COUGHLIN
employee benefits specialists

COURIER

OCTOBER 2011

AT A GLANCE ...

COUGHLIN
employee benefits specialists

Government heads ponder retirement tsunami

Senior members of the federal cabinet and public service have been meeting to address the looming rise in health care and retirement benefits costs that will result from the pending retirement of baby boomers, *The Globe and Mail* reports.

According to the newspaper, Finance Minister Jim Flaherty and the most senior members of the civil service met recently to discuss Canada's rapidly aging workforce and the growing strain retirees will place on the funding of health care and related social services.

With the leading edge of the baby boom population facing retirement in 2011-12, the need to address the retiree health care funding issue is considered to be of such importance that it *"shouldn't be overshadowed by the current focus on wildly fluctuating stock markets,"* the newspaper reports.

"The oldest baby boomers start to turn 65 in 2011, meaning the dependency ratio will start to increase significantly in a matter of months," says a report developed by Privacy Council Clerk Wayne Wouters.

While warnings about the impact of the pending mass retirement of the largest segment of the population have been published for years, the immediacy of the retirement wave has forced government leaders to tackle the issue, despite economic uncertainty.

"The need to address current challenges must not keep us from tackling the key questions that affect our future prosperity," Mr. Flaherty is quoted as saying.

As much as one-quarter of the Canadian population will be over the age of 65 by 2036, reducing the ratio of workers to retirees from the current level of roughly 4:1 to an estimated 1:1.

"A Canada where seniors outnumber children is uncharted territory," Mr. Wouters' report says.

While the government has introduced measures to encourage workers to remain in the workforce, such as providing more generous Canada Pension Plan benefits to those who work beyond the normal retirement age, more drastic — and visible — measures are being contemplated, the *Globe and Mail* says. Among them: raising the minimum retirement age and dramatically increasing immigration levels. However, a royal commission on the issue may be required to gauge and build public support for such reforms.

Complicating federal health care planning is the scheduled renewal of the health care transfer agreement between the federal government and provinces in 2013. With federal health care funding transfers growing at a rate of six per cent per year, the ability of the Canada Health Transfer Program to channel even more money to the provinces for health care without raising taxes will be a significant challenge.

With the aging population issue unlikely to disappear, expect hard negotiations between the federal government and the provinces on health care funding issues.

"It's a real problem," says retired federal Human Resources Minister Monte Solberg, whose former ministry manages the Canada Pension Plan, Old Age Security, Employment Insurance and other social programs. *"It's easily the largest unfunded liability that we have, without question. We have this wave coming at us and there is no extra money set aside to address it."* ❧

To see the future, look at teachers' pension plans

While the prospect of a pending retirement boom may be daunting, governments and plan sponsors need only to look at the impact the retirement tsunami has had on other pension plans.

A good place to look: the pension plans of the nation's teachers.

The teaching profession was one of the first segments to face the impact of the baby boom population. As the population bulge hit the schools, employment increased, climaxing in 1970s.

Then, the baby bust occurred.

According to Ontario Teachers' Pension Plan President Jim Leech, the number of teachers paying into that province's pension peaked in 1970 when the ratio of active teachers paying into the plan for each retiree was 10:1. Today it is 1.5:1.

"We're 20 years ahead of the demographics," Mr. Leech says. *"If people want to know what having fewer workers per retiree means, all they have to do is look at us. We went from having a huge surplus in 1990 to a deficit."*

Mr. Leech warns that as the ratio of workers to pensioners reduces, the impact of investment losses becomes especially painful. For example, with a 10:1 ratio, the Ontario Teachers' plan could increase its premiums by 0.5 per cent for each 10 per cent loss in asset value. By 1990, when the active member to retiree ratio was 4:1, a 10 per cent decline could be handled by a two per cent increase in premiums. Today, a four per cent increase is required.

"It's a huge issue. We've done a lot of work but it's not fixed," the pension plan president says.

Compounding the problem: Plan members are retiring earlier and living longer.

"Back when we had a 10:1 ratio, people worked for 35 years and retired for 20. Today, they're working for 26 years and retiring for 30," he says. *"All the actuarial assumptions we made in 1970 were right except for life expectancy."*

And, with today's volatile equity markets, generating additional revenue through increased exposure to equities is not a viable option, Mr. Leech says.

