

CSS Recommended Contribution Rate Increase

Background

Under the Rules of the CSS Pension Plan, each employer must set a “matched” contribution rate between 1% and 9% of salary or total compensation. While employers are free to set any rate within this range, the Plan sets a recommended “matched” contribution rate that is reviewed and adjusted from time to time. In the past CSS has tested the recommended rate periodically, offering guidance on the pension levels that might be generated by various contribution rates, long-term interest rates and investment returns.

When setting the Plan’s recommended rate, CSS attempts to balance two conflicting objectives – pension adequacy¹ and contribution affordability.² While there is no guarantee in a defined contribution pension plan like CSS, in general terms, the objective is to set a recommended rate that is likely to generate an estimated retirement income of approximately 70% of final five-year average earnings after thirty-five years of service.

Current Rate Distribution

The Plan’s most recent recommended “matched” contribution rate of 5% on earnings up to the CPP YMPE limit, and 6% on earnings thereafter was adopted in 1988 in response to CPP contribution rate increases then occurring.³ The prior recommended “matched” contribution rate was 6% applied to all earnings. As demonstrated in Chart 1 on page 2 below, the vast majority of the Plan’s 439 employers did not change their “matched” contribution rate in 1988, when the Plan’s recommended rate was reduced from 6%/6% to 5%/6%.

The following observations can be made about the contribution rate distribution shown in Chart 1:

- Most CSS employers have set a “matched” contribution rate in excess of the Plan’s recommended 5%/6% contribution rate.
- Employers are using the flexibility permitted by the Plan’s Rules to set contribution rates that are suitable to their particular circumstances. Some have adopted a contribution rate below the CSS recommended rate, either to control costs or because they wish to permit their employees to contribute to non-pension retirement savings options. Others have adopted a contribution rate in excess of the Plan’s recommendation.

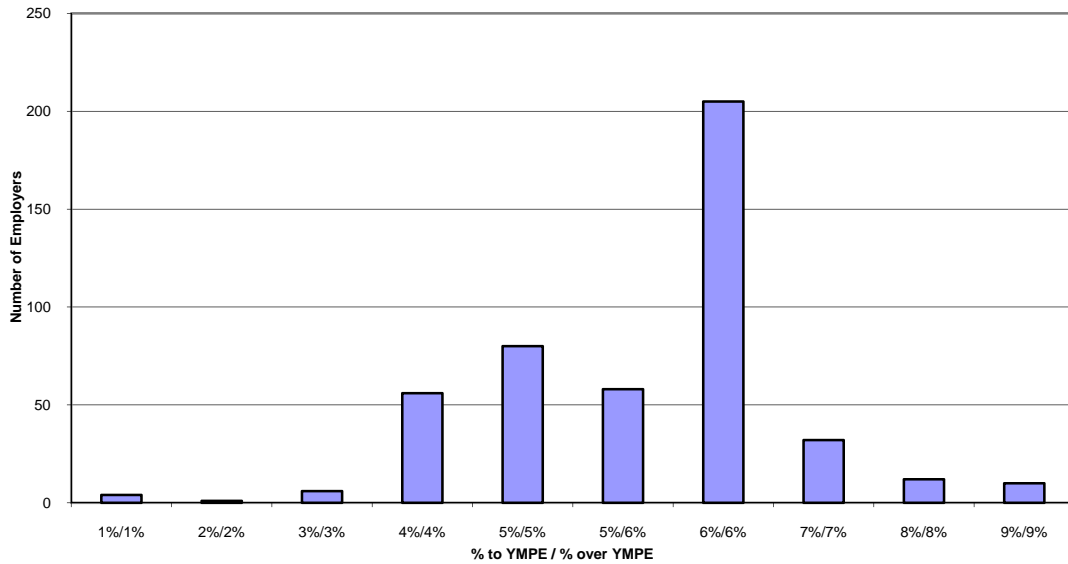
¹ “Adequacy” refers to the rate of contributions necessary to produce a satisfactory pension result for the employee.

² “Affordability” refers to the rate of contributions that represents an acceptable total cost for the employer and the employee.

