

YOUR PENSION UPDATE



CHRISTIAN SCHOOLS
INTERNATIONAL

Facing a Challenge: Results from the 20-Year Projection Study

As mentioned in the last edition of *Your Pension Update*, in fall 2007 the Board of Trustees commissioned another 20-year projection study of the CSI pension plan's costs and contribution levels to test the long-term impact of financial and demographic variables on the plan. The study was designed to assist Trustees with their decision making regarding future benefit and contribution levels. It is based on data that was current as of August 2008; however, the study does not take into account the impact of the recent instability in capital markets.

Using best-estimate financial and demographic projections, the study confirmed that the CSI pension plan cannot be sustained over the long term with the current plan design. This conclusion is based on three key observations:

- **Changing demographics of plan members: increased life expectancies.** With a defined benefit (DB) plan, more pension benefits must be paid out when retirees live longer.
- **Historically low interest rates.** Lower interest rates increase the estimated costs of plan liabilities (i.e., pension benefits), so more money needs to be set aside in the plan to pay the value of these liabilities. For example, when interest rates drop by 1%, plan liabilities increase by about 12%.
- **Lower investment returns.** Investment returns have been extremely volatile over the last decade and are projected to be generally lower into the future.

The study also confirms that the challenges the plan currently faces will not go away on their own, and waiting to take corrective action may only compound the problem. The reality is that we need to make adjustments now to keep the plan properly funded, healthy, and sustainable for the long term. *If we do not act now, we risk putting plan members' future pension benefits in jeopardy.*

In this issue of *Your Pension Update*, we discuss the current financial status of the plan and present a first look at plan design alternatives on the table. We also describe the next steps required to move forward together as a community. Finally, we provide a refresher on DB pension plans and their value to members.

Mark your calendar! Pension plan webinars: April 14 & 15, 2009

Learn more about the plan design alternatives on the table, ask questions, and provide your input at the upcoming webinars. The content in this newsletter will help you get the most out of the webinars. Your school administrator has been invited to sign up for one of four webinar sessions, led by the Trustees and our plan actuary from Mercer, Luc Girard.

Your school administrator will provide local details of date, time, and venue. If you are a retired or inactive plan member and would like to attend the webinar, contact your local school for participation details.

Financial Status of the Plan: How Plans Are Monitored

Canadian pension law requires that DB plans have a full actuarial valuation every three years. The purpose of a valuation is to assess if the plan's assets (money in the pension fund) are sufficient to meet its liabilities (cost of pensions being paid to current retirees in addition to the cost of pensions earned so far by active members) and whether contributions to the plan are sufficient to meet the cost of benefits that will be earned by active members in the future. To make that assessment, the plan actuary makes assumptions about things such as life expectancies, future pension amounts, interest rates, and investment returns.

During a valuation, a plan's funding status is tested in two ways:

- The "going concern" test estimates liabilities as if the plan continued indefinitely.
- The "solvency" test estimates the ability to pay all pension benefits as if the plan were terminated on the valuation date.

A plan must pass both tests to be considered fully funded by pension regulators.

Actuarial Valuation at August 31, 2007 and Recent Developments

In the August 2008 edition of *Your Pension Update*, we indicated that the plan was experiencing a shortfall on both a "going concern" and "solvency" basis, based on the most recent actuarial valuation at August 31, 2007. When a pension plan has a funding shortfall, pension legislation requires that contributions paid to the plan be sufficient to meet the plan's "service cost" (the cost of one year's earned pensions by active members) as well as the amounts required to eliminate the funding shortfall. Based on the actuarial valuation at August 31, 2007, contributions to the plan were sufficient to meet minimum funding requirements.

Between August 2007 and August 2008, plan assets decreased because of low investment returns, while plan liabilities increased because of falling interest rates. This combination has caused the plan's funding shortfall to worsen, especially on a solvency basis. The next valuation is not legally required until August 2010. However, if a full actuarial valuation at August 2008 had been prepared and filed with the regulators, contributions to the plan would have been insufficient to meet the minimum funding requirements.

