

YOUR PENSION UPDATE



CHRISTIAN SCHOOLS
INTERNATIONAL

Pension Funding Update

How Are We Doing?

If you have been reading or hearing about pension plans in the media lately, you will have heard that many plans are facing funding challenges. A large number of plans have become under-funded, mostly due to the significant downturn in the stock markets since 2000 and ongoing low interest rates.

The purpose of this newsletter is to tell you that both these factors have also affected the funding of the CSI pension plan. Currently, the CSI trustees expect that the next plan *valuation* – an assessment of the plan's funding – will show a funding shortfall.

Pension regulations require that a valuation of the pension plan be prepared every three years. The next valuation report will be released in January 2005 and will be based on results at August 31, 2004. In between those formal assessments, the CSI trustees watch over the investments carefully by providing direction to the investment managers and monitoring their performance with the assistance of our pension consultants and actuaries, Mercer Human Resource Consulting. Mercer has told us that the valuation results will probably reveal a shortfall. In keeping with our efforts to fully inform members of relevant events, we want to let you know about these expectations now, rather than wait for the formal report. At the same time, we also want to ensure that you understand the meaning of a shortfall so that there is no unnecessary anxiety.

As you know, our pension plan is a *contributory defined benefit plan*. This means that both members and schools contribute to the plan. Contributions are deposited in the pension fund, which is held in trust and invested in securities in order to pay for pension benefits as determined by the pension formula. (A refresher about the plan is included at the end of this newsletter.)

The purpose of a valuation is to compare the current *assets* (invested contributions) to the current *liabilities* of the CSI pension plan. Current liabilities represent today's value of the pensions earned by plan members, based on their service to date. While these earned pensions will not be paid until some time in the future, it is necessary to determine the dollar value *today* of all of those future payments.

It is completely normal for the assets and liabilities to fluctuate from one year to the next. However, if the next valuation shows a shortfall, it will be the first time that the current assets are less than the current liabilities.

We have developed the following questions and answers to help you understand the meaning of this potential shortfall, its possible impact on the plan and its membership, and the steps the trustees plan to take to address the issue.

As you review this information, keep in mind that increasing interest rates and an improvement in the stock markets could eliminate the shortfall experienced by our plan and by many other plans. And there are reasons to be optimistic. Many market analysts have gone on record to say that the market downturn is over and better times are ahead. Whether the analysts' expectations are right or wrong remains to be seen. In either case, we will be sure to keep you informed on a regular basis about the progress of the pension plan funding.

Questions: If you have any questions, please contact Howard Van Mersbergen, Director of Employee Benefits Plans, at 1 (800) 635-8288 ext. 226 or hvanmersbergen@csionline.org.

Questions and Answers

Q: What are the next steps if there is a funding shortfall?

A: The following steps are possible if the plan shows a funding shortfall in the next valuation report:

1. The first option would be to consider a plan amendment to change how the cost of early retirement subsidies is determined when a valuation is conducted. Currently, the “cost” of early retirement subsidies under the plan is taken into account even before a plan member is eligible to retire. By shifting the assumptions so that this cost is realized only at the time a plan member is eligible to retire *does not reduce benefits at retirement*, but allows the valuation to recognize these costs later – changing the outcome of the valuation.
2. If the first option does not eliminate the shortfall, the trustees would consider either a temporary reduction to some benefits or a temporary increase in contributions. The benefit reduction probably would be considered first, because it is likely that a temporary benefit reduction could be reversed (the benefits reinstated) so that no actual benefits are lost among those people still in the pension plan. A temporary increase in contributions would be more intrusive on plan members’ welfare, because the contributions would have to stay in the plan and could not be refunded.

Even if we reach option two, our pension consultants at Mercer do not expect that anyone who stays in the plan until retirement (or leaves their money in the plan for a deferred pension) will ever experience a permanent reduction in benefits. If some kind of benefit reduction were found to be necessary, the trustees would decide which benefits would be reduced. It is likely that any benefit reductions would be applied first to anyone who leaves the pension plan before retirement age and takes his or her funds out of the plan. The next type of benefit reduction would likely be the type that could be restored easily and repaid when the plan regains a fully funded position.

Q: How are decisions made about how to invest the CSI pension plan assets?

A: The trustees work with the selected investment managers to set the direction for the investment of the pension plan assets. The investment managers select the individual securities (stocks, bonds, funds, etc.) based on this direction, and all investments are governed by the principles set out in the pension plan’s *Statement of Investment Policies and Procedures* (SIP&P).

Q: How have the plan assets performed recently?

A: For the period from August 31, 2000 to December 31, 2003, the CSI pension plan had a return of about 2.1% per year, which compares favourably with the return of the average pension plan during the same period. This suggests that the general performance of the markets and low interest rates, not the individual performance of the managers, are the main reasons for the losses experienced by the plan assets.

Q: I thought the pension plan was designed so the amount of contributions from participants and schools would be enough to pay for the pensions promised to employees. So how can we have a shortfall?

When a valuation is done every three years, several assumptions must be made about the future. The actuary for the plan makes predictions about several things, including the following:

- What is the current level of contributions and can it be expected to change?
- What is the expected return on assets?
- How many people will join the plan?
- How many people will leave the plan (through retirement, termination or death)?

All of these estimates adhere to professional actuarial standards and methods.