"Just at the time you need greater investment income, you can't prudently take the risk to get it," he says.

While it may be cold comfort for Mr. Leech and the members of the various teacher pension plans across the country, it appears they will soon have company as they grapple with the retirement boom. ❧

2011 mini-crash erodes pension liquidity

The liquidity ratios of Canada's pension plans once again went into a tailspin following the summer 2011 mini-crash of world equity markets.

After recovering from the 2008-09 market crash, where equity markets lost almost 50 per cent of their value, the world's stock markets flirted with their pre-crash highs in April 2011. However, the markets once again crashed on worries about the potential bankruptcy of Greece and other European nations and growing concern about the United States' ability to meet its growing debt obligations.

Marching in lock step with the equity roller coaster were liquidity ratios of Canada's corporate pension plans.

According to estimates published by Aon Hewitt, the average funding ratio of corporate pensions in Canada slipped from 97 per cent in July 2011 to 85 per cent as of August 8, 2011. With further declines experienced in late August and early September, funding slipped to 78 per cent.

Compounding the problem is the drop in government bond yields, with 10-year yields slipping from 3.47 per cent to 2.88 per cent. According to pension industry guidelines, each percentage point drop in bond yield increases a pension plan's liabilities by 15 per cent.

The TSX roller coaster October 2010-September 2011

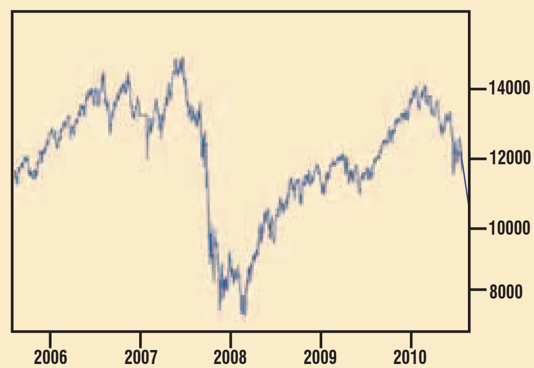
From its April 2011 high, the TSX index has lost 15 per cent of its value. Liquidity ratios of pension plans have followed suit.

For pension managers, this past summer's volatility wiped out many of the strong gains — and improved pension liquidity — recorded in the economic recovery of 2010.

While the sharp decline has once again left pension managers with the prospect of injecting more money into their plans in order to improve their funding ratios and meet their regulatory obligations, the mini-crash of 2011 still remains relatively tame compared to the 2008 slide. During that time, pension liquidity ratios were eroded to the 70 per cent level, leaving some plan sponsors facing potential bankruptcy.

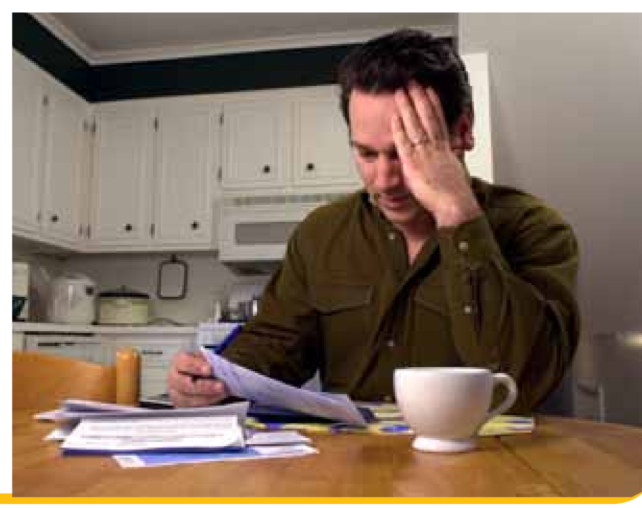
The relative tameness of the 2011 market mini-crash compared to the 2008 debacle can be seen on the following chart:

TSX results 2006-2011



While the TSX exchange lost more than 15 per cent of its value in August 2011, its losses are still relatively conservative compared to the 50 per cent fall experienced in the 2008 crash.