Since August 31, 2008, plan assets have declined significantly due to the downturns in capital markets.

How are other teachers' pension plans doing?

In 2008, the Ontario Teachers' Pension Plan (OTPP) announced an 11% solvency shortfall (\$12.7 billion) as of December 31, 2007. This shortfall occurred despite the plan's reputation for excellent management and high levels of contributions—both schools and employees contribute between 10.4% and 12% of their gross pay to the plan. The OTPP addressed this shortfall by reducing automatic indexing from 100% to 50% of the increase in the consumer price index (CPI) for pensions earned after 2009.

Similarly, the Alberta Teachers' Retirement Fund (ATRF) experienced an 18.4% funding shortfall (\$1.2 billion) as of August 31, 2008. This shortfall only accounts for unfunded plan liabilities after 1992, as the Government of Alberta recently assumed the responsibility of managing almost \$5 billion in pre-1992 plan liabilities. Private school employees are contributing 8.5% of their gross pay to the plan while employers are contributing 7.9%.

At December 31, 2005, the BC Teachers' Pension Plan (BCTPP) was facing a 6% funding shortfall (\$0.9 billion), excluding the cost of future ad hoc indexing. To address this shortfall, contribution rates were increased for both employees and employers by 1.61% from July 1, 2007. Currently, school employees contribute between 9.16% and 10.66% of their gross pay to the plan (of which 2% is directed to an ad hoc indexing account), while employers contribute between 12.29% and 13.79% (of which 1.13% is directed to the ad hoc indexing account).

Given the downturn in capital markets in 2008 and 2009, the financial situation of the OTPP, the ATRF, and the BCTPP has likely worsened.

What Action Are We Taking?

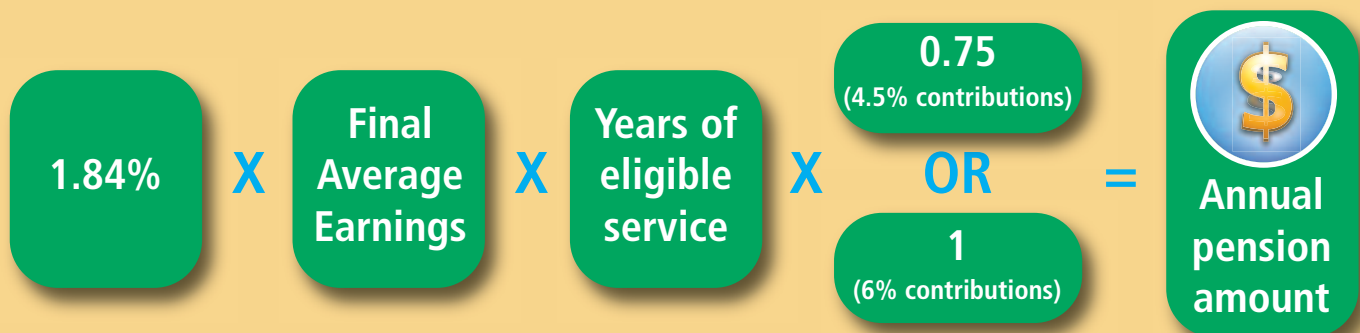
Even though we use forward-looking methods such as valuations and projection studies, we cannot predict the future. Our challenge is to successfully adapt to an unpredictable future. The changes we are proposing aim to add more flexibility into the plan design while reducing costs where it makes the most sense.

Some smaller plan design changes are being recommended by the Board of Trustees: increasing the number of consecutive years from three to five to calculate Final Average Earnings and eliminating the 10-year guarantee period for single retirees (see page 8 for more information). Alone, these changes are not enough. We need to make significant design changes to sufficiently deal with the shortfall and to maintain an adequate level of pension benefits for members.