³ Until the end of 2008, the CSS recommended contribution rate was a ““matched”” rate of 5% of salary up to the Canada Pension Plan (CPP) Yearly Maximum Pensionable Earnings (YMPE) threshold (which is \$46,300 for 2009) and 6% thereafter. A ““matched”” contribution rate is one where the stated percentage (5%/6%) is deducted from the employee’s salary for each pay period and then “matched” by an equal contribution made by the employer. Where an employer adopts the CSS recommended contribution rate therefore, the total amount remitted to the Plan for each pay period was 10% up to the YMPE and 12% thereafter.

Chart 1

Employers' Matched Rates



2008 Contribution Rate Review

Last fall, the CSS Board of Directors directed Management to conduct a review of the Plan's recommended "matched" contribution rate. The purpose of the review was to reassess the adequacy and affordability of the current 5%/6% recommended rate, given the likelihood of a Balanced Fund loss in 2008, and the possibility of lower average investment returns going forward.

The 2008 review considered three different contribution rates:

- 5% of salary to CPP YMPE and 6% thereafter (5%/6%). This was the Plan's recommended contribution rate from 1988 to 2008.
- 6% of salary to the CPP YMPE and 6% thereafter (6%/6%). This was the Plan's recommended contribution rate before 1988.
- 6% of salary to the CPP YMPE and 7% thereafter (6%/7%).

CSS and CPP pensions were estimated for employees at four different annual salary levels: \$40,000, \$60,000, \$80,000 and \$100,000. Estimates were calculated for a member retiring (i) at age 60 with 35 years of service and (ii) at age 65 with 40 years of service. Average CSS Balanced Fund returns in the future were assumed at 6%, 7% and 8%. All calculations used a pension conversion rate of 5%. The Plan's actual average conversion rate in 2008 was 5.02%.

The review confirmed that for members retiring at **age 60 after 35 years of service:**

- A 6%/6% contribution rate will produce a total pension income (CSS + CPP) in the range of 65% to 70% of final five year average earnings assuming a long-term average Balanced Fund return of 7%.

The review confirmed that for members retiring at **age 65 after 40 years of service:**

- A 6%/6% contribution rate will produce a total pension income (CSS + CPP) in the range of 75% to 86% of final five-year average earnings assuming a long-term average Balanced Fund return of 6%.⁴

Pension Estimates

The charts appearing in the Appendices on pages 5 to 8 show expected total retirement income (CSS+CPP) as a percentage of an employee's final five-year's average salary. The estimates were calculated assuming 2.5% inflation, a 3.5% annual wage increase, total CPP contributions of 9.9% and a 5% pension conversion rate. Separate charts were created for starting annual salaries of \$40,000, \$60,000, \$80,000 and \$100,000. Each chart shows estimated income replacement using "matched" contribution rates of 5%/6%, 6%/6% and 6%/7%, and for average Balanced Fund returns of 6%, 7%, and 8%. The charts in Appendix A assume retirement at age 60 after 35 years of service. The charts in Appendix B assume retirement at age 65 after 40 years of service. The Chart in Appendix C shows the relative proportion of CSS and CPP pension for each salary level using a "matched" contribution rate of 6%/6% and a Balanced Fund average return of 7%.

Observations on Pension Estimates

- Estimated total retirement income decreases as salary level increases. This is because CPP becomes a smaller proportion of total retirement income as salary rises above the CPP YMPE (see Appendix C).
- For employees retiring at age 60 after 35 years of service, an average Balanced Fund return of 8% produces an estimated total retirement income in excess of 70% for all four salary levels and for all three contribution rates tested.
- For employees retiring at age 60 after 35 years of service, an average Balanced Fund return of 7% produces an estimated retirement income in excess of 70% for only the \$60,000 and \$80,000 salary levels, and for only the 6%/6% and 6%/7% contribution rates.
- For employees retiring at age 60 after 35 years of service, an average Balanced Fund return of 6% will not produce an estimated retirement income in excess of the Plan's 70% target (CSS + CPP).
- For employees retiring at age 65 after 40 years of service, all returns, contribution rates and salaries tested produce an estimated retirement income in excess 70% of final five-years average earnings.

