Pension News

UBC Faculty Pension Plan
Third Quarter 2009 Edition

Update on the OAS and CPP

Two important sources of retirement income are the government administered pension programs, Old Age Security (OAS) and the Canada Pension Plan (CPP). This article examines these two programs, including some of the proposed changes to CPP, and looks at the critical issue of when to start these pensions.

Old Age Security

OAS is a universal program that provides income to Canadians who reach age 65. Eligibility depends only on the period of residency in Canada. The eligibility rules are complex; generally at least 10 years of residency is required for any benefit. Unlike CPP, OAS is available only at age 65 or later, and deferring OAS beyond age 65 does not increase the amount of pension.

The maximum OAS payment in 2009, for new or ongoing recipients, is $516.96 per month. The maximum amount is available to those who have been resident in Canada for 40 or more years; for retirees who have fewer than 40 years of residency in Canada, the pension is reduced pro-rata. The rules applicable to individuals who have moved in and out of Canada or retire outside of Canada are complex, and may affect the amount of OAS pension. For details of your own situation, you can contact Service Canada.

OAS benefits are adjusted for inflation four times per year. No death benefits are payable on the death of an OAS pensioner or on death before payments start. If there is a spouse, the spouse's OAS benefit will be calculated and paid when the spouse reaches age 65, based on the spouse's period of residence in Canada.

In this issue

OAS is funded from government tax revenue and administered by Human Resources & Skills Development Canada (HRSDC). The federal government has long recognized that the cost of OAS will rise dramatically as the baby boomer generation retires. A mechanism is in place to control the future cost of OAS – the OAS clawback. Canadians who meet the age and residency tests still qualify for OAS, but if their income exceeds a certain level, some or all of their OAS is "clawed back" when they complete their annual income tax return.

Contact Service Canada for information about OAS or CPP

http://www.servicecanada.gc.ca/eng/audiences/seniors/index.shtml

1-800-277-9914 (Canada & US)

Outside Canada & US: 1-613-957-1954
(collect calls accepted)

In 2009, the OAS clawback begins at an income of $66,335 at a rate of 15 cents for each dollar of income above that level. OAS is fully clawed back at an income of $107,692. The clawback thresholds are normally adjusted each year for inflation. If necessary, the federal government can control the cost of OAS by simply adjusting the clawback. Because the cost of OAS is expected to increase sharply and the benefit is paid from tax revenue (and is not pre-funded), some financial planners exclude OAS when they create retirement plans for their clients.

Starting your OAS pension

To receive your OAS pension, you must make application to HRSDC through Service Canada. HRSDC then determines the amount of your payment, which is typically deposited directly to your bank account. Depending on your income level, some or all of your OAS will be taxed when you file your income tax return.

Because OAS is not payable before age 65, nor are larger OAS benefits available if you start after age 65, the natural starting age for OAS is 65. Although some seniors may have income at a level that would lead to their entire OAS being clawed back, all seniors are advised to apply for and receive their OAS in the event that their future income or the clawback mechanism may change.

Canada Pension Plan

CPP is a government-administered employment-based retirement program funded by employees and employers. The federal government administers CPP, but does not pay for any of the cost of the pensions.

Employees and employers currently each contribute 4.95% of an employee's contributory earnings (with a combined rate of 9.9% for the self-employed), where contributory earnings are earnings between a base level of $3,500 and a maximum annual amount (referred to as the Year's Maximum Pensionable Earnings, or "YMPE"). The YMPE in 2009 is equal to $46,300, and will be adjusted for wage inflation each year. The adequacy of the CPP contribution rate is assessed by the CPP's actuary every five years; if required, the rate is adjusted.

CPP provides retirement benefits that may start as early as age 60. CPP also provides survivor benefits on death before or after retirement, and provides pre-retirement income to disabled contributors.

The rules applicable to CPP, including the contribution rates, are established jointly by the federal and provincial governments. From time to time, the actuarial review leads to changes in the CPP; this article outlines some proposed changes.