Your CSI pension plan formula determines the basic pension earned. The plan also provides “features,” which modify the pension amount in specific ways. *In a nutshell: we have to reset the balance between the pension benefit formula and the features to create a benefit we can afford.*

A refresher on the current CSI pension benefit formula

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



A pension plan that uses a 1.84% benefit formula compares favourably with the best public sector pension plans in Canada. The highest formula allowed by law is 2% and most public sector plans only reach that level when the Canada Pension Plan benefit is added.

When will the design changes take effect?

Plan design changes will be effective for service on and after September 1, 2010. For service up to and including August 31, 2010, pension will be earned under the current formula.

Will the changes affect pension benefits already earned?

The laws governing multi-employer pension plans such as ours allow benefits already earned by members and retirees to be reduced. **However, this is not currently CSI's intention.** Instead, at this time, we propose changes that would affect future benefits only, from September 1, 2010. However, if the significant investment losses experienced by plan assets since August 2008 are not reversed by the time the next actuarial valuation is filed with regulators in August 2010, reduction to benefits already earned or being paid may need to be considered.

What's On

If we keep the current pension formula, we cannot afford the features as they are today.

To keep the pension formula at or close to today's level, we need to pull up to three levers. Each lever represents a modification to the plan's features:

- Increasing employee and school contributions.
- Reducing or removing early retirement subsidies.
- Capping or slowing down the phase-in of indexing.

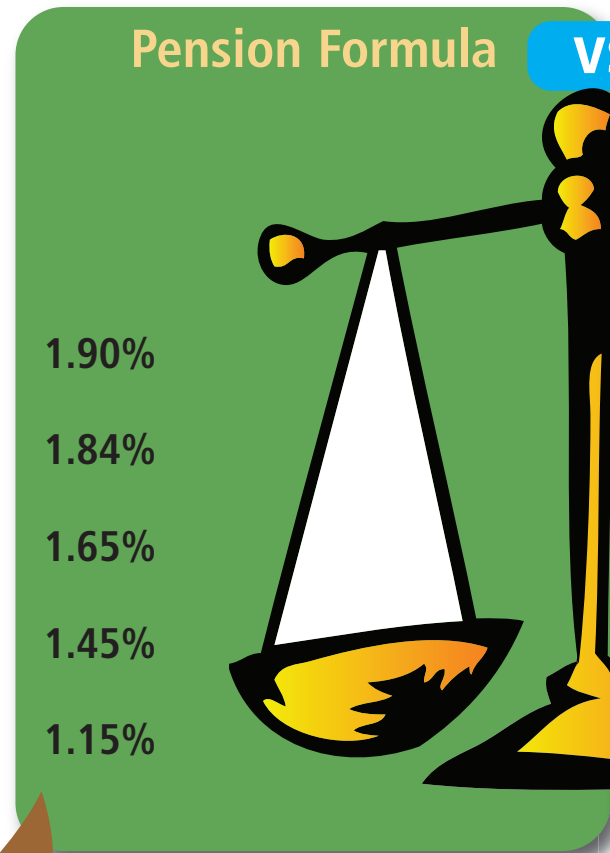
On the other hand...

If we keep today's features, we must reduce the current pension formula and offer a smaller benefit at retirement.

To keep today's features at or close to today's level, we need to pull a different lever:

- Reducing the pension formula, resulting in a smaller pension benefit.

Each lever will have a different impact on plan members and schools. We don't have to pull all of the levers, but whichever combination we choose to pull, the result must put the plan back on the track of long-term health and sustainability.



Pension Formula Lever: Reducing Pension Benefit Amounts

Current design: annual pension benefit at retirement is calculated using a 1.84% formula.

Proposed:

- A less generous pension formula (anywhere from 1.15% to the current level, depending on what features are kept) for service earned after September 1, 2010.

Impact:

- A less generous pension formula would result in a lower annual pension amount when you retire. However, pulling this lever—either part way or all the way—and accepting a less generous pension formula will reduce the cost to provide pension benefits and may allow the plan to keep some of the other valuable features.