While a rapid market rebound is always a possibility, it would be prudent for pension plan sponsors and administrators to prepare for a difficult year-end, where investment performance and plan liquidity ratios turn negative compared to last year. ❧



What does the loss of half an "A" really mean?

Global equity markets plunged this past summer when the Standard & Poors rating agency downgraded its credit rating of the United States from AAA to AA+, the first downgrade of the American economy since 1941.

The rating cut compounded market concerns about ultimate solvency of Greece and, potentially other Euro zone countries including Portugal, Ireland, Italy and Spain.

With equity markets already down by almost 15 per cent from mid-April, pension plans and other equity-based investment vehicles faced mounting losses as an important measure of economic confidence in the US disappeared.

If the world's largest economy no longer enjoys an AAA rating, which countries still enjoy that confidence? Following is the list of countries that still have Standard & Poors' highest rating:

Australia, Austria, Canada, Denmark, Finland, France, Germany, Hong Kong, Liechtenstein, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, United Kingdom.

While the reduction to AA+ status is a blow to both the world economy and American pride, the United States can hardly be classified as a dubious place for equity investments by pension plans and mutual funds.

Countries with the same AA+ rating from the S&P include New Zealand and Belgium, both considered safe havens for equity investment and economic management.

Canadians also have experienced the stigma of an AA+ rating. Canada was downgraded to the AA+ level in the 1990s when it experienced similar debt management concerns as those now being faced by the United States. It regained its AAA status in 2005.

Countries with an even lower yet but still credible AA or AA- rating include Bermuda, China, the Czech Republic, Estonia, Japan, Kuwait, Qatar, Saudi Arabia, Slovenia and Spain. ❧

One in four re-admitted following depression

One-quarter of those hospitalized for depression are re-admitted or require emergency room treatment within 30 days of discharge from hospital, according to a study released by the Centre for Addiction and Mental Health (CAMH).

According to the CAMH study, published in the *Canadian Journal of Psychiatry,* only 63 per cent of those treated for depression received follow-up care with a physician following their release from hospital. That compares to 99 per cent for those hospitalized for heart failure.

Of the 13,000 people the CAMH study tracked following their discharge for treatment for depression, 5,000 did not receive appropriate care, the organization reports.

"The data tells us that while 63 per cent of people who were hospitalized did see a physician within a month of leaving hospital, many did not, resulting in increased visits to the ER or repeat hospital stays," says Dr. Elizabeth Lin of the CAMH Department for Social and Epidemiological Research.

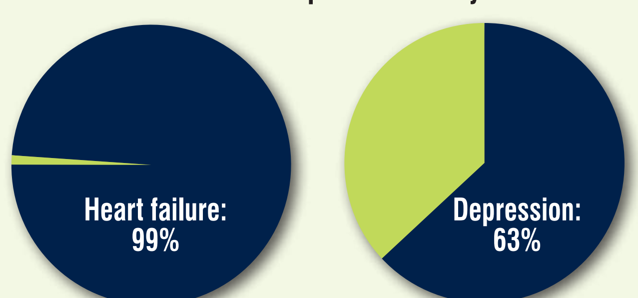
The period immediately following discharge is the most critical time for monitoring potential relapse or suicide.

The difference in follow-up rates between incidents of depression and heart failure is also noteworthy, Dr. Lin says.

"The differences in these rates tells us that there is room for better integration of care and transition planning for people with mental illness," she stressed. *"Hospitals, general practitioners, family health teams and community partners need to be better co-ordinated."*

For plan sponsors, the CAMH study underscores the need for appropriate disability management and follow-up, particularly when a disability involves a mental illness such as depression. Otherwise, higher incidents of recurrence compared to other illnesses should be expected. ❧

Medical follow-up within 30 days



Document pension benefits requiring administrator consent, OSFI says

Pension plan administrators must clearly indicate when their pension benefits are subject to their consent, the Office of the Superintendent of Financial Institutions (OSFI) says.

In a recently released advisory, OSFI states that pension plans that offer benefits that are subject to the administrator's consent, such as unreduced early retirement benefits, have a fiduciary duty to ensure that documents or agreements confirming their right to consent to the payment of benefits be reflected in the terms of the pension plan.