Conclusions

Although the Plan's 60 year average return is 8%, the CSS Board has elected to increase the Plan's recommended "matched" contribution rate from 5%/6% to 6%/6%, given the

⁴ Although the Plan's 60-year average return, including the loss suffered in 2008 is 8%, given current market weakness, the Balanced Fund's average return could be lower for some time. For example, over the twenty years from 1959 to 1978, the Plan's average return was only 6.88%

current economic and market environment. This increase will permit employees, and particularly those in the middle salary ranges, to accumulated reasonable balances after 35 years of service, even if the Balanced Fund's average return falls to 7% for an extended time. Should the Balanced Fund's average return fall to 6%, none of the contribution rates tested will reach the Plan's 70% target over 35 years. To make up the shortfall, either a contribution rate higher than those tested, or a delayed retirement would be necessary. In this regard it can be noted that all rates tested reached the Plan's target where an employee delays retirement until age 65 with 40 years of service.

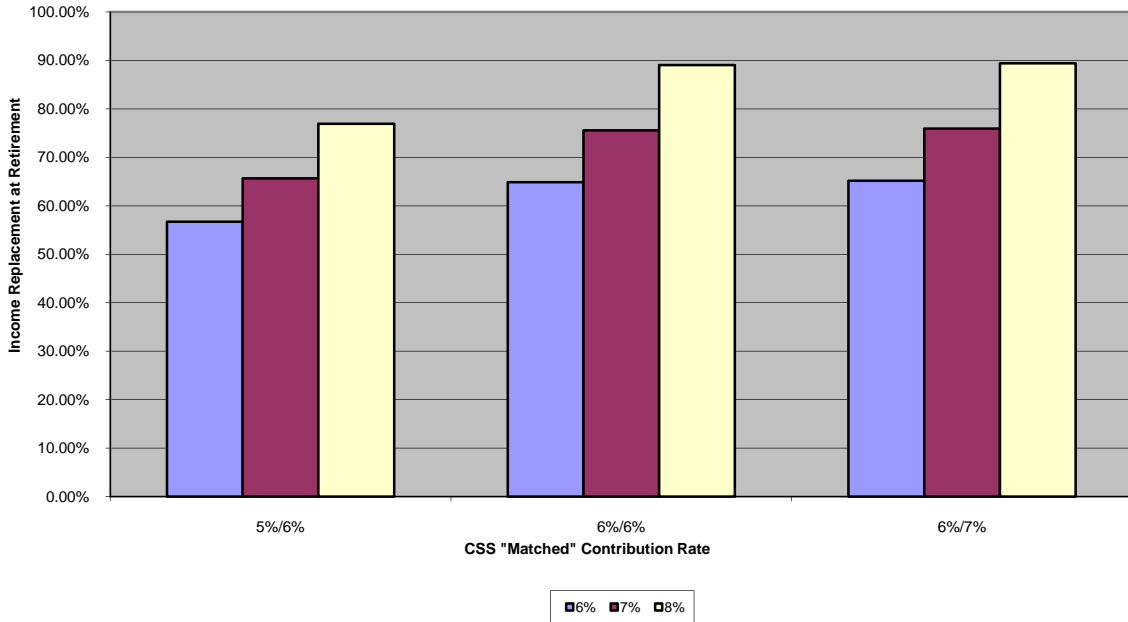
Notwithstanding the Board's decision to increase the Plan's recommended contribution rate to 6%/6%, each employer has the right, under the Plan's Rules to set its own "matched" contribution rate between 0% and 9%. This permits a lower CSS contribution rate to be set where the affordability of "matched" contributions to the employer and its employees is judged to override the level of retirement income to be expected.

It should be remembered, however, that where an employer chooses a "matched" contribution rate that is lower than the Plan's recommended rate of 6%/6%, the issue of pension adequacy could arise. Where an employer chooses to set a contribution rate that is significantly lower than the Plan's recommended rate, employees should be advised that their CSS account will probably only provide a portion of their retirement income. In such a case employees should be encourage to save additional funds for retirement outside the Plan.