A shortfall occurs when the *actual experience* (the combination of factors listed above) over the recent past is not as good as the *predictions* made in the most recent valuation. This usually means that actual experience has been *significantly* less favourable than reasonable expectations, because actuarial assumptions tend to be conservative in order to provide a measure of security for the plan. In other words, the assumptions are set in such a way that the calculations will tend to over-fund the plan rather than under-fund it.

The current value of benefits also depends on market interest rates at the time of the valuation. A change in interest rates can have a significant impact on the plan. Rates have dropped by about 0.5% since the most recent valuation and are at historic lows since defined benefit plans started to become popular about 40 years ago. When interest rates drop by 1%, the plan's liabilities increase by at least 10%, due to lower expected earnings on the invested assets.

Q: How can the plan reduce benefits? My friend is in a defined benefit plan and he says that pension benefits are guaranteed.

A: The CSI pension plan is a type of defined benefit plan called a *multi-employer pension plan* or MEPP, which differs from a single-employer pension plan.

A single-employer pension plan involves one company that not only makes the employer contributions to the plan, but also is responsible for the adequacy of funding. In a MEPP, there are several employers (in this case, schools) making contributions to the plan, but a designated Board of Trustees acts on behalf of the employers and oversees the funding adequacy of the plan.

The participating employer membership is constantly changing, so it would be unfair to automatically place the responsibility of funding shortfalls – perhaps created years earlier but only coming to light now – on the employers currently in the plan. As a result, the pension regulations governing MEPPs allow for either benefit reductions or contribution increases in the case of a funding shortfall.

Q: Is there any possibility that current retirees could have their benefits reduced?

A: There is always a chance, however small, that retiree benefits could be reduced (the rules of MEPPs allow this). However, this would only be considered in the most dire of situations, so there is very little chance of this happening.

Q: When can we expect the shortfall to be resolved?

A: First of all, we have to wait for the valuation report in order to be certain that there is, in fact, a shortfall.

If a shortfall exists, then the rules of the Financial Services Commission of Ontario* (FSCO), where the plan is registered, require that the shortfall be resolved within five years after first appearing in the valuation results.

One option that the trustees may consider is to continue the current indexing-related contribution increase over a longer period of time. If you recall from earlier newsletters, the contribution increase required to pay for indexing is estimated to be required for 10 years. This schedule will be subject to regular review and approval. Extending the contribution period for a few additional years could provide the required income for the plan to resolve the shortfall until the market conditions and interest rates improve.

* A pension plan is registered in the province where the largest number of its members work. For the CSI pension plan, that province is Ontario.

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CSI Pension Plan at a Glance

A Defined Benefit Plan

The CSI pension plan is a defined benefit (DB) pension plan. It is called a DB plan because the level of pension benefits is defined by formulas. Historically, these formulas have been revised from time to time.

The plan is designed so the amount of contributions from participants and schools, when invested via the pension fund, should be sufficient to pay for the pensions promised to employees. In contrast to single-employer DB plans, where the employer makes up any additional contributions if the designed amount is insufficient, the CSI pension plan is a multi-employer DB plan, which means that both the employer and employee contributions are predetermined by formulas that have been changed periodically.

Pension Plan Highlights

- The CSI pension plan is designed to provide monthly retirement income based on the pensionable service of plan members.
- Benefits are determined by formulas that make it possible for plan members to predict final pension amounts.
- Employees and schools both contribute.
- Schools decide whether to contribute 3% or 4% (4½% or 6% starting September 1, 2004).
- Based on each school's contribution rate decision, employees contribute the same percentage of their annual salary through payroll deduction.
- The CSI trustees assume the responsibility for investing the plan assets and overseeing pension fund investments.

- Pension amounts are vested when a member has participated in the CSI pension plan for two or more years. (When pension benefits are *vested*, it means a pension plan member is eligible to receive a pension at retirement based on contributions from both the employee and employer.)
- Starting in September 2004, the plan will begin to apply indexing to pension benefits in a phased-in approach over approximately 10 years. Indexing permanently raises a retiree's pension benefits by a percentage to help offset the impact of inflation. The proposed indexing schedule, subject to regular review and approval, is as follows:

Indexing Phase-In Year	Annual Indexing Increase	Date Approved
2004/2005	0.2%	March 2003
2005/2006	0.4%	To be determined (TBD)
2006/2007	0.6%	TBD
2007/2008	0.8%	TBD
2008/2009	1.0%	TBD
2009/2010	1.2%	TBD
2010/2011	1.4%	TBD
2011/2012	1.6%	TBD
2012/2013	1.8%	TBD
2013/2014	2.0%	TBD

Calculating Your Pension

Under the current plan rules, you can use the formula below to calculate pension benefits at retirement.

3% Plan (4½% starting September 1, 2004, due to indexing)

$$1.38\% \times \text{Average of best three consecutive years} \times \text{Years of eligible service} = \text{Annual pension benefit}$$

4% Plan (6% starting September 1, 2004, due to indexing)

$$1.84\% \times \text{Average of best three consecutive years} \times \text{Years of eligible service} = \text{Annual pension benefit}$$

Note: If you have belonged to both the 3% and 4% plan, you will have to use a combination of the two formulas, according to your length of service under each plan. For instance, if you belonged to the 3% plan for your first 10 years of service and to the 4% plan for the past two years, you will use the 4% formula for two years and the 3% formula for 10 years.