In its investigations, OSFI has found that, despite provisions in some plan texts that state that a benefit is subject to consent, some pensions operate in ways where benefits are not genuinely subject to such consent.

"In order to be considered a consent benefit, an administrator, in its fiduciary role, must have the discretion to grant or deny the benefit," the OSFI advisory says. *"Where an administrator does not have such discretion, the benefit is not a* consent *benefit but rather a* promised *benefit that must be funded."*

In establishing whether a plan is a consent or promised benefit, documents, agreements or correspondence outside of the plan document must be considered and reflected in the terms of the pension, OSFI says. If they are not, the regulator may require administrators to administer the plan without reference to the outside documents. That would effectively turn the consent benefits into promised benefits, requiring specific funding.

The regulator also stressed that member communications must *"clearly indicate that consent benefits are subject to the administrator's discretion and may be denied."*

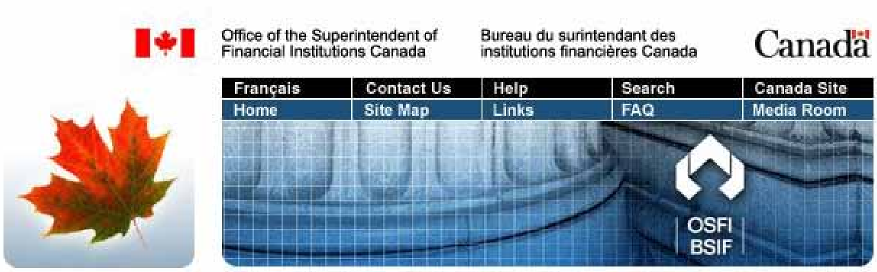
In addition, OSFI says, documented procedures should:

- demonstrate that the administrator has discretion to grant or deny consent;
- describe the administrator's considerations when exercising its discretion; and
- demonstrate that the administrator's considerations are consistent with its fiduciary role.

For pension plan actuaries, the OSFI advisory notes that actuaries should receive confirmation on how consent benefits are handled on a day-to-day basis by the pension plan administrator and how they have been communicated to plan members.

"OSFI allows the exclusion from solvency liabilities of benefits genuinely subject to consent," it notes. *"Where a benefit is excluded from the solvency liabilities because it is subject to consent, the actuary should indicate this in the actuarial report. If...it is determined that the administrator does not have true discretion and these are promised benefits payable from the pension fund, then these benefits should be included in the solvency liabilities."*

Full details of the release entitled *"Benefits subject to consent"* can be seen at: www.osfi-bsif.gc.ca. ❧



Confusing TFSA rules criticized

The federal Taxpayers' Ombudsman has criticised the Canada Revenue Agency (CRA) for failing to clarify its rules regarding withdrawals and over-contributions to tax-free savings accounts (TFSAs).

According to the Ombudsman Paul Dubé, while regulations allowing withdrawals have been published since 2009, the Canada Revenue Agency did not specify that once an individual contributes the maximum $5,000 to a TFSA and then withdraws money from the plan, he/she must wait until the next calendar year to replace the withdrawn funds.

Mr. Dubé's office received more than 72,000 complaints last year from individuals who received notices alerting them that they owed money to the CRA because they had contributed too much to their TSFA.

Most thought they could withdraw funds from their TFSAs and replace it within the same calendar year. While information on the over-contribution rules appears on the CRA website, the agency did not take appropriate steps to let people know where to find that information or the implications of over-contributing, the ombudsman noted.

"The CRA did not do a good enough job alerting people," Mr. Dubé says. *"The TFSA is only tax-free if you follow the rules."*

In response to Mr. Dubé's criticism, the CRA says it will waive the over-contribution fees for those who made a genuine mistake. It will also do more to publicize the TFSA tax rules. ❧

Poor have more cardiac arrests, study says

The poorer you are, the greater your chance of suffering a cardiac arrest, according to data published in the *Canadian Medical Association Journal.*

In a review of 9,000 medical incidents where an individual's heart stopped beating, researchers found that those living in neighborhoods with average annual household incomes of $30,000 were three times more likely to suffer cardiac arrest than those living in areas where household annual incomes ranged as high as $97,000.

