Annual Report

of the

Budget Advisory Committee

McMaster University Faculty Association

June 14, 2010

Budget Advisory Committee, 2009/10

Virginia Aksan (Chair)
History
Trevor Chamberlain
Finance & Business Economics
Ian Hambleton
Mathematics & Statistics
Graeme Luke
Physics & Astronomy
Daphne Maurer
Psychology, Neuroscience & Behaviour
Khalid Nainar
Accounting & Financial Management Services
Gladys Peachey
Nursing
Herb Schellhorn
Biology

Understanding the Pension Muddle or,

The Idiot's Guide to the McMaster Pension Plan

MUFA Budget Advisory Committee
June 14, 2010

Introduction

Pensions have been all over the news. Federal discussions about the viability of the CPP, provincial publication of the Arthurs report on Ontario pensions in 2008, and the release of the ***Final Report of the Working Group on Pensions*** by the Council of Ontario Universities in February 2010, recommending pension reform, are all indications that the question of the sustainability of current pension plans has moved to centre stage in both government and educational circles. Proposed alternatives to the long-standing pension models, based on defined benefits (DB, the McMaster model) or defined contributions (DC), such as a province-wide super-plan for educational institutions, group RRSPs, and self-financing savings plans, are representative of the pension evolution discussion underway.

At McMaster, alarming predictions about our ballooning pension fund deficit were given further fuel by the global economic crisis, when pension plans joined the general decline in asset values. The final report of the **President's Advisory Committee on the Impact of the Current Economic Crisis (PACICES),** released in March, highlights a pension deficit, mainly due to investment losses, of $298M as of July 2009 (see Figure 1) and an accumulated balance of unfunded non-pension post-retirement obligations of $195M. If the University were required to fund these two deficits out of its operating budget over the next 20 years, PACICES notes that the cost would be an extra $45M per year, an amount which is comparable to the present annual cost of the pension itself. (In the context of Table 3, this would correspond to 20 years of "Special Payments" of $45M/year to eliminate the pension deficit and to establish a fund to pay post-retirement health and dental which presently cost the University about $4.6M/year from operating.)

Recent investment gains, the present, cautiously optimistic news about the Canadian economy, and the 2010 provincial budget which provided some relief for educational institutions, have mitigated the problem but will not eliminate the deficit in the McMaster pension plan in the foreseeable future. There seems to be a widespread assumption that "something has to give" around pensions, which is already apparent in the compensation packages negotiated by the CAW or imposed on the TMG group.

We are entering a negotiation year, and are acutely aware that pension adjustments will likely be high on the Administration's agenda, as was recommended by PACISES. Hence, MUFA's Budget Advisory Committee (BAC) decided that its annual report should concentrate on the important issue of our pension plan and its future at McMaster. Our intention here is to inform MUFA members, including newly-appointed faculty as well as those close to retirement, about the nature of the investment they and the University are making in members' post-employment life.

Background

The McMaster Registered Pension Plan [***The Contributory Pension Plan for Salaried Employees of McMaster University* (2000 & 2008)**] is a single defined benefit (DB) plan for salaried employees of the University, including faculty. Simply put, it means that a base pension (defined benefit) at the time of retirement can be estimated in advance according to the formula defined in the text of the plan. (Calculated as 1.4% of best average salary up to the average Year's Maximum Pensionable Earnings (YMPE),[1] multiplied by Pensionable Service (PS); plus 2.0% of best average salary in excess of the average YMPE, multiplied by Pensionable Service.) See Section 5.01, p. 16 of *Plan Text* above. The annual, legislated YMPE limits are implemented by the Canada Revenue Agency (CRA) in the Canada Pension Plan.

Table 1: Contribution Rates — Defined Benefit Plans

DB Pension Plan	to YMPE	>YMPE	2xYMPE
McMaster University	5.00%	6.50%	—
University of Ottawa	4.25%	6.55%	—
University of Toronto	4.50%	6.00%	—
University of Waterloo	5.80%	8.30%	9.65%

Table 2: Summary of Benefits

Pension Plan	Average Earnings (Years)	Benefit Rate to YMPE / > YMPE	Automatic Indexing (% of CPI)
McMaster University	4	1.4% / 2.0%	Excess interest (threshold at 4.5%)
University of Ottawa	5	1.3% / 2.0%	CPI<3%: 100% up to 2% CPI≥3%: CPI - 1%
Queen's University	4	1.4% / 1.8%	Excess interest over 6%
University of Toronto	3	1.5% / 2.0%	75%
University of Waterloo	3	1.4% / 2.0%	100%
York University	5	1.4% / 1.9%	Excess interest over 6%

Many universities in Ontario are facing pension shortfalls. In some cases, they are in a much worse position than McMaster because of higher investment losses, particularly the University of Toronto, which experienced losses as high as 28% (McMaster experienced 17% losses over the same period). At the U of T the Administration took pension holidays during the 1990s (like McMaster) which contributed to the current shortfall (see **http://utfa.org/images/file/UofT%20Bus-Board%20-%20%20Dec-2009-final-26p.pdf** for a discussion of this issue). Both the University of Toronto and the University of Waterloo have, like McMaster, non-unionized faculty and also have defined benefit plans. As this report goes to printing, both institutions are re-negotiating contracts and MUFA is monitoring developments closely. Some universities, like York and Queen's, have defined contribution plans with a minimum pension benefit (and are thus called "hybrid") that is comparable to that provided to retiring McMaster faculty.

[1] As of July 1, 2010, the YMPE stands at $47,200; the maximum monthly benefit is $2494.94.

Member contributions to the fund are determined in remuneration negotiations. The University's contributions are equal to the current service cost, minus member contributions, plus any deficit or solvency payments that are required. (The University's total contributions are usually expressed as a fraction or multiple of member contributions.) The current service cost is the cost of all pension benefits earned in the current year by members of the plan, as determined by periodic actuarial evaluations (normally made every 3 years). The calculation is dependent on assumptions about years of employment, salary levels, post-retirement longevity, and the return on pension plan investments. If the plan is in deficit, then extra payments may be required, over and above current service costs. Furthermore, when the deficit gets too large, additional "solvency" payments are required. At the moment the University is making extra deficit payments, but no additional solvency payments.

Investment returns of the fund do not affect the monthly pension payments to retirees which are fixed by agreement (hence, a defined benefit).

Table 3: Pension Holidays

Plan Year	Current Service Cost	Special Payments	Members' Contribution	Employer's Contribution*	Surplus Used
1987/88	16,069,340	0	4,840,162	8,399,033	2,830,144
1988/89	17,483,825	0	5,203,519	7,175,725	5,104,458
1989/90	18,653,555	0	5,550,344	8,021,683	5,081,528
1990/91	20,784,869	0	6,197,601	9,195,161	5,392,107
1991/92	23,755,197	0	6,782,610	11,465,560	5,507,027
1992/93	23,238,087	0	6,347,990	11,919,543	4,972,554
1993/94	21,603,022	0	4,294,835	1,875,758	15,432,429
1994/95	23,475,687	0	5,081,318	1,781,563	16,612,807
1995/96	23,072,595	0	5,546,297	863,527	16,662,771
1996/97	20,233,403	0	5,814,196	0	14,419,207
1997/98	***9,920,530	0	***2,695,796	0	***7,224,734
1998/99	***10,123,847	0	***2,787,221	0	***7,336,626
1999/00	***11,191,662	0	***2,929,754	0	***8,261,908
2000/01	***10,867,104	0	***2,902,852	0	***7,964,252
2001/02	23,560,783	0	3,051,915	0	20,508,868**
2002/03	23,619,000	0	2,952,000	0	20,667,000**
2003/04	24,542,077	0	6,015,215	3,340,062	15,186,800
2004/05	29,764,000	0	7,295,000	7,343,000	15,126,000
2005/06	34,892,000	0	8,552,000	18,454,000	7,886,000
2006/07	36,898,000	8,168,000	10,265,000	34,801,000	0
2007/08	41,071,000	7,134,000	12,633,000	35,572,000	0

Source — Annual Information Returns *for Contributory Pension Plan for Salaried Employees of McMaster University including McMaster Divinity College*, various years

*Employer's Contribution is equal to the employer's share of the current service cost plus special payments, if any.
**Includes surplus used as a result of partial (50%) member contribution holiday.
***As reported by the University on the Annual Information Returns to the Financial Services Commission of Ontario (FSCO).

As McMaster has learned the hard way, both surpluses and deficits in pension plans such as ours engage the stakeholders in the pension scheme in lengthy debates (and litigation) about who "owns" the surplus and who is responsible for the deficit. Both the University and plan members, including MUFA members, were awarded a payout from the surplus in our pension plan in 2001, which has contributed in part to the deficit the University now faces. In addition, arguing that the University bears the ultimate liability (as residual payor), the University Administration historically has used so-called “pension holidays” as a means of supplementing a chronically-underfunded operating budget, especially in the 1990s. Nominally, the employer is responsible for the deficit, but funding the deficit diverts funds from other activities and is, thus, a burden borne by the entire University community.

A pension holiday simply means the University did not make the calculated contribution, but instead allowed the pension surplus to be used for that purpose. While that protected the McMaster community from the worst of the last funding crisis by leaving more money in the operating budget, it rested on the assumption of continued robust growth of the fund. The current pension fund deficit, already evident in the years before 2008, was aggravated by the decline in equity markets in 2008 and 2009.

The best discussion of the payout and pension holidays is by our colleague, Economics Professor Emeritus Les Robb, and can be found on the MUFA website: **A McMaster Pension Plan Primer** and **Pension Plan Primer: The Sequel**. See also the MUFA position paper ***Who(se) Benefits?*** (July 20, 2009).

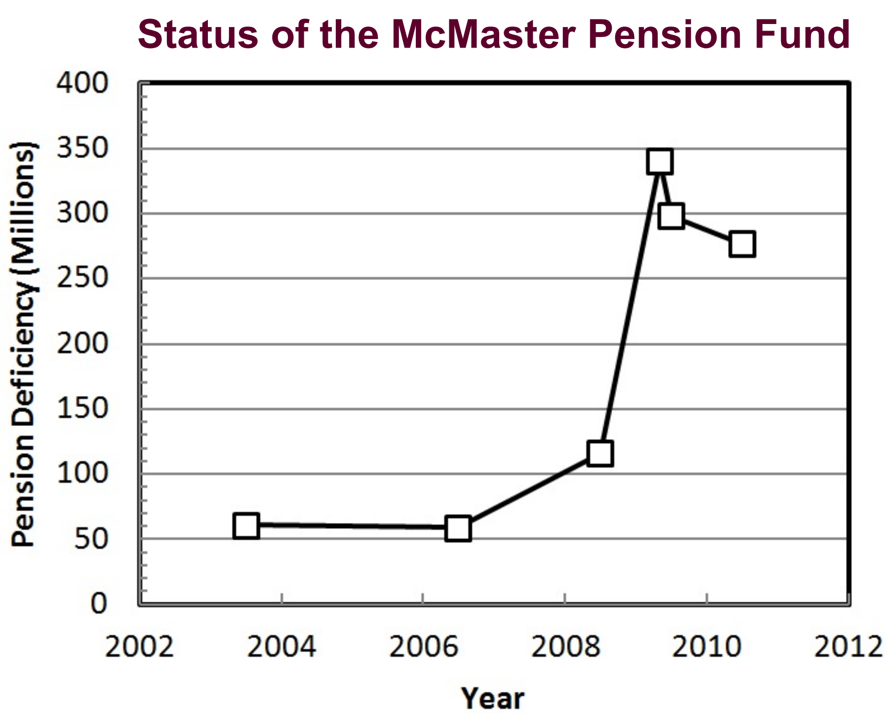

Figure 1. McMaster Salaried Pension Deficiency (Going- Concern). **Data obtained from PACICES report and from the proposed 2010/11 consolidated budget.**

Our pension fund is overseen by the Pension Trust Committee (PTC) of the Board of Governors, with representatives from all stakeholders.[2] As noted above, the University has ultimate responsibility (and legal liability) for the fund. The PTC serves in a fiduciary role for the fund, to make sure that the actuarial assumptions are reasonable and that the Plan is run effectively. At the MUFA General Meeting of December 2009, Sherman Cheung reported on the status and future of the pension fund and the role of the Pension Trust Committee. The minutes of that meeting (included in the **Agenda for the April 28 Annual General Meeting**) summarize his comments.

[2] Our 2010/11 representatives are Trevor Chamberlain and Sherman Cheung, Finance & Business Economics, and Marc André Letendre, Economics. Les Robb serves as the representative for the McMaster University Retirees Association.

The problems facing McMaster's pension plan are numerous and complicated. Of particular concern to the University is the possibility that the next pension valuation may lead to a requirement for extra solvency payments, in addition to deficit catch-up payments. Ontario universities have been asking the Province for relief from solvency payments which are intended to protect against the possibility that the pension provider might go bankrupt. The fear is that extra solvency payments will put an unmanageable strain on the University's budget. The Province has so far resisted requests for relief from solvency payments by universities and has instead pushed for increased member contributions.

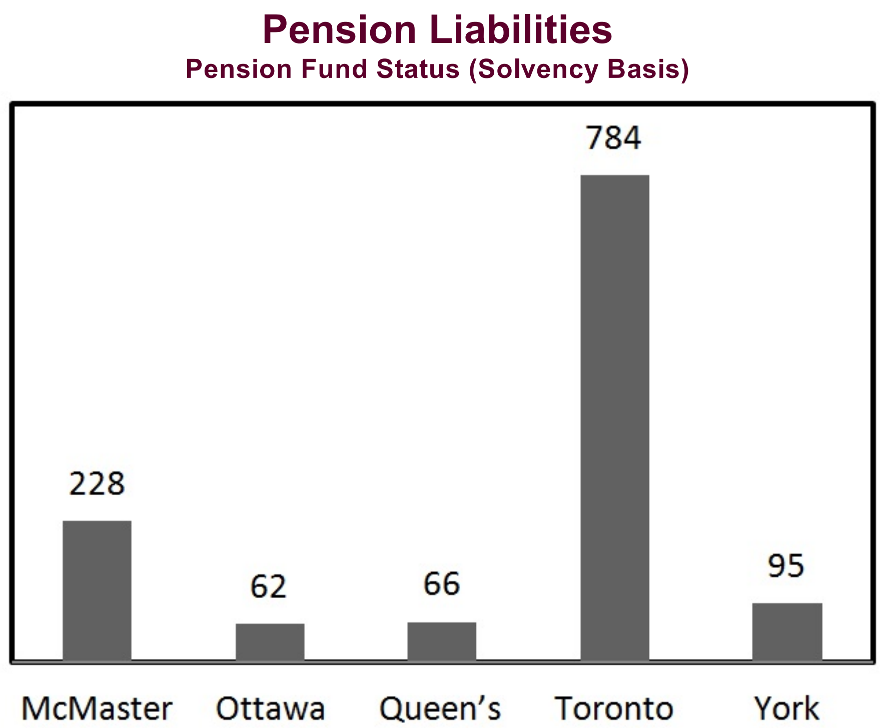

Figure 2. Comparison of Pension deficits at other Ontario Universities with the Mercer estimated deficiency for 2010 (as listed in proposed consolidated budget).

Ours is a shared fund, and includes the CAW employee group, which negotiates its contributions, and the TMG (The Management Group), who have little say in how their contributions are calculated. This past year, CAW negotiated an increase in their contribution rate. The question of closing the plan and enroling new employees into a group RRSP was taken to arbitration. The arbitrator maintained the defined benefit plan. The outcome is that the new members (hired after May 1, 2010) will receive a reduced, but still defined benefit. Members of the TMG group have had their contributions increased *and* new members will be enrolled in a group RRSP. Similar transitions to group RRSPs have been negotiated for some of the smaller unions on campus.

The abolition of mandatory retirement has also introduced a further complication to the fund inasmuch as it is no longer possible to identify a terminal date for retirement. At the same time, MUFA agreed to a phased-in rule of 85 for faculty (see Table 4), which has extended the years of contributions individual members make before payout begins. Revised actuarial assumptions indicate that pension costs to the University will fall as a result of these changes.

In a letter to MUFA dated October 26, 2009, President Peter George asked faculty to consider increasing their pension plan contributions before the expiry of the current agreement (June 2011). MUFA members polled expressed an appreciation of the concern about the continuing health of the defined benefit plan, but felt it inappropriate to consider such an option in the midst of an existing agreement. The 2009/10 MUFA Executive reiterated its longstanding support of other members of the plan on campus. MUFA's response to President George can be found in the **October/November 2009 MUFA Newsletter**.

Table 4: Phase In to Rule of 85

For Retirement Dates	Age + Plan Participation Must Equal at Least
Prior to December 31, 2011	80
January 1, 2012 to December 31, 2012	81
January 1, 2013 to December 31, 2013	82
January 1, 2014 to December 31, 2014	83
January 1, 2015 to December 31, 2015	84
January 1, 2016 onwards 85	85

Examples of Faculty Pensions

In order to make some sense of what all this means to the individual faculty member, we present two stylized pension payments to MUFA members, based on an assumed retirement age of 65, with YMPE at $47,200.

McMaster Pensions are calculated as follows:

> 1.4% of the Best Average Salary up to the Average YMPE, multiplied by Pensionable Service; plus
>
> 2.0% of the Best Average Salary in excess of the Average YMPE multiplied by Pensionable Service.

The possible pension amounts for a MUFA member retiring as of July 1, 2010 given below assume a career span (pension service) of 30 years, current McMaster Pension plan accrual rates and the current maximum benefit amount of $2494.94 per year of service (as per Canada Revenue Agency [CRA] rules now in effect).

Case 1: Best Average Salary = $100,000

> 1.4% times $47,200 = $660.80, the benefit amount up to YMPE salary
> 2% times $52,800 = $1056, the benefit amount in excess of YMPE salary.
>
> So, $660.80 + $1056 = $1716.80 times 30 = $51,504 pension payment

Case 2: Best Average Salary = $150,000

> 1.4% times $47,200 = $660.80, the benefit amount up to YMPE salary
> 2% times $102,800 = $2056, the benefit amount in excess of YMPE salary
>
> So, $660.80 + $2056 = $2,716.80 times 30 = $81,504 pension payment.

But, the pension payment is capped by the Canada Revenue Agency at $2,494.44 per year of service; hence the pension received by the MUFA member drops to $74,833.20.

The pension difference of: $81,504 - $74,833.20 = $ 6,670.80, which is a 8.18 % decrease because of a CRA cap.

Concluding Remarks

- MUFA remains committed to the current shared defined benefit plan for its members.

- MUFA remains cognizant of the status of pension funds of faculty at comparator universities and follows negotiations such as those at the University of Toronto and Waterloo with keen interest.

- MUFA will guard against locking our members into rigid long-term control measures to address transient, short-term pension problems.

- MUFA will also resist efforts, intended or not, that have the effect of transferring both contributory capacity and claims on any future surpluses from one employee group to another.

- MUFA believes that maintaining a competitive compensation package with a pension plan that will ensure its members are secure in their retirement is an important element in recruiting and retaining the best faculty.

Links:

COU Final Report of the Working Group on Pensions
http://www.mcmaster.ca/mufa/COUPension%20Feb2010.pdf

PACICES
http://www.mcmaster.ca/opr/html/discover_mcmaster/presidents_message/documents/PACICES_Final_March_2010.pdf

McMaster Pension Plan **http://www.mcmaster.ca/mufa/PensionPlanTextRestatementJuly2008.pdf**

A McMaster Pension Plan Primer
http://www.mcmaster.ca/mufa/lespensn.htm

Pension Plan Primer: The Sequel
http://www.mcmaster.ca/mufa/lespens2.htm

Who(se) Benefits?
http://www.mcmaster.ca/mufa/Who%28se%29BenefitsJuly20-09.pdf

MUFA AGM Agenda, April 28, 2010
http://www.mcmaster.ca/mufa/AGMagendaApr28-10.pdf

October/November 2009 MUFA Newsletter **http://www.mcmaster.ca/mufa/NewsOctNov09.pdf**