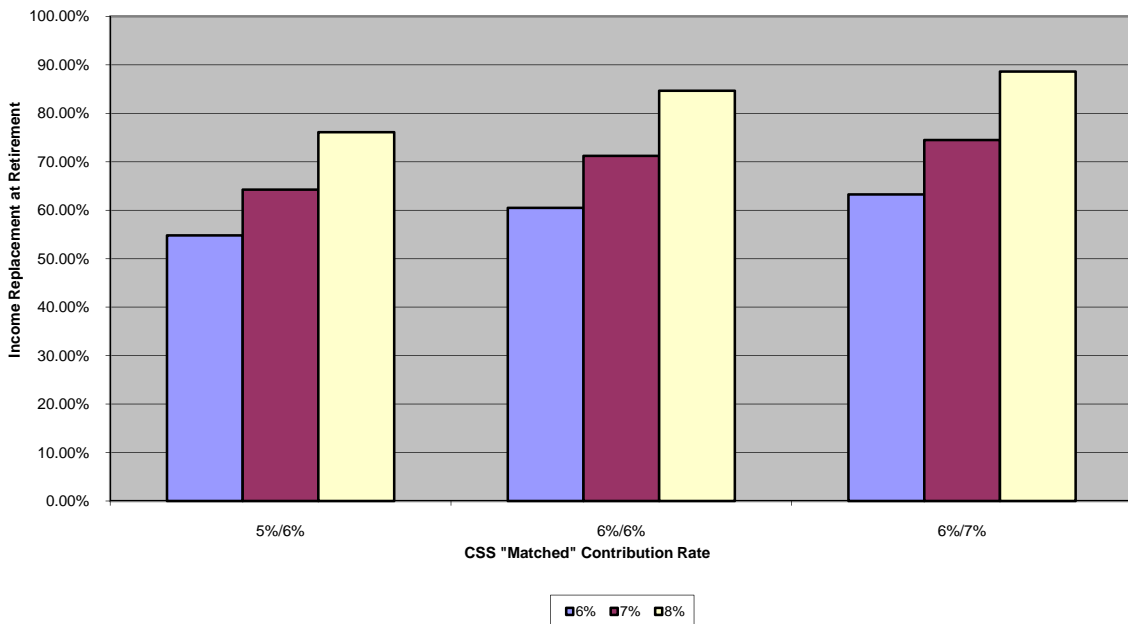
Appendix A – retirement at age 60 with 35 years service

The four charts appearing on pages 5 and 6 show estimated total retirement income at age 60 assuming 35 years of service for “matched” contribution rates of 5%/6%, 6%/6% and 6%/7%, using long-term average Balanced Fund returns of 6%, 7% and 8%.