The study involved seven US and Canadian cities and included those living at home as well as people confined to assisted living facilities and nursing homes. Incidence rates of cardiac arrest among the poor were significantly higher among those under the age of 65, the study indicated.

Similar research has also suggested that those living on lower incomes face shorter lifespans and increased risks of chronic disease (see February 2010 issue of the *Coughlin Courier* for background.)

"In other words, the poor always do poorly," says study author Dr. Sumeet Chugh of the Cedars-Sinai Heart Institute of Los Angeles.

If this and similar studies prove to be correct over the long term, plan sponsors and administrators should anticipate higher levels of claims activity among plan members with lower incomes. ❧

GM grapples with $2.5 billion retiree health care trust

General Motors of Canada Ltd. has agreed to provide more than $2.5 billion to establish a trust fund to manage the extended health care benefits of the company's 30,000 unionized retirees.

The establishment of the new Auto Sector Retiree Health Care Trust is designed to separate the costs of managing the company's retiree benefit program from the expenses associated with its auto and truck manufacturing.

Separating the two expenses will reduce hourly production costs by $14, the company says. Without the trust fund, hourly labour costs will rise to $70 per hour, compared to $57 in the United States.

While the establishment of the benefit trust has been accepted by both management and the Canadian Auto Workers Union, many GM retirees and survivors have actively campaigned against the fund, arguing that its proposed funding is inadequate.

According to actuarial valuations, the proposed funding is enough to provide only 77 to 84 per cent of the plan's coverage.

"The contributions by GM Canada will not be sufficient to maintain the retiree health care benefits at their current levels," according to information prepared by retirees. *"It is expected that benefits will have to be reduced or otherwise modified to ensure that the available funds will be sufficient to look after the needs of current and future retirees."*

The establishment of a separate retiree benefits trust fund was a condition of the $10.8 billion bailout provided by the federal and Ontario governments when the auto manufacturer faced bankruptcy in the 2008-09 recession.

Retirees have campaigned to be allowed to vote on the new benefits arrangement.

"If you're going to start taking away our benefits and negotiating downward, it would be nice if we could protect ourselves with a vote," says retiree negotiating committee representative Gord Vickers. *"We have a collective agreement and we expect them to honour it. We want the commitment that people retired with."*

GM has suggested that the continued production of the Chevrolet Impala in Oshawa may depend on the acceptance of the new health care trust by its workers and retirees.

If adopted, plan funding will occur in two stages, with $1 billion being contributed by General Motors in 2014 and $1.5 billion in 2018. ❧

Biologics gradually dominating drug plans

The impact of biologic drugs on health care spending continues to grow at double digit rates, according to information published by Green Shield Canada.

According to the Green Shield 2010 *Drug Trends Study* of more than 56 million drug claims from 2005 to 2010, the use and impact of biologic medications (drugs developed from living cells, tissues and micro-organisms using highly controlled manufacturing processes) on drug plans continues to be significant.

Among its findings:

- the total market share of biologics has grown from 8.3 per cent of drug spending in 2005-06 to 11.3 per cent in 2009-10, an annual growth rate of 12.1 per cent;
- while the most expensive five per cent of drug claimants account for 40 per cent of drug plan costs, almost half of those costs are now derived from biologic drugs; and
- those age 35 to 44 have the highest annual growth rate in drug costs, thanks largely to the use of biologic medications.

While biologic drugs have a far higher success rate than traditional chemical-based medications, their costs far exceed those of older pharmaceuticals. For example, the newly developed vaccine Provenge, used to treat prostate cancer, costs $100,000. To date, many of the newly developed biologic drugs are immunomodulators and anti-neoplastics, used to treat illnesses such as rheumatoid arthritis, Crohn's disease, ulcerative colitis, psoriasis and certain cancers.

However, their expansion into other treatment modalities is just a matter of time. According to a Thompson Reuters-Newport study of US drug trends, 6,000 biologic drugs were in clinical trials in 2009. That compares to 1,200 in 2005. The study predicts that by 2014, six of the top 10 drugs on the market will be biologics.

Already, the top 12 biologic drugs account for $30 billion in US drug spending, the Thompson Reuters-Newport study says.

For plan sponsors with drug plans, biologic drugs is one issue that can be expected to dominate their claims experience — and its related costs — in the near future. ❧

PPN update

The **Loblaw Drug Store** pharmacy network has joined the Coughlin & Associates Ltd. Preferred Provider Network. To see if a Loblaw pharmacy is located near you, check the pharmacy locator on the Coughlin website at www.coughlin.ca ❧

Need back issues of the Coughlin Courier?

Just scan this icon with your *iPhone*® or *Blackberry*® device to go directly to a listing of previous issues of the *Coughlin Courier.* ❧

Fast facts

- Effective October 1, 2011, the basic Old Age Security benefit will increase to $537.97 per month.

- Canada is tied with Britain to be the fourth largest holder of pension funds in the world. According to the *Towers Watsons Pensions & Investments* rankings of 300 of world's largest pension funds, Canada controlled five per cent of the world's pension assets.

  The top five asset holders by percentage were:

United States	34%
Japan	19%
Netherlands	6%
Canada	5%
United Kingdom	5%

- The Ontario government has proposed an amendment to its Employment Standards Act that would allow workers to take up to eight weeks of unpaid leave to care for a friend or family member with a serious injury or illness. Current legislation allows such leave but only for those caring for the terminally ill. The government has also called for the proposed benefit to be integrated with Employment Insurance benefits.

- Approximately 10 per cent of employees experience a substance abuse disorder during their working lives, according to a 2009 study by the National Institute on Drug Abuse. Those with mental disorders are more than twice as likely to have a substance abuse problem, data indicates.

- A 2010 US study by Unum Insurance says that only 50 per cent of employees receive printed information on their employee benefits plan such as booklets or brochures. That compares to 70 per cent in 2008. The percentage that had access to that information on-line has also declined, from 51 per cent in 2008 to 36 per cent today.

- Percentage of Canadians covered by supplemental health care insurance, as reported by the *Deloitte Survey of Health Care Consumers:* 79.

- The average weekly earnings of public sector workers increased from $756.01 to $1,023.20, or 35 per cent between 2001 and 2011, according to data released by the Canadian Taxpayers Federation. The earnings of workers in the private sector increased from $598.81 to $777.69, or 30 per cent, it says.

- Percentage of Canadians reporting their overall health as *"very good"* or *"excellent"* in 2011, according to the *Deloitte Survey of Health Care Consumers:* 55. In 2009: 60 per cent. Percentage reporting to have a chronic illness: In 2011: 52. In 2009: 47.

- A total of 66 per cent of Americans age 65 or older say that Social Security benefits account for 50 per cent or more of their retirement income. More than one-third say Social Security benefits make up 90 per cent or more of their retirement income. At current benefit and funding levels, the Social Security trust fund is projected to be exhausted by 2036.

- While the market rebound of 2009 and 2010 eased funding pressures on US pension plans, the market turmoil experienced in the second quarter of 2011 has once again undermined assets of US pension plans. According to estimates from Credit Suisse, 243 of S&P 500 companies had asset funding ratios of 80 per cent or less as of September 2011, up from 166 companies at last report.

- The ranking of Canada's 10 largest pension plans on the Towers Watson list of the world's 300 largest pension funds:

Pension plan	**Rank**
Canada Pension Plan	8
Ontario Teachers' Pension Plan	20
Ontario Municipal Employees Retirement Service	47
Quebec Government and Public Employees Plan	67
Federal Public Service Pension Plan	80
Hospitals of Ontario Pension Plan	81
Quebec Pension Plan	89
BC Municipal Pension Plan	112
Local Authorities Pension Plan (Alberta)	173
BC Public Service Pension Plan	184

- Single people are more likely to die sooner than those who are married, according to the *American Journal of Epidemiology*. Based on its study of 95 different research papers on mortality dating back to 1912, the *Journal* extrapolates that the risk of death for single males is 32 per cent higher than for their married counterparts. Single women have a 23 per cent increase in mortality risk than married women. ❧

The Coughlin Courier is published by Coughlin & Associates Ltd.
Board of directors: Brian Bockstael, Kirby Watson, Mark Hogan, Brent Moore & Ken Kaitola
Editor: David Whitbread **Graphic designer:** Victor Lima