pension plan was not vested in the employee. Thus, up to $3,500 per can be transferred for years of service before 1989.

Part time employment qualifies for years of service, so if you worked only one day in a year, that year counts as a year of service.

If a severance or retirement payment is not transferred directly, it can still be transferred into an RRSP and qualify for a deduction in the year in which it was earned, but only if the contribution is made within 60 days of the calendar year in which it was received.

If you have a generous severance package, you would be wise to talk to a credit union advisor or other financial planner as you will likely be taxed at the highest tax rate for the year in which you retire. You may find that it is to your tax advantage to retire in the first week of January rather than the last week of December as your income and thus your tax rate will likely be less if you only work one week. **Again, you should talk to your financial advisor.**

Bridging
A few plans provide a bridging payment to those who take early retirement. Bridging payments usually stop at age 65 when the person becomes eligible for OAS and can start to draw unreduced CPP. This bridging payment is a factor to consider when looking at your budget before 65 and deciding whether to draw CPP before 65.

HANDOUT # 14 - SHOULD I USE MY RRSP TO BUY BACK PENSION CREDITS?

In to-day's environment of attacks on good Registered Pension Plans, this question is more complex than it once was. The simple answer is which do you have more faith in, your pension or your RRSP?

Funds from an RRSP that has not yet started to pay you retirement income may be transferred to a Registered Pension Fund if there is an opportunity to buy back pension credits. The RRP must be for the benefit of the individual holding the RRSP. The payment must be transferred directly from your RRSP to your RRP if you want the transfer to be tax-free. It must not pass through your hands.

Pension Plan payments are partly determined by the length of service. In general terms, it is usually wise to increase the payments by adding years of service, if possible. However, this is not always true. It may be that the cost of a buy back is much too high for what you are buying. Ask for the rate of interest that was used to determine the cost of the buy back. This will not tell the whole story, but will give you some idea of whether or not the cost is reasonable. For example, a rate of 20% per year is totally unreasonable and caution is advised.

You will probably want to consult with someone experienced in actuarial probabilities when making this decision. Your union's pension expert is an excellent person with whom to start. A word of **caution** about whom to consult; remember that the person who sold you the RRSP has a vested interest in having you maintain your RRSP. It affects her paycheque. It is best to consult someone who will not gain or lose, financially, from your decision.

HANDOUT # 15 - HOW SECURE IS MY PENSION?

It a general sense all pensions are targeted as no pension is 100% secure.

CANADA PENSION PLAN
Federal government run pension funds such as CPP are the closest to 100% secure as they are backed by the government. However, even they legally are a targeted benefit as it is possible, though not likely, that the fund could be out of money and the government refuse to make up the difference. It must be stressed that the CPP is actuarially sound for the next 50 years, which is as far ahead as experts are willing to look.

PUBLIC SECTOR DEFINED BENEFIT PLANS
Negotiated DB plans in the public sector are the next most secure. It is possible for a municipality to declare bankruptcy and be unable to meet its pension needs as some US cities are threatening to do, but it is not likely. What is more likely is a demand by employers, including public sector ones, that new employees not have access to a DB plan but only a DC one. Canada Post threatened to do this in 2011 negotiations.

Effective January 1, 2013, new federal government employees who become public service pension plan members on or after January 1, 2013 may be eligible to retire with an unreduced pension benefit from the public service pension plan at age 65. This is a change from the ability to take early retirement at age 55 with a minimum of 30 years of service or at age 60 with an unreduced pension. The increase in the retirement age will generate a two-tier system, creating inequities between young and older workers in the federal public service, forcing younger workers to retire at an older age.

The government should be focusing on strengthening pensions for all Canadians instead of weakening pension plans and retirement security for Canadians dedicated to public service.

PRIVATE SECTOR DEFINED BENEFIT PLANS
DB plans in the private sector can be in far more jeopardy. The case of Nortel and the threatened bankruptcy of auto companies showed the danger here. Employers here like VALE – INCO and US STEEL have shown a determination to end DB plans for future hires.

DEFINED CONTRIBUTION PLANS AND PRIVATE RRSP'S
Those in a DC plan or private RRSPs bear the risk directly. Sudden drops in the stock market can have an enormous effect on what money is available.

This cautionary note should not lead us to conclude that all will fail; rather it should stress the importance of our keeping active to protect pensions just as we did when we were working at the job.

HANDOUT # 16 - DEFINED CONTRIBUTION PLANS AND RRSP'S

Some people may have all or a major portion of their non-government pension money in one or both of these types of plans. What these plans will pay a person cannot be determined in advance with any degree of certainty. Factors affecting it include what the stock market is doing at the time they want the money (recently returns have not been good) and how soon and how much money the person needs.

For the purposes of this course, the participants should examine their guaranteed pension income from government programs like CPP and any defined benefit plan they are eligible for. This figure should be compared to their draft budget to see how much they would have to receive from their DC plan or RRSP to meet their budget.

In the book " Pensionize Your Nest Egg: How to Use Product Allocation to Create a Guaranteed Income for Life", the authors make a strong case for turning some or all of your RRSP funds into a life annuity which would pay you a monthly income for the rest of your life. The book is published by Wiley Canada and costs $ 26.95. This book is written by people associated with the Quantitative Wealth Management Analytics Group or QW*e*MA Group Inc. which is privately owned and operated by a group of financial engineers, economic scientists and applied mathematicians operating out of Toronto. Their web site is : http://www.qwema.ca

The web site has a calculator to estimate the cost of a life annuity.

NOTE This is only an estimate as the cost will vary as interest rates do. Nevertheless it can give you a general idea when you discuss the issue with the financial experts at your credit union or other financial institution. That calculator can be found at : http://www.qwema.ca/calc/annuity.aspx

Examples The cost of buying an annuity to provide income for life would be:

Gender	Age	Cost of $ 1/ year	Cost of $10,000/ year	Cost of $20,000 / year
Male	60	$ 14.20	$ 142,000	$ 284,000
Female	60	$ 16.56	$ 165,600	$ 331,000
Male	65	$ 12.20	$ 122,000	$ 244,000
Female	65	$ 14.48	$ 144,800	$ 289,600

Note: The above annuities are not indexed for inflation like your CPP and OAS. You can buy inflation protection, but it makes the cost higher.