

# Auto Facts – Pension Update

## Why are Pension Plans in Trouble?

- Concerns have been raised about the implications for pension benefits given the current uncertainties and instability for the auto industry. The current financial crisis has highlighted concerns about the possible implications for pensions and has subjected pension plans and their members to two related risks.

First, the viability of many employers is being put into question by deteriorating financial conditions which are affecting their credit, the demand for their products, and the credit position of their customers.

Second, the meltdown of financial markets has meant that the various assets that pension plans have been invested in, have lost significant value.

## Restructuring, Creditor Protection and Bankruptcy

There has been a great deal of speculation about the possibility of various employers becoming bankrupt, and what that would mean for pension plan members.

It is extremely difficult to speculate on the possible outcomes of these situations. In Canada, usually before recourse to any possible bankruptcy proceedings, companies often go through a restructuring process under the Companies' Creditors Arrangement Act ("CCAA"). There are many possible outcomes under a CCAA process, including a sale of some or all of the business, a restructuring of part of the business, and even the continuation of the Collective Bargaining Agreement and Pension Plan.

In the event of a bankruptcy of an auto or auto parts company, and in the event that restructuring does not involve the continuation of the Pension Plan, either with a restructured company or with some new corporate entity which would continue the operations in Canada, then there would be a wind-up of the Pension Plan. Depending on the assets available to satisfy the creditors, there may be some additional assets available for the Pension Plan, but quite often in bankruptcy proceedings, there are insufficient assets left after secured creditors have been able to satisfy their liabilities.

It is important to note however, that the current assets of Pension Plans are in separate trust accounts, and those assets are only available exclusively to pay for the pension benefits of the Plan members. These pension assets are not available for any creditors

in bankruptcy proceedings, nor can they be accessed by companies prior to such proceedings. They can never be used for any other purpose than to pay the accrued liabilities of the Pension Plan, i.e. the pensions of retirees, and the future pensions of active workers.

Should any auto company or any auto parts company enter into the CCAA process, the final outcome is very difficult to predict? Few things are certain, except that the judge with jurisdiction over the CCAA proceedings has enormous discretion to fashion a restructuring or “exit” plan. There is nothing that the law requires to be included in an “exit” plan pertaining to workers’ wage, benefit and pension compensation. For example, to return to the Air Canada situation, Air Canada wanted to change its pension plan from a defined benefit plan to a defined contribution plan, and as well, reduce benefits. CAW-Canada adamantly refused to agree to such a proposal. The CCAA judge was able to direct the process so that Air Canada backed off its pension demands. The pension plan remained intact when Air Canada left CCAA proceedings.

Certainly, companies could try to use the CCAA statute to assist future restructuring initiatives. However, the union has direct input into such proceedings, and, in our view, the law does not permit the Court to amend a collective agreement or pension plan of any kind during CCAA proceedings without the union’s explicit consent.

## **Wind-Ups and Pension Protection**

- Concerns have been raised about the funded status of many pension plans based in the auto industry. Below, we detail some of the implications of what may happen in worst case scenarios, and we also provide information about the protection which currently exists for Plan members.
- In Ontario if an employer sponsoring a defined-benefit plan becomes insolvent, and contributions to the plan cease, the plan will be subject to a wind-up, under the procedures established by the Pension benefits Act (PBA).
- In 1980 the *Pension Benefits Act of Ontario* was amended to establish the PBGF. Ontario became the only Canadian province to provide a system of governmental protection for the pension promises of private employers.
- In the event of a bankruptcy, if the pension fund has insufficient assets to provide the accrued pension benefits then upon wind-up those benefits would have to be adjusted to reflect the financial state of the pension fund and the application of the Ontario Pension Benefits Guarantee Fund (PBGF).
- It is important to note that the PBGF applies not only to the benefits of those who have retired, but also to the benefits of active participants of the plan. The benefits which the PBGF guarantees are subject to certain restrictions.
  - First, the PBGF guarantee only applies to the first \$1,000 of monthly pension income, (an amount that has not been increased since 1980)

- Secondly, it does not guarantee any benefit levels that have been in place for less than 3 years prior to the date of wind-up
- In general, the first \$1,000 of monthly income is fully guaranteed, while the “excess amount” above \$1,000 would be paid out at the funded ratio of the Plan on wind-up.

## PBGF Examples

Because there have been so many questions about what would happen to Pension Fund assets along with any entitlement from Ontario Pension Benefits Guarantee Fund (PBGF), we have prepared the following examples.