CPP provides a maximum retirement income at age 65 equal to 25% of pre-retirement pensionable earnings. The calculation of "pre-retirement pensionable earnings" is complex: for individuals who have earned at least the YMPE in each year from age 18 up to retirement, pre-retirement pensionable earnings are equal to the average YMPE in the five years before retirement. For 2009 retirees, the maximum CPP pension at age 65 is $908.75 per month.

For retirees who have not earned the YMPE in each year before retirement, the pension is reduced proportionately to the extent that the average earnings over the working period fall short of the average YMPE. A number of the low-earning years are dropped from the calculation, which is beneficial to individuals who were studying, travelling or unemployed for a portion of the period. Currently, 15% of the low-earning years may be dropped from the calculation. It is proposed that the drop-out percentage will increase to 16% in 2012, which will allow up to 7.5 years to be dropped, and to 17% in 2014, which will allow up to 8 years to be dropped. You can contact Service Canada for details of your own situation, including your pensionable earnings each year and the years that may be dropped.

CPP benefits may be started as early as age 60, and benefits may be deferred up to age 70. In starting CPP before or after age 65, the initial part of the calculation is as described above, equal to 25% of pre-retirement pensionable earnings, adjusted for years of low earnings, subject to the earnings drop out. On retirement before age 65, the pension is currently reduced by 0.5% for each month that the retirement date precedes age 65. For instance, for an individual with maximum earnings, the pension at age 60 is 70% of the maximum pension, because the reduction is 60 months (before age 65) x 0.5% = 30%.

Proposed changes to the CPP

When the early retirement reduction percentage of 0.5% per year was introduced, it was intended to be "actuarially equivalent", which means that an individual starting a pension at age 60 is expected to receive a larger number of smaller pension payments that are equivalent in value to the pension the individual would have received had the pension started at age 65. Proposed changes reflecting evolving economic and demographic conditions will gradually increase the early pension reduction, starting in 2012, from 0.5% per month for each month that the pension is taken before age 65, to 0.6% per month in 2016.

If CPP benefits are deferred beyond age 65, the pension is currently increased by 0.5% for each month that the retirement date is beyond age 65. For example, for an individual with maximum earnings, the pension at age 68 is 118% of the maximum pension, because the enhancement is 36 months x 0.5% = 18%. The adjustment for deferred pensions is proposed to be gradually increased over a period of three years, starting in 2011, from 0.5% per month for each month that the pension is taken after an individual's 65th birthday up to age 70, to 0.7% per month.

Another proposed change in the CPP is the elimination of the requirement to either stop work or reduce earnings to receive CPP benefits before age 65. This change would not affect anyone who takes their CPP retirement pension before 2012. There has never been a requirement to stop working to receive CPP benefits at or after age 65.

Starting your CPP pension

To receive your CPP pension, you must make application to HRSDC through Service Canada. HRSDC then determines the amount of your payment.

Choosing a start date for your CPP needs some consideration, because the amounts vary according to the age when benefits start. One simple approach is to consider the "breakeven age" – the age at which the total amount that you would receive as a result of retiring early (or late) would be equal to the total amount that you would receive by retiring at age 65. For instance, if you are choosing between starting your CPP at 65 or starting at a later date, if you die before the breakeven age, you will receive more pension by starting your pension at age 65; if you live to an advanced age, you will do better with the larger pension starting after age 65.

With the current deferred retirement enhancement, and ignoring wage and price inflation, the breakeven age is 86. An individual contemplating starting their CPP at age 65 would consider the advantage of receiving payments immediately (a bird in the hand is worth two in the bush), which would deliver more benefits in total in the event of early death, while the potential for a long life span would favour choosing a larger pension that starts later than age 65. The breakeven approach must be used with caution, as there are many other factors that should be recognized:

- The initial amount of CPP at age 65 is based on a wage index. The initial pension on retirement after age 65 will not only be increased by the 0.5% per month adjustment, but will reflect any increases in the wage index after age 65. Consequently, the initial amount at deferred retirement could be even higher than simply the percentage-per-month amount.
- Pension payments are adjusted for price inflation, so the benefits starting at age 65 have additional value when these adjustments are included.
- The breakeven calculation does not take into account the potential earnings that could be generated from earlier payments, nor the tax on those payments or the investment earnings.
- For individuals who continue to work after age 65, CPP benefits can commence. CPP contributions stop (provided UBC payroll is notified), which is a considerable savings that could generate additional investment earnings in (for instance) a tax-free savings account.

