WLUFA BARGAINING ADVISORY

November 28, 2011

THE PENSION "CRISIS"

The Administration has put on quite a show in the past two years about the serious deficit in our pension plan. A deficit is when assets in the pension plan are less than the pension liabilities. Another way of saying this is that the pension plan is underfunded. Yet, with all the talk of pension "crisis," the Administration has deemphasized how this deficit originated.

Technical issues will be addressed below. But first let us look at the origins of the deficit in the Laurier pension fund by providing an analogy.

Suppose that you buy a home (an asset) with a mortgage loan (a liability). One day the bank says that you cannot make payments on the mortgage loan for the next five years. During this five year time period the mortgage loan balance grows at an increasing rate because interest is charged on the unpaid interest. At the end of the five years the bank allows the homeowner to again make payments on the mortgage loan including all past payments not yet made.

What should the homeowner do?

A prudent and careful homeowner would realize that the mortgage loan will continue to grow and must be paid eventually. So, the homeowner sets cash aside each month equal to the amount of the mortgage payment during the five year period. When the five year period has elapsed, the homeowner can resume paying the mortgage loan and also has the cash to cover the mortgage payments not made to the mortgage loan and the accumulated interest on those mortgage payments. Thus, the homeowner never falls behind on the payments that must be made to successfully pay off the mortgage loan.

Alternatively, suppose the homeowner decides not to set money aside and decides to spend the money instead. In five years they face a much larger mortgage loan. This is because of compound interest, where interest is accrued not only on the original mortgage loan, but also on all of the payments that were not made. In the worst case scenario, the mortgage loan (liability) could grow to more than the value of the house (the asset). In which case the homeowner would be in a deficit position, where the amount of the mortgage loan (liability) is greater than the value of the home (asset). In effect, the homeowner has not only borrowed using the mortgage loan, but has borrowed an amount equal to all of the payments that should have been made, with interest, over the last five years.

The Laurier Administration has acted much like the homeowner who did not set money aside for mortgage payments and decided to spend the money. Just like that homeowner, the Administration borrowed from the pension plan and has not paid the pension plan for the loan. This is the origin of the deficit in the pension plan where liabilities are greater than assets. If this loan were paid, there would be no pension "crisis."

To understand how the Administration borrowed from the pension plan a brief description of the actuarial design of the Laurier is needed. The actuarial design of the pension plan rests with three key components: (1) a seven percent of salary contribution to the pension plan by employees, (2) a matching seven percent contribution to the pension plan by the employer and (3) payouts to retirees made in accordance to the formula in the pension plan document. All of these components must be in place in every year and must be adhered to every year for the Laurier pension plan to be actuarially sound and sustainable. Otherwise, the Laurier pension plan will not perform as it is designed.

The deficits in the Laurier pension plan started with the Administration taking what is called **pension contribution holidays** in 1994. A pension contribution holiday is a suspension of the actuarially defined cash contributions to the pension plan. This continued until 2002. The employees kept contributing seven percent of wages to the pension plan, but the Administration did not contribute a matching amount. This is no different from the Administration taking a loan from the pension plan. As with all loans, the funds must be paid back with interest. The amount of this loan explains the deficit in the pension fund that we see today. In short, the actuarial design of the Laurier pension plan was not adhered to and therefore a deficit occurred.

To be fair, it must also be mentioned that employees at Laurier also took partial pension contribution holidays from 2000 to 2001. So, employees also partially suspended cash contributions to the pension plan and have also taken a loan from the pension plan. This loan must also be paid back to the pension plan.

At the end of 2010, our actuary calculated the Administration's loan to be $59.27 million and the employee's loan to be $4.94 million, both resulting from the pension contribution holidays.

If these loans were paid as of 2010, our actuary has determined that the Laurier pension plan would be properly funded. There would be no pension "crisis."

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"Creating a useful crisis is part of what this will be about. So the first communications that the public might hear might be more negative than would be inclined to talk about (otherwise). . . Yeah, we need to invent a crisis and that's not an act of courage, there's some skill involved."

(John Snobelen, Minister for Education, Toronto Star, 13 September, 1997. P. A3)

DID YOU KNOW…

Over the last three years the Administration has talked many times of serious budget issues, but the audited financial statements have showed a cumulative surplus of over $43 million over that same period?