
De Thomas Financial Corp

Written and published by:
Michael J. Hill CIM, CFP
Certified Financial Planner
Branch Manager
300 Giles Blvd. East,
Windsor, Ontario
N9A 4C4
(519) 973-5719

Financial Solutions

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Pension plans are a relatively new concept in financial dealings, born in the early 50's and 60's most pension plans have not seen a full retirement scenario and market turmoil as they have in the last few years. Pension plans generally were designed to provide lifelong income to retired workers to help remove the burden of support from governments and families, and provide a standard of living for older workers. The amounts needed to fund such plans were thought to be adequate at the time, but the longevity of members and increased incomes were not given the level of priority that, in hindsight, they should have had.

Current and Future Status of Pensions

When most pensions were formed life expectancy was much less than now and working careers were much longer. In the 1950's most if not all workers worked for more than 35 years and life expectancy for most people was

about 66 years of age. The family system helped with older parents completing the cycle that had been in place for centuries, parents look after children and then children look after parents, but much changed after WWII.

Companies and workers began to implement pension plans in an effort to increase the standard of living for both workers and retirees and the system was based upon earnings, not savings. This seemed to be a good system, until life spans and earnings increased at a much faster pace than the pension plans to cover them. The average life span in 2006 was 80 years and most workers with pension plans stopped working before age 65. Now many companies are trying to drop their pension plans.

Current Status of Pension Plans

The restructuring of Ontario's economy poses many challenges for workers, employers and pension plans. Present procedures for dealing with the impact of corporate change on pension plans are too slow and cumbersome for sponsors and offer inadequate protection for members who must leave their present plan and move to another or to none at all.



According to the Government of Ontario, pension plans are an important feature of Ontario's social and economic landscape. Over three million Ontarians receive or expect to receive occupational pensions, which currently provide an estimated \$36.1 billion per year to Ontario retirees — about 20% of their overall income. Ontario pension plans hold assets with a total value of \$380 billion and, together with other Canadian pension plans, are the country's second largest source of investment capital, after the banks.

In a major review of pension plans conducted by the province in late 2007 they found the following:

1. The percentage of the Ontario workforce covered by occupational pension plans has been slowly declining, from just under 40% of the workforce in 1985 to just fewer than 35% today.

2. Increasing numbers of workers with pension coverage — but still less than one in five — are now enrolled in defined contribution (DC) plans rather than defined benefit (DB) plans, though the latter are often seen as more attractive by workers.

3. Many pension plans have failed in recent years, and many have been severely underfunded for extended periods for various reasons: financial difficulties encountered by sponsoring companies that are feeling the effects of global competition; declining long-term interest rates, equity prices and plan asset values; increasing numbers of retired members relative to the number of active members still contributing to their plan; and the rising cost of providing pensions to a workforce whose life expectancy has been increasing.

4. The reconfiguration of pension plans triggered by the restructuring of Ontario's economy, as well as their actual or threatened failure, has given rise to considerable litigation.

5. Other critical concerns include the rules governing the funding of plans; the ownership of surplus in plans when they are ongoing,

wound up or reconfigured; and the protection of worker interests when sponsoring employers do not or cannot make good any deficiency in plan funding.

6. Attempts to resolve these concerns by changes to Ontario's pension laws have faltered, either because they have been politically controversial or because they require legislation that only the federal government can constitutionally enact.



These difficulties have also revealed shortcomings in the legal and regulatory framework governing pensions, in the agency responsible for pension regulation in Ontario, and in the architecture of plan governance.

On April 9th the CAW held an emergency meeting in response to Premier Dalton McGuinty's warning that the Ontario Pension Guarantee Fund is insufficient to provide pensions to autoworkers in the event of a bankruptcy of GM.

Rick Laporte, president of local 444 stated: "Our retirees are very scared; there is no question about it. We don't know from one day to the next whether or not the company is going to survive".

Windsor has 5000 retired GM workers and 2400 retired Chrysler workers with almost

1200 more GM retirees joining this group in early 2010 when the transmission plant closes. Premier McGuinty told reporters on April 8th, 2009 that the Pension Guarantee Fund had only \$100 million in assets which would be no where close to covering the multi-billion dollar pension liabilities which could be owed to not only autoworkers, but also many other struggling companies. The fund is set up to help pensioners who lose their pension payments due to a company bankruptcy. The fund will provide up to \$1000 per month in benefits- less than 1/3 of an auto sector pension.