Perhaps the most important factor to consider in deciding when to start CPP is income tax. Near the top of the list of advice on financial planning is the advice to use all non-tax-sheltered sources of income first, and defer all tax-sheltered income until needed. If you receive CPP early but do not need it, then you may be paying a higher rate of income tax on it than if you defer. To some extent, CPP is a tax-sheltered retirement income vehicle, where deferral is often the best strategy.

Retirement planning may be complex, requiring a review of all assets and potential income sources, and income needs in retirement. Although CPP is sometimes excluded by financial planners in advising their clients because of uncertainty about its long-term sustainability, CPP is generally believed by actuaries to be viable over the long term. In developing a plan, it should be recognized that CPP benefits can be split between spouses, which helps reduce income taxes.

This article was prepared by Satanove & Flood Consulting Ltd. Comments should be sent to: fpp@hr.ubc.ca

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Trustee Election

The UBC Faculty Pension Plan is holding an election for two trustees this fall. There are four nominees running for the trustee positions, including two incumbents, Rob Heinkel and Neil Guppy, and two new candidates, Ken Carlaw and Millan Patel. Election packages have been mailed to members and voting began on October 22, 2009. The closing date for casting ballots is on Wednesday, November 18, 2009 and results of the election will be announced on Thursday, November 26, 2009. Members are able to vote online, by mail, or by fax.

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Faculty Pension Plan Workshops

The Faculty Pension Plan offers two regularly scheduled seminars – one provides general information about the Faculty Pension Plan, and is of interest to new and existing members. The other provides information about the Plan's retirement options and is suited to members who are approaching retirement. Please visit the Workshops page on the FPP website for upcoming seminar dates.

To register or learn more about these seminars, please contact Jim Loughlean at (604) 822-8987 or jim.loughlean@ubc.ca.

Custodian Change

The UBC Faculty Pension Plan has changed its custody service provider to CIBC Mellon and the assets will be transferred on November 1, 2009. CIBC Mellon was selected as it was felt their investment and administration systems better meet the requirements of the Plan. Effective November 1, 2009, pensioner payments will be made by CIBC Mellon. Correspondence of this change has been mailed to our retirees including a Retiree Assistance card with contact information. If you have not received this mailing, or have any questions, please contact Jim Loughlean at (604) 822-8987 or jim.loughlean@ubc.ca.

Christmas to New Year Closure

The Pension Administration Office will be closed from December 25, 2009 to January 1, 2010, inclusive. All termination benefit payments and retirement benefit cheques will be calculated and sent before December 23, 2009. If you are planning to transfer funds in December or January, or to begin a retirement benefit in January, please send the forms to the Pension Administration Office by November 25, 2009. In case of an emergency during the closure, messages on the general reception line at (604) 822-8100 will be monitored daily.

Market commentary

The third quarter of 2009 provided strong returns in almost all asset classes, with low interest rates and high government spending fuelling the global economy. Many pundits feel the worst of the deep recession is behind us and investor sentiment has been improving. Unemployment rates continue to be high, causing a concern regarding a sustained economic recovery.

The Canadian equity market had another strong quarter, returning 10.6%, resulting in seven straight months of positive returns. The one year return is now positive at 0.5% with the index up almost 50% from its low in March 2009. Almost 87% of the stocks in the index saw gains with Health Care (22.2%) and Financials (16.1%) being the strongest sectors in the quarter. The only sectors with negative returns were IT (-8.1%) and Consumer Staples (-2.7%).