Indexing Lever: Capping or Slowing Down

Current design: post-retirement indexing is providing incremental increases each year originally was to provide indexing increases thereby reaching 2.0% by 2013. As you may increase the indexing rate by only 0.1% effect already slowed down the timetable due to the

Proposed:

- Option A: Slow down phase-in – The indexing rate per year, reaching 2.0% in 2019. While a 0.1% beyond 1.0% per year would be provided on contractual.
- Option B: Cap indexing at 1% – Indexing up to the plan's financial health allowed it.

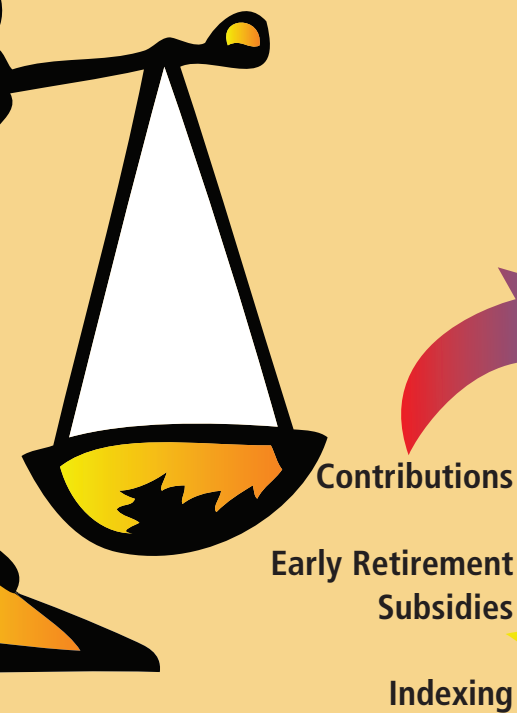
Impact:

- Capping or slowing indexing will reduce pension after you retire.
- Indexing levers are the only changes that

Which Levers Should We Pull?

at the Table?

5. Pension Features



Contribution Level Lever: Increasing Employee and School Contributions

Current design: you and your school each contribute either 4.5% or 6% of your annual salary to the pension fund. Contribution levels were increased in 2004 to help fund the new indexing feature. At the time, this increase was anticipated to be temporary (until 2013).

Proposed:

- The 2004 increase becomes permanent.
- Option A: Employee and school contributions increase to 5.25% or 7% of earnings (depending on the school's current contribution level).
- Option B: Employee and school contributions increase to 6% or 8% of earnings (depending on the school's current contribution level).

Impact:

- Increases the amount of contributions each employee would have to make to the plan.
- Increases the amount each school would need to set aside in its budget for pension contributions.
- This is the only lever that puts more money into the plan and the only way to directly increase plan assets.
- This lever has a greater impact on younger employees, since they will have to pay increased contribution amounts over a longer period of time compared with employees who are closer to retirement age. However, if current trends continue, younger employees will live longer and receive their pensions for a longer period of time.

the Phase-In of Indexing

at 0.9% per year, with the goal of until 2.0% is reached. The intention at the rate of an additional 0.2% per year, remember, the Trustees felt it prudent to effective September 2008. In effect, we have the financial health of the plan.

ing rate would continue to increase by 0.1% % increase per year is the goal, increases an ad hoc basis and would not be

ould not increase above 1.0% per year until

rotection from increased cost of living

affect both active members and retirees.

Early Retirement Subsidy Lever: Reducing or Removing Subsidy

Current design: retire at 60 (with at least 10 years of service) with no reduction in the pension formula. Retire as early as 55 with a 5% reduction per year for every year you retire in advance of age 60. This feature is considered a subsidy because it creates additional costs for the plan.