In the event of a bankruptcy, pension benefits would have to be adjusted to reflect the financial state of the pension fund and the application of the provisions of the (PBGF).

To illustrate the way the PBGF works, we will use some examples with differing wind-up ratios, that is, the amount of assets available compared to the total liabilities for all members of the pension plan, including active employees, as well as retirees and surviving spouses.

Although the calculation of how the PBGF works can be rather complex, the general rule is the first \$1,000 of monthly income is fully guaranteed, while the “excess amount” above \$1,000 would be paid out at various funded ratios of the Plan on wind-up.

Example: If a Big 3 production worker had retired on Oct. 1, 2005 with 30 years of service at age 65, they would be receiving a pension of  $\$65.00 \times 30 = \mathbf{\$1,950}$  per month. In this example, upon wind-up, the funded ratio is assumed to be **60%**.

Of the first \$1,000, the pension plan would be paying \$600 and the PBGF would be paying \$400, while the amount above \$1,000, namely \$950, would be paid by the plan at 60%, or \$570.

Based on the above scenario, the retiree would be entitled to a total amount of **\$1,570** or **80.5%** of their normal entitlement.

Example: If a Big 3 production worker had retired on Oct. 1, 2005 with 30 years of service at age 58, they would be receiving a pension of \$3,335 per month until age 65 and  $\$65.00 \times 30 = \mathbf{\$1,950}$  per month after age 65. In this example, upon wind-up, the funded ratio is assumed to be **75%**.

Again, based on the above “worst-case scenario”, until age 65 they would be getting \$1,000 per month from a combination of the PBGF and the pension plan, plus 75% of the “excess amount”, i.e. 75% of \$2,335, or \$1,751 from the Plan, for a total amount of \$2,751 or **82.5%** of their normal entitlement.

After age 65, this retiree would be receiving \$1,462.50 from the Plan, plus \$250 from the PBGF, for a total of \$1,712.50, or **88%** of their normal entitlement of \$1,950.

Example: Using the same example as above, but with a wind-up ratio **90%**, the retiree would be entitled to the following.

Until age 65 they would be getting 90% of \$3,335, or \$3,002 from the Plan and \$100 per month from the PBGF, pension plan, for a total amount of \$3,102 or **93%** of their normal entitlement.

After age 65, this retiree would be receiving \$1,755 from the Plan, plus \$100 from the PBGF, for a total of \$1,855, or **95%** of their normal entitlement of \$1,950.

Example: If an auto parts worker had retired on Oct. 1, 2005 with 30 years of service at age 65, with a benefit rate of \$48 per month per year of service, they would be receiving a pension of  $\$48.00 \times 30 = \mathbf{\$1,440}$  per month. In this example, upon wind-up, the funded ratio is assumed to be **70%**.

Of the first \$1,000, the pension plan would be paying \$700 and the PBGF would be paying \$300, while the amount above \$1,000, namely \$440, would be paid by the plan at 70%, or \$308.

Based on the above scenario, the retiree would be entitled to a total amount of **\$1,308** or **91%** of their normal entitlement

Example: Consider the surviving spouse of a retiree who had retired in 2004, and who is presently receiving a monthly pension of \$1,200. If the wind-up funded ratio was **70%**, then the surviving spouse would be entitled to a monthly pension of \$840 from the pension plan, and an additional \$300 from the PBGF. This spouse would be receiving a total **\$1,140** per month, or **95%** of their original entitlement.

[For simplicity's sake, in the above examples we have ignored indexing and any spousal options. Any indexing which has occurred 3 or more years prior to the wind-up date, and any such spousal options are both subject to the PBGF]

## **GM, Ford and Chrysler**

Based on the most recently filed reports by the auto majors, the funded status of their pension plans is as follows; on a wind-up basis GM was at 57%, Ford was at 73.5%, while Chrysler was at 91%. On a going concern basis, which is based on the Plan continuing indefinitely, GM was at 81%, while Ford and Chrysler were both above 100%. Since the filing of these reports, market conditions have deteriorated, and the value of the investments in these Plans will have declined.

## **Non-Pension Benefits**

Health Care, other insurance benefits as well as other benefits are provided on a pay as you go basis. That means that there is no fund set aside for the purpose of paying these benefits – they are paid for from the company's general revenues, either through premiums to insurance companies or through direct payments. In a "worst case scenario", a bankruptcy would mean that there would be no source of funding for benefits current and future retirees.

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