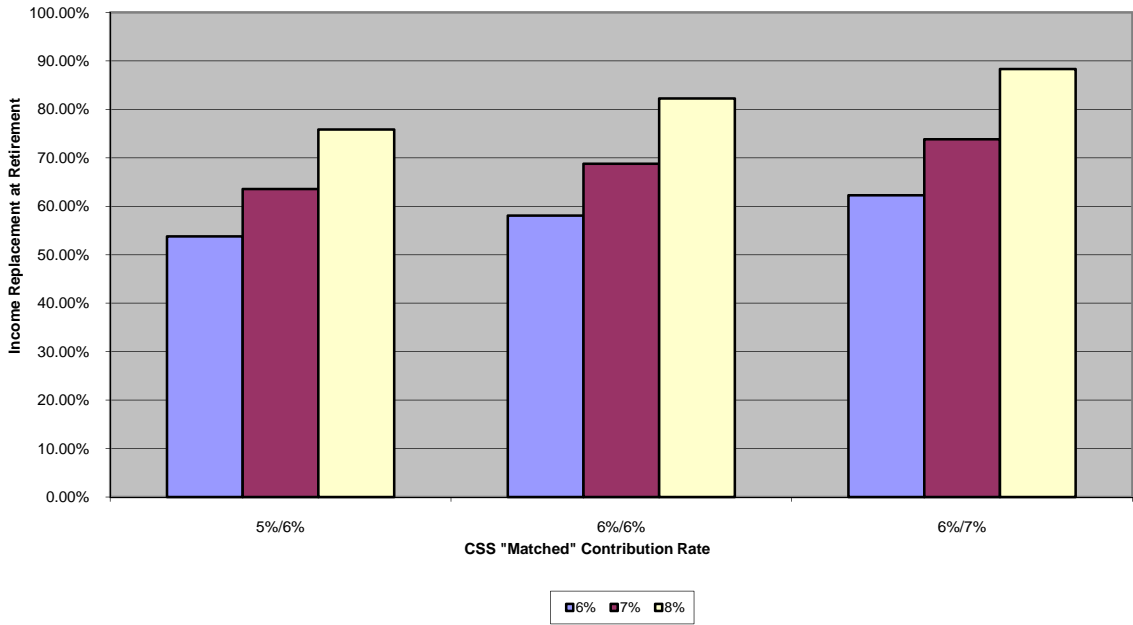
CSS+CPP - Starting Salary \$40,000



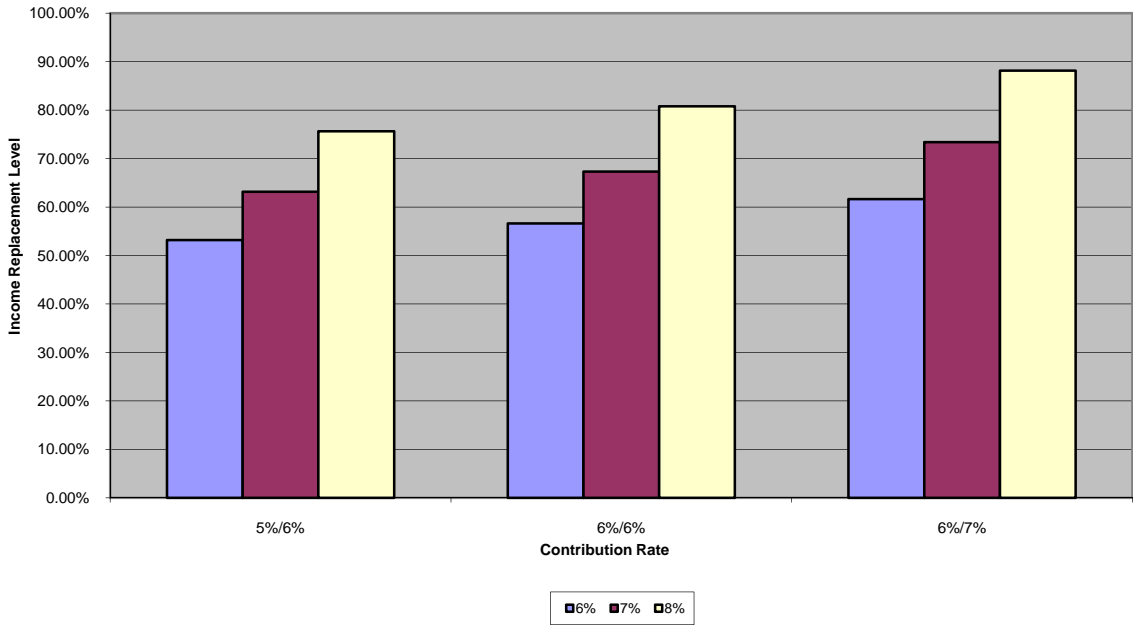
CSS+CPP - Starting Salary \$60,000



CSS+CPP - Starting Salary \$80,000



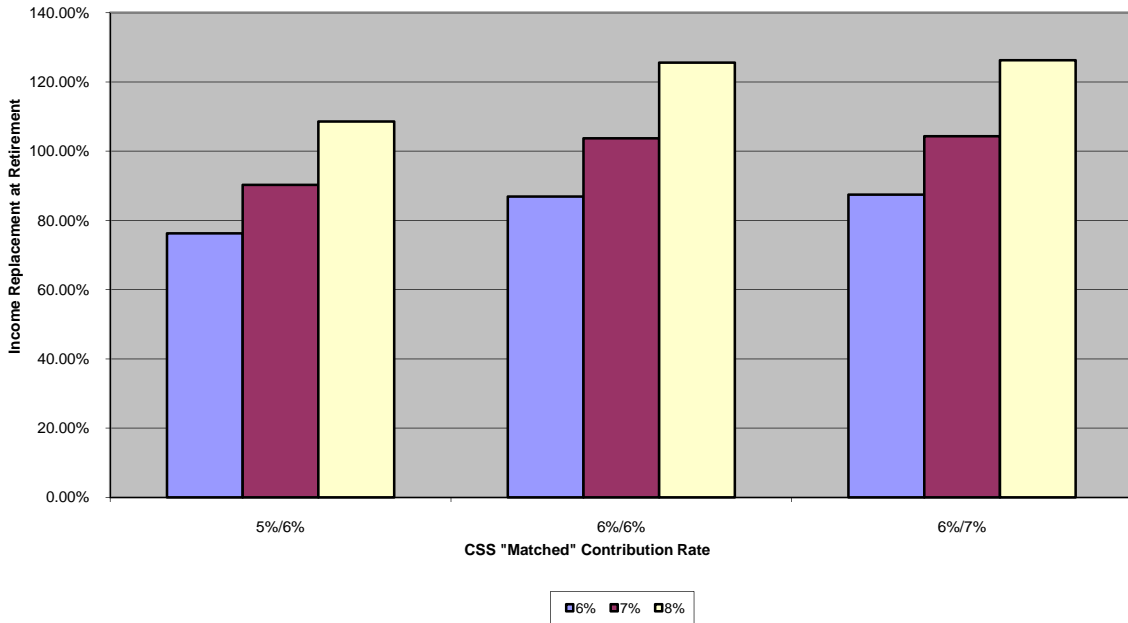
CSS+CPP - Starting Salary \$100,000



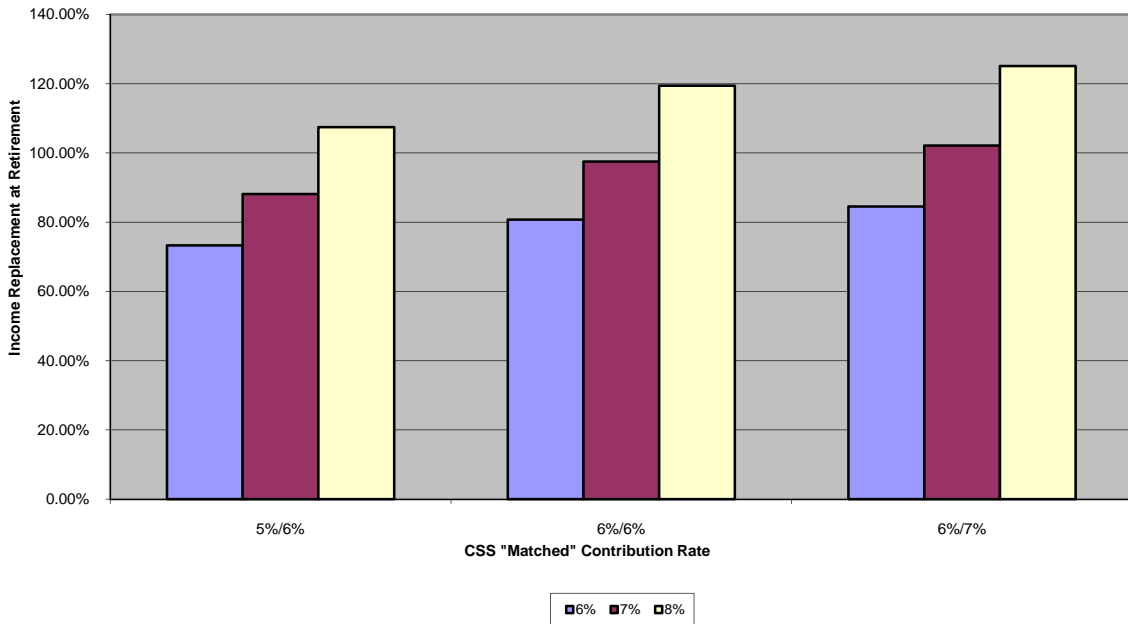
Appendix B – retirement at age 65 with 40 years service

The four charts appearing on pages 7 and 8 show estimated total retirement income at age 65 assuming 40 years of service for “matched” contribution rates of 5%/6%, 6%/6% and 6%/7%, using long-term average Balanced Fund returns of 6%, 7% and 8%.