Proposed:

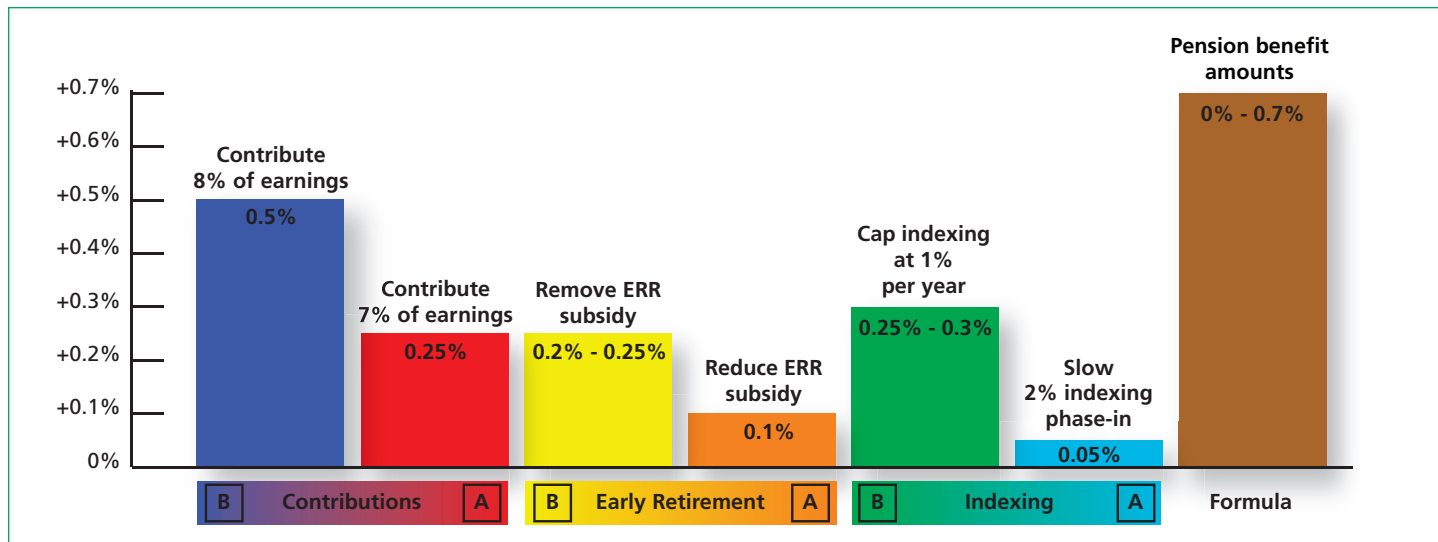
- Option A: Reduce the subsidy – With at least 10 years of service, retire at 62 with no reduction in the pension formula. Retire as early as 55 with a 5% reduction per year for every year you retire in advance of age 62.
- Option B: Remove the subsidy – Still retire as early as 55, but with a 6% reduction in pension from the formula for every year that you retire in advance of age 65.

Impact:

- The early retirement levers affect only those members who want to retire early. They do not affect members who retire at 65 or current retirees.
- More teachers working until 65 might affect school staffing patterns and budgets for salaries.

How Much Each Lever Can Help

What kind of impact does each lever actually have on the pension formula? The **indexing** and **early retirement subsidy** levers save the plan money by reducing the cost of the underlying features. If these levers are pulled, it would help to sustain the pension formula at a higher level. The **contribution** lever achieves the same effect by increasing the money going into the plan. If no levers are pulled other than current contribution rates becoming permanent, the **pension formula** percentage would have to be reduced by approximately 0.7% (from 1.84% to 1.15%). The following diagram illustrates how much each lever can contribute towards restoring the pension formula closer to 1.84%.



For example, increasing contributions to 7% and capping indexing at 1% could potentially raise the 1.15% revised base formula by 0.55% (0.25% + 0.3%), bringing it to approximately 1.70%. Only one of the two possible levers (A or B) can be pulled for each feature.