The U.S. stock market also had a strong quarter, up 15.6% in U.S. dollar terms. However, due to the weakening U.S. dollar, this resulted in a 6.8% return in Canadian dollars. The U.S. returns have been at lower levels than in Canada, with a one year return of -6.0% in Canadian dollars. Financials, Industrials, and Materials were the strongest sectors for the quarter. Non-North American equities, as measured by the MSCI–EAFE index, returned a strong 10.4% for the quarter. All regional markets except Japan had strong returns this quarter, with the European markets posting their best quarterly return this decade.

The Bond market also had a positive quarter with the DEX Universe Bond index returning 2.7%, resulting in a one year return of 10.3%. Long-term bonds again outperformed both mid and shorter term bonds. The Corporate bond sector continued to show the best sector returns as the appetite for risk and liquidity conditions improved.

Performance of Funds for periods ending September 30, 2009

	3 Months	1 year	3 years	5 years	10 years
Balanced Fund - gross	6.08%	3.40%	1.99%	5.94%	5.64%
Balanced Fund - net	5.96%	2.91%	1.50%	5.46%	5.19%
Composite Index 1	5.57%	3.82%	1.91%	5.43%	5.12%
Bond Fund - gross	4.10%	11.59%	5.48%	5.69%	6.41%
Bond Fund - net	4.01%	11.25%	5.19%	5.43%	6.15%
Composite Index 2	2.80%	10.28%	5.22%	5.63%	6.46%
Canadian Equity Fund - gross	9.50%	0.08%	2.33%	8.96%	9.16%
Canadian Equity Fund - net	9.38%	-0.38%	1.89%	N/A	N/A
Composite Index 3	10.15%	0.25%	2.13%	8.42%	7.53%
Foreign Equity Fund - gross	8.33%	-2.65%	-6.80%	0.08%	-0.95%
Foreign Equity Fund - net	8.20%	-3.12%	-7.20%	N/A	N/A
Composite Index 4	8.27%	-0.76%	-5.33%	0.31%	-0.84%
Short Term Investment Fund - gross	0.06%	0.97%	3.01%	3.08%	3.55%
Short Term Investment Fund - net	0.03%	0.80%	2.86%	2.90%	3.32%
Composite Index 5	0.04%	0.86%	2.77%	2.90%	3.29%

Composite Index 1: *33% DEX Universe, 10% S&P/TSX Capped, 5% S&P/TSX,5% S&P/TSX 60 Capped, 15% S&P 500, 15% MSCI-EAFE, 2% DEX 91-Day TB, 10% IPDCPI, 5% DEX Real Return Bonds*

Composite Index 2: *86.8% DEX Universe, 13.2% DEX Real Return Bonds*

Composite Index 3: *25% S&P/TSX, 50% S&P/TSX Capped, 25% S&P/TSX 60 Capped*

Composite Index 4: *48% MSCI-EAFE, 48% S&P 500, 4% DEX 91-Day TB*

Composite Index 5: *DEX 91-Day TB Index until Aug 2007, DEX 30-Day TB Index commencing Sep 2007*

Composition of Funds as at September 30, 2009

BALANCED FUND	**Market Value ($ Millions)**	**% of Fund**
Equities - Canada	209.3	20.9%
Equities - U.S.	151.0	15.1%
Equities - EAFE	145.3	14.5%
Absolute Return Hedge Fund	21.5	2.1%
Real Estate - Canada	88.8	8.9%
Fixed Income	325.6	32.5%
Real Return Bonds - Canada	52.7	5.3%
Cash & Short term	6.6	0.7%
Total Balanced Fund	1,000.8	100.0%
BOND FUND		
Fixed Income	45.1	86.1%
Real Return Bonds - Canada	7.3	13.9%
Total Bond Fund	52.4	100.0%
CANADIAN EQUITY FUND	85.0	100.0%
FOREIGN EQUITY FUND		
Equities - U.S.	14.9	48.7%
Equities - EAFE	14.4	47.1%
Absolute Return Hedge Fund	1.3	4.2%
Total Foreign Equity Fund	30.6	100.0%
SHORT TERM INVESTMENT FUND	55.2	100.0%