Devaluing retirement dreams

>The financial burden of company pensions has forced some of B.C.'s biggest companies to switch to options perceived to be less expensive

>But those alternatives have resulted in class-action lawsuits and have yet to reduce corporate financial burdens that could last generations

By Richard Chu

At 58, **Leonard Bleier** was looking forward to retirement after a 32-year career as a supervisor at the zinc and lead smelter in Trail.

After he hung up his boots in 2006, Bleier bought a fifth-wheel RV trailer that he and his wife hoped to use to travel and snowbird in the winter. But that trailer has been idle for longer than Bleier hoped because, despite his pension plan, he couldn't afford to stay retired for long.

Three years ago, he went back to work for **Teck Resources**' (TSX:TCK.B) smelter in Trail to supplement his income.

Bleier was one of hundreds of employees persuaded in 1992 to switch to the company's defined-contribution (DC) pension plan from the defined-benefit (DB) plan provided by then-**Cominco Ltd.** (now **Teck Resources**).

Under a DC plan, employees and employers set an amount they both contribute to an employee's pension. A DB plan, however, spells out a specific pension value at retirement. Based on the materials Cominco provided employees, Bleier switched plans thinking he was getting a good deal.

"It showed that at 58 I'd get the same amount [as the other plan] and there would be a year or two where it would drop a little, but after that, it would increase quite a bit more than if I were in the DB plan," said Bleier.

But as he got closer to retirement, he noticed that the payoff wasn't going to be as good as if he had stayed in the DB plan.

"When we were given more information about what was happening, that's when I realized it wasn't a good thing for me to switch. A lot of the information was in favour of the company wanting us to switch."

In October, Bleier filed a class-action suit against Teck and their adviser **Towers Perrin** (now **Towers Watson**). It claimed breach of duty of good faith, fiduciary and statutory duties and negligent misrepresentation. His case is the second suit against Teck. An initial suit launched by **James Weldon** in 2009 has been delayed in legal technicalities.

So far, only a handful of cases have been filed in B.C. where companies are alleged to have breached their fiduciary duties and misrepresented the benefits of converting pension plans. Another case involved lumber giant **Tolko Industries**, which was settled out of court earlier this year.

Because the law around pensions remains relatively weak in Canada, industry analysts suggest the risk of litigation for companies that have converted pensions will increase.

Naveen Kapahi, manager of Mercer's retirement practice in Western Canada, said that most requirements for companies that sponsor pension plans are guidelines as opposed to law or regulations. So far, a company's legal liability for not following the guidelines has not been fully tested.

"The case law around this in Canada remains in its infancy," said Kapahi. "In the U.S., there has been more litigation around this, and, as a result, they've created some [prescriptive] safe harbour rules that say if you provide this type of information, with this type of content, with this frequency you've met your obligation. We don't have such things in Canada yet."

Ken Burns, a partner at **Lawson Lundell** who focuses on employment law, said, "If the Weldon case or similar ones go to trial and there's a decision for the plaintiffs, one can anticipate that there will be similar actions taken against other companies who make similar conversions. But the allegations would be very fact-specific."

He noted the probability of cases would increase if plan members find that their DC plans aren't providing the pension they were expecting.

Chris Roberts, a senior researcher of social and economic policy at the **Canadian Labour Congress**, said numerous studies have shown that funds invested in DC plans have consistently underperformed those in DB plans.

A **Towers Watson** study found the rate of return difference has averaged at least 1% annually since the mid-1990s. This is partly because DB plans are pooled funds managed by professional investment managers and can carry smaller administrative costs compared with individual DC member plans.

> **"It hurts when you supervise these fellas for 30-some years and their pension is better than yours"**
>
> – Leonard Bleier, 63, Teck Resources employee

Financial obligations on the rise

In addition to the increased litigation risks, companies that decided to close their DB plans to new members in the 1990s have yet to reduce their costs.

While a majority of Canadian companies surveyed by Towers Watson said they plan to close their DB plans to new members, Burns noted that such a transition isn't going to provide any short- or medium-term savings in pension obligations.

"A lot of companies that made the switch 10, 15 years ago have found their pension liabilities have continued to increase even though no one is accruing additional benefits," said Burns.

An analysis of pension obligations for some of B.C.'s largest public companies shows that in the past decade obligations for some DB plans have more than doubled, even though some of the plans have been closed to new members.

Teck's DB pension obligations, for example, have risen 85% between 2000 and 2010 to $1.6 billion from $751 million.

Catalyst Paper's (TSX:CTL) DB pension obligations were up 68% in the past decade to $379.4 million from $226.2 million.

Another reason companies

Lawson Lundell partner Ken Burns: companies have yet to reap the benefits of switching pension plans

Naveen Kapahi, Mercer retirement practice manager: pension case law in Canada is in its infancy

want to close their DB plans is to mitigate the financial risk to a company's cash flow and income. Because companies are required to keep their DB plans solvent, the company must then put in more cash if the plan's investment returns fall short of expectations. The bigger the plan obligation, the bigger the potential cash injection that might be required.

With the unprecedented market volatility in recent years and persistently low interest rates expected in the future, a company's pension costs could soar, seriously affecting its financial stability.

Meantime, Burns noted savings from closing a DB plan would be minimal in the short term.

In fact, much of the savings wouldn't be realized for decades. Depending on the age of the youngest person (and their spouse) in the DB plan, a company could wait half a century or more before it completely eliminates its DB plan.

Meantime, companies are also incurring new costs managing both their DB and DC plans.

"Now you have two pension plans, each with some overlap around pension governance and legislation, but to a great extent, they're different, requiring different people, different skill sets and different third-party providers," said Burns. "So you've actually duplicated your obligations."

The DC pension guidelines for employers have also become far more onerous, not only adding to the cost of managing a plan but also increasing future litigation risks.

Roberts noted, "It's a worst case scenario for companies."

Uncertainty around future obligations

But defining how onerous a company's DB pension obligations are is a matter of perspective too.

Kapahi noted that in the past couple of years, the burgeoning growth of pension obligations has largely resulted from record low interest rates. He suggested that a 1% drop in interest rates can increase a pension plan's obligations 15% to 20%.

That has also affected the solvency of many DB pension plans, which have large increases in fund deficits in recent years. Teck's DB pension plan, for example, went from a modest surplus in 2006 to a $137 million deficit in 2010.

In its third quarter, the company posted a $163 million estimated loss on its DB pension, partially due to the investment performance of the pension's assets.

Catalyst Paper's pension deficit has jumped to $133 million from $93 million in the same period.

While companies have five years to replenish a DB plan, Kapahi noted that it's also feasible that, over time, a company's pension obligations will fall as interest rates return to normal levels. Higher inflation can also help if the plans are not indexed to inflation. An August 2011 report from rating agency DBRS suggested the funding deficits of some of the largest pension plans in North America could be eliminated in 2012 if markets provide an average return next year assuming a continued economic recovery.

The report suggested that for most remaining DB plans, the pension obligations are manageable, even though they remain difficult plans to manage and a significant long-term obligation.

While companies are making the switch to DC plans, the report noted, "this is no short-term fix as it can take many years for plan obligations and funding costs to begin to fall after new staff are converted to a defined-contribution plan."

Roberts noted that prior to 2007, when pension plans were in surplus, many companies tried to raid the surplus or decided to take a contribution holiday. Such moves only worsened pension deficits when they arose.

While DB pension obligations are cited as key issues affecting the viability of large companies, Roberts suggested the issue is more a question of executive responsibility than the financial burden of the plan.

"When companies took contribution holidays in good times and made conscious decisions not to fund their plans, those were strategic decisions to lower costs. I'm not sure there is anything necessarily terminal in DB plans."

DB plans valuable staff retention tools

Most human resources experts agree that a defined-benefit pension plan remains one of the best employee retention tools, because an employee's pension usually grows for each successive year of employment. A Towers Watson survey released earlier this year noted that companies that maintain an open DB plan are seen as more attractive to prospective employees, because the DB plan is seen as more valuable than a DC plan.

Elaine Jensen, manager of corporate human resources at **West Fraser Timber** (TSX:WFT), said that's the primary reason that her company continues to keep their DB plan open to most of its 6,800 employees, even though its pension obligations have risen 279% to $945 million from $249 million in 2002.

For Bleier, the benefits of a DB plan are obvious.

If he had stayed in the DB plan, he'd have double the income he receives today.

But he'd also have more retirement security after his three decades of employment. By law, he can draw only 6% out of his DC pension each year. But with market declines and high volatility since 2008, the total dollar amount of that percentage has shrunk each year.

Now 63, Bleier said he's lucky that he's still able to work to supplement his income.

But he'd still like to enjoy retirement.

"It's a time thing, eh? I have a lot of friends in the union and their pension is considerably better than ours. It hurts when you supervise these fellas for 30-some years and their pension is better than yours."

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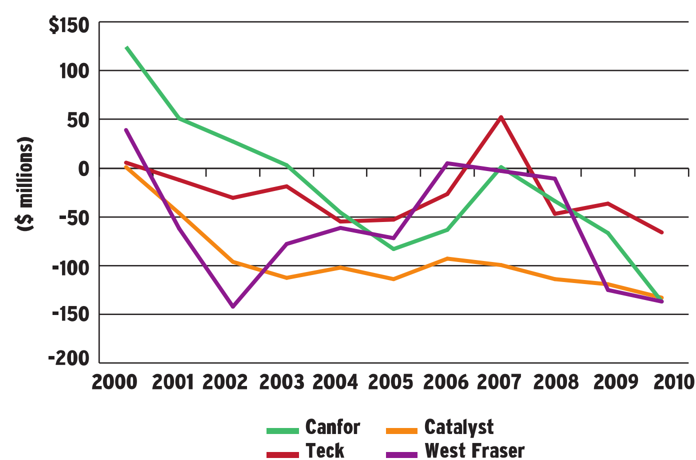

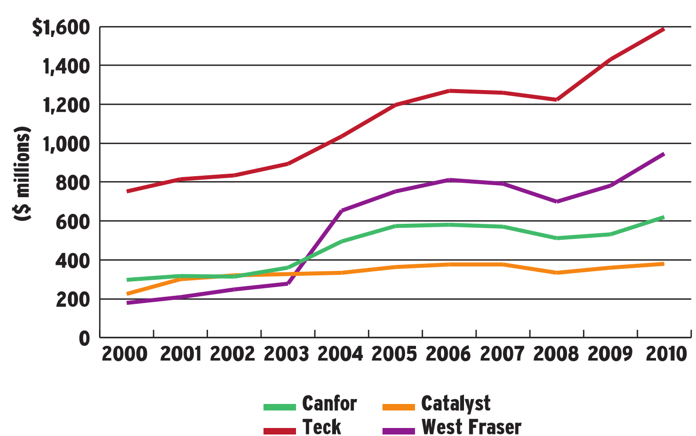

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