What We've Been Hearing From You

In January, we tested plan design alternatives in two focus groups with teachers, retirees, board members, and administrators. Here are some key findings from the focus groups:

- Increasing **contribution levels** was the most acceptable change. Many focus group participants acknowledged that current contribution levels are relatively low, especially in comparison with the OTPP.
- On the whole, focus group participants were very cautious about making concessions on **early retirement**. Most participants agreed that early retirement subsidies benefit not only teachers, but also schools and the broader CSI community. Many participants noted that even though early retirement adds considerable cost to the plan, it has a favourable impact on the financials and staffing patterns of schools.
- Almost all focus group participants were open to either slowing down the phase-in of **indexing** (option A) or capping indexing at 1% (option B). Once they realized how much of an impact capping indexing had on the plan, most participants preferred option B over option A. Participants recognized that the indexing lever is the only one that affects both active and retired members, therefore allowing all plan members to work together to improve the financial health of the plan.
- Almost all focus group participants were strongly opposed to any significant reduction in **pension formula**, although some were willing to have a small reduction in the formula to “save” other plan features.

Pension Plan Refresher

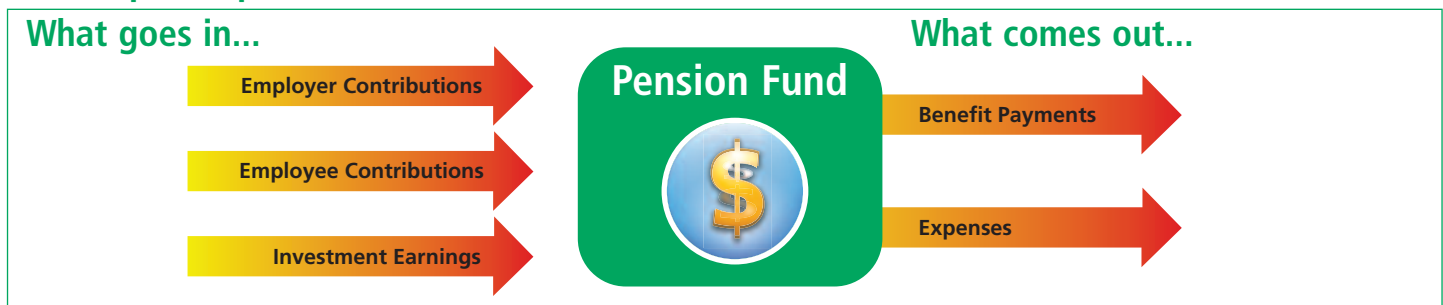
As you know, the CSI pension plan is a *defined benefit* (DB) plan. The pension at retirement is defined or predetermined based on a formula that includes your earnings and eligible service. Benefits are payable for life.

In contrast, in a *defined contribution* (DC) plan or RRSP arrangement, a member's pension at retirement is unknown: it depends on how much is contributed to the member's individual account and how well investments perform over time. There is no guarantee that benefits will last for life, so it is possible that a DC plan member could outlive this source of retirement income.

Employees and schools both contribute to the CSI plan. Contributions are deposited in the pension fund, which is held in trust and invested. The amount of contributions, plus the investment earnings on those assets, must be enough to pay for benefits promised and the expenses of pensions currently being paid. If there is not enough in the pension fund to cover these liabilities, the plan is considered to be facing a funding deficit, or *shortfall*.

You might ask: who has to cover a shortfall when it occurs? The CSI pension plan is a multi-employer DB plan (i.e., many schools contribute to the plan), so no single school can be entirely responsible for a shortfall. Therefore, the shortfall repayment must be managed through the current level of contributions being made by employees and schools. If the shortfall cannot be managed in this way, the plan must increase contributions or reduce benefits.

The DB plan equation



What's the Value of a DB Pension Plan?

Besides providing a predictable, lifetime benefit regardless of whether you retire during favourable or unfavourable economic times, a DB plan offers its members additional advantages in comparison to other arrangements:

- **Valuable features.** A DB plan can include valuable features such as favourable early retirement and indexing.
- **Better investment performance.** A DB plan pools all contributions into a collective pension fund, which enables the plan to more aggressively invest. DC plan and RRSP members generally invest more conservatively as they near retirement so their money is not exposed to risk. In a DB plan, the investment risk is spread over a larger pool of members of various ages and over a longer period of time. Studies show that a DB plan's returns outperform a DC plan's returns by 0.5% to 1.75% each year. An outperformance of just 0.5% translates into a 12% increase in benefit for the average employee.
- **Shared longevity risk.** In a DC plan or RRSP arrangement, individuals run the risk of either saving too much or not saving enough because they do not know exactly how long they will live. Members of a DC plan must therefore take a benefit reduction of 10% to 15% to ensure enough funds are available if they live longer than average. In a DB plan, pension benefits are provided for a member's lifetime, so members cannot outlive their pension.
- **Lower investment fees.** Fees for investment transactions are lower in DB plans, meaning that more money remains invested. These lower costs allow a DB plan to support a formula that offers a 5% to 10% increase in benefit for the average employee compared with DC plan arrangements.
- **Professional investment management.** A DB plan's pension fund is managed and monitored by professional investment advisors who are hired by the plan sponsor.

Taking into account better investment performance, shared longevity risk, and lower investment fees, a DB plan can support a benefit level that is at least 25% higher than the benefit level provided under a DC arrangement.

Plan Design Changes Being Recommended

Final Average Earnings: Best Five Consecutive Years

Final Average Earnings (FAE) is used in the pension formula to calculate your pension benefit amount. Currently, FAE in the CSI pension plan is the average of your best three consecutive years of earnings in your last 20 years of service, up to a set date (currently August 31, 2010). This set date is updated by way of an amendment, if the financial status of the plan allows it.

The change will increase the number of average consecutive years from three to five for service earned after September 1, 2010. While the average of the best three years is not an uncommon FAE arrangement in DB plans, two-thirds of DB plans that use an FAE formula average earnings over five years, including the OTPP, the ATRF, and the BCTPP. Because the average of five years of earnings will in most cases be lower than the average of three years, a five-year average will provide a slightly lower pension for the typical member than a three-year average and so it will cost the pension plan slightly less.

Normal Form of Pension: Elimination of 10-Year Guarantee

The normal form of pension refers to how pension benefits are paid at retirement. In the current plan, the normal form of pension for a retiree who does not have a spouse at retirement is a pension payable for his or her lifetime, with a 10-year guarantee period. That is, if you die within 10 years of receiving pension benefits, the payments continue to your beneficiary for the balance of the 10-year guarantee period.

The normal form of pension for a retiree with a spouse at retirement is a *reduced* pension payable on a “joint and survivor” basis, where the pension is paid for the lifetime of both the retiree and the spouse. The surviving spouse receives either 60% or 66.7% of the retiree’s pension amount (depending on the province).

The *value* of both forms of pension is the same, but the *monthly pension payments* will differ: under the joint and survivor form, initial pension payment to the retiree is smaller compared with a single retiree because the joint and survivor pension is likely to be paid over a longer period of time.

The change will eliminate the 10-year guarantee period for single retirees, and because the value of a single retiree’s pension is equivalent to a joint and survivor pension, the change will also slightly decrease the pension amount payable to a retiree with a spouse. If you still want a 10-year guarantee period with your pension, you can choose a smaller pension at retirement in order to provide for it.

Moving Forward Together

Through the focus groups, we have heard from a representative but small group of plan members. Obtaining understanding and input from the entire CSI community is the crucial next step, and we plan to accomplish this through the webinars, which will build on the content presented in this newsletter and invite your input on the plan design alternatives. It’s our pension plan and our future, so we encourage all plan members to be informed, have an opinion, and participate in the webinars and the decision making process.

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Questions?

If you have any questions, please contact Howard Van Mersbergen, Vice President of Employee Benefits, at 1-877-274-8796 or hvanmersbergen@csionline.org.