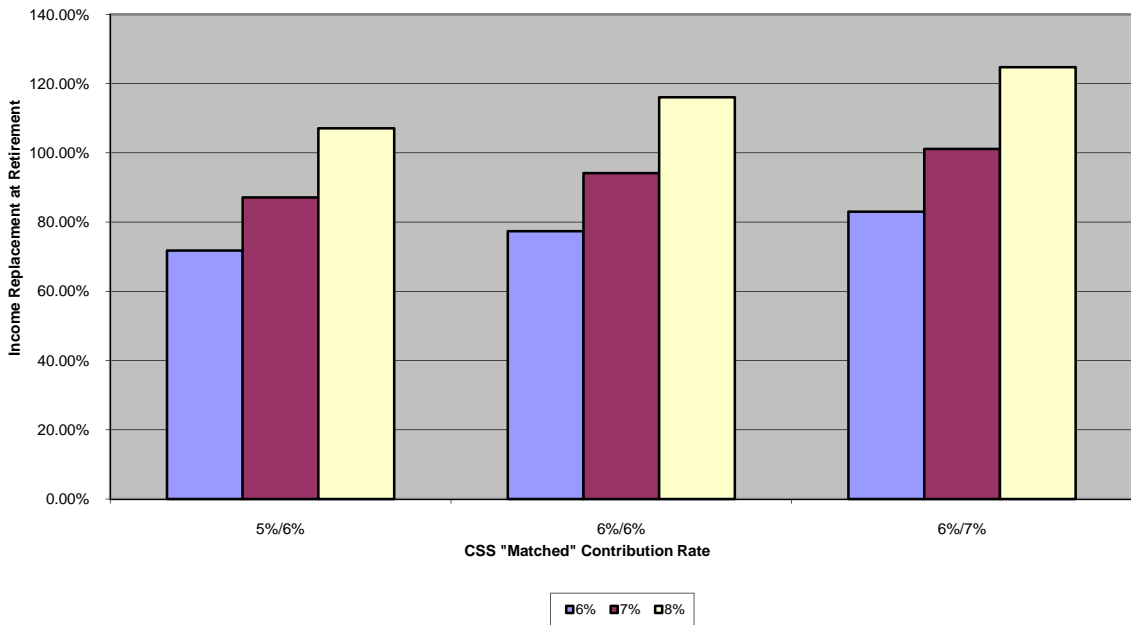
CSS+CPP - Starting Salary \$40,000



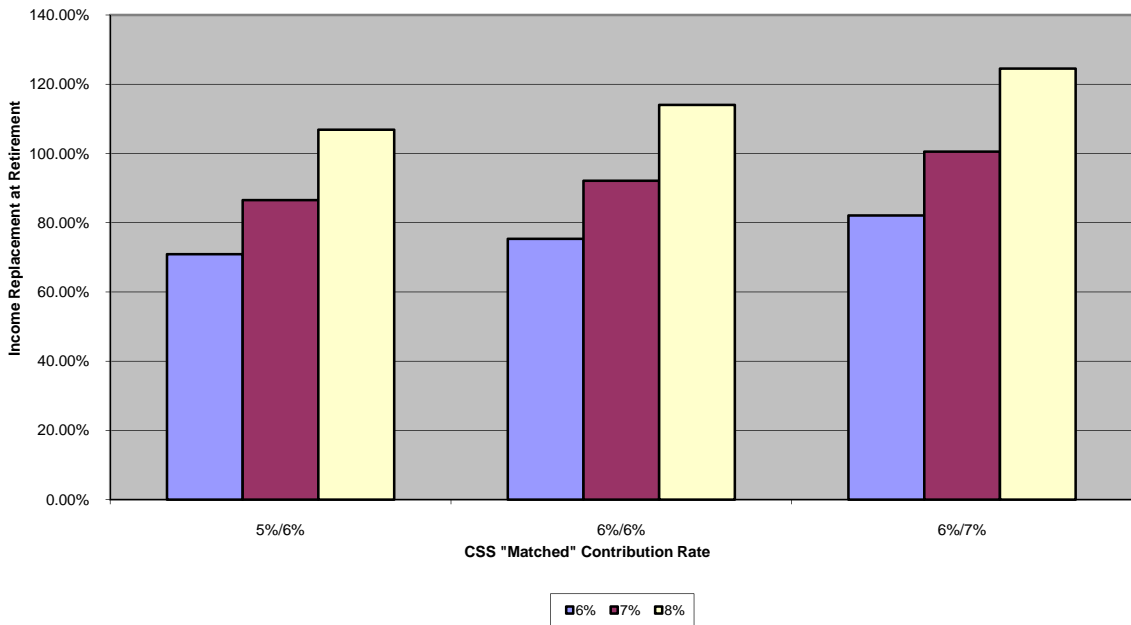
CSS+CPP - Starting Salary \$60,