Ken Lewwnza, president of the CAW recently declared: “Retired auto workers are being singled out today, but every pension in Ontario with a defined benefit is also at risk if the government abandons its responsibility to backstop the system.”

Many defined plans are under siege recently, not only because of falling stock markets and never seen before low interest rates, but also because of a smaller work force being forced to support an ever larger retirement population. For example, the Teachers’ Pension Plan recently announce a number of new directives as well as the largest loss in its almost 70 year history.

Teachers’ announced an end to full inflation protection, instead choosing to review inflation protection annually and allowing 50% protection when the plan can afford this. They also announced that in back in the 1970’s they had ten workers to support one retiree. Now they have only 1.8 workers for each retiree and this puts a great deal of additional stress on their retirement system.

Consider the following pension plans in Canada:

OMERS lost \$8 billion in 2008 an almost 15% drop in assets.

Teachers’ lost \$19 billion and assets dropped by \$21.1 billion in 2008

Quebec’s Cassie lost over \$40 billion a full 25% of its value!

Nortel, Air Canada are considering bankruptcy and this greatly affects their pension plans.

Many other plans, public and private are under tremendous stress to survive and pay their members and retirees.

The recent media coverage of pension plans has only highlighted what many in the know have had great concerns about for a few years.

CAW Local 444 submitted in November 2007 the following to the Ontario government:

We would also like to comment on the Pension Benefits Guarantee Fund (PBGF) whose coverage has not changed in over 27 years -- the current \$1,000 limit is insufficient.

Pension Benefit Security in Bankruptcy – The Commission should acknowledge the particular hardship that a bankruptcy poses for plan members, particularly retirees, when the pension plan is under-funded. Any discussion on “risk” in providing pensions must clearly articulate the risks plan members face.

We would like to see improvements in the PBGF:

The maximum amount of \$1,000 per month should be increased to at least reflect inflation adjustments over the last 26 years. And there should be automatic adjustments to increase the maximum amount in future years.

The PBGF should include indexation in the calculation of the benefit entitlements.

The Ontario government should work with the federal government to amend the *Bankruptcy and Insolvency Act* to give pension plan members fully secured creditor status in a bankruptcy.

According to documents available and researched by the Toronto Star newspaper, information available only to plan members



and regulatory officials, actuaries estimate GM's pension plan for 43,717 hourly rated employees, retirees and survivors in Canada would be short 43.5% of the money needed to pay all pension promises if GM failed, based on estimates as of November of 2006.

Then CAW president Buzz Hargrove and GM executives insisted pension fears "are unwarranted." A worst-case scenario that would trigger pension reductions is "so remote a possibility it's not worth speculating on," said Hargrove.

Yet Hargrove stated: "I think it's inevitable GM will file for Chapter 11 (bankruptcy protection) in the U.S., but that doesn't mean that all the GM plants will close".

"It simply means they are operated by a trustee and GM will start bargaining with everyone, the union and banks and bondholders; but the operations will continue. They don't cut off pensions. (They may very well) negotiate with the UAW in the U.S. to (change the pension plan from a defined benefit) but we would never agree to that in Canada."

So, if GM were to fail the portion of any pension greater than \$12,000 a year would be cut by the 43.5%, based on the calculations done in 2007 and perhaps more for 2009. If the province ended its pension guarantees, a retiree's entire pension would be reduced by at least that much.

When Plans Fail

The Ontario government, in a special report in 2007 stated: Plan failure should be avoided if at all possible, that if failure occurs it will have to be dealt with largely in the context of federal insolvency legislation over which the province has relatively little control, and that to the extent possible, plan members — victims of failure — should be buffered against the consequences of losing their pensions.

The Superintendent of Financial Institutions should have the power to identify plans at risk of failure, to approve arrangements agreed to by the sponsor and union or other representative organization (or, in their absence, the members themselves) for resetting plan funding obligations and providing additional forms of security, and to condition such approval on the suspension or cancellation of plan improvements until full funding is restored.

Payments relating to improvements made within the past five years should also be excluded from protection by the Pension Benefits Guarantee Fund (PBGF).

The Ontario government should support recent federal legislation that gives priority to unpaid current service costs in the event that a sponsor becomes bankrupt; explore the extension of this priority to missed special

payments owing to the fund; permit the Superintendent to approve arrangements arrived at in bankruptcy and insolvency proceedings; allow the Superintendent, plan members and organizations representing them to intervene in federal bankruptcy and insolvency proceedings; and permit courts to award costs to them if their intervention succeeds in advancing the interests of the pension fund.

The PBGF should be continued for at least five years or until completion of a study of possible alternatives, whichever is later. The level of monthly benefits eligible for protection by the Fund should be raised from \$1,000 to \$2,500, and a report should be completed within one year on how levies should be assessed and benefits adjusted going forward.

Of course none of these recommendations were followed and the PBGF remains as it has been for the last 27 years.



The Future of Pension Plans.

According to the Globe and Mail the Ontario government is moving to cut support for GM pensioners just as GM teeters on the edge of bankruptcy. The primary move is to limit the amount of money it will be obliged to pay pensioners in the event of bankruptcy of GM.

New rules recently tabled in the Ontario budget would make it illegal for the PBGF to run a

deficit and with a GM pension shortfall of over six (6) billion dollars in Ontario alone, the \$100 million fund could not support a GM pensioner, let alone any other pension for auto sector people or any other corporation near or in bankruptcy.

Premier McGuinty replied: “We would never have all the money that would be needed to top it up to meet the demands of all Ontarians who are experiencing troubles with their pension plans.”

Even our own Dwight Duncan said that the legislative changes were needed because the PBGF had not been managed properly for decades.

It is important to note that GM is only required to set aside funds to pay pensions as long as they have operations in Canada. If and or when they do not have operations here, they will not be required to fund payments.

Mitch Frazer, a pension lawyer at Torys LLP believes that the recent Ontario budget changes are a provincial response to GM, saying that this is the last remaining “too big to fail” plan in Canada. Frazer states: “The government is basically saying if we have a whole series of bankruptcies we’re not going to backstop the fund, let’s make that very clear. One large bankruptcy would wipe out the entire provincial fund”.

All pension plans in future will also change the way they invest and manage clients money. Most pension funds including the Teachers’ pension fund and OMERS have begun to replace active management of assets with a more passive approach to help lower costs and reduced risk. Take the Teachers’ plan for example, yes they lost \$19 billion, but the plan dropped overall \$21.1 billion, but more importantly is the investments which lost money. Equity or stock market investments dropped by 23% but fixed income, or bond type investments dropped by a whopping 46%. This cause The Teachers’ plan to revisit their risk and investment strategy and change how

they invest. Now they want a more simplistic passive, index fund type of approach. In fact most if not all pension plans are reviewing their investment doctrine and looking to change how they invest.

Any pension plan member would be well advised to take a close look at how pensions have changed and look at their own portfolios and pension plans to seek to reduce risk, and reduce costs and fees, to prevent another major shortfall in their assets.

After all this what can we expect in the future in regards to pension plans and pension funding:

1. Pension plans will change and change traumatically.
2. People will need to consider working longer.
3. People will need to consider accepting less payout.
4. Members of pension plans will need to begin to contribute and contribute higher amounts than in the past.
5. Retirees will need to refocus their spending to accept smaller payments.
6. Members approaching retirement must consider all options for payments including, life long pension, reductions or elimination of benefits and commuted payments.
7. Many benefit plans, drug, dental and hospital will be cut back or require co-pays from members.

There is no doubt that pension plans will change, here in Ontario, in Canada, the USA and world-wide. The US Congress (The Congressional Budget Office) recently discussed the concept of Legacy Costs and concluded that over 70% of the biggest problems in regard to pensions were within the auto, steel and airline sectors- 70%! The

report stated that pension costs and payments prevent companies from deploying cash to build the business and force the company to fund plans, while business investment falls. They believe that all pensions should be self-insured and should not be backed or guaranteed by any levels of government. Governments should not be in the business of protecting or paying for pension plans.

For those readers who are currently considering retirement, or in retirement, this report was not meant to scare or surprise you, but arm you with the knowledge which will allow you to take action, proper action to protect your pension, your earnings and your family. Don't allow others to dictate your future, take control and forge your own destiny. Now that you have some knowledge, learn more, learn all you can so that when you make decisions, you will be informed as to the choices, the consequences and understand what you are doing and why.

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The Financial Solutions Specialists

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300 Giles Blvd. East Suite "C"

Windsor, Ontario N9A 4C4

Phone (519) 973-5719 Fax (519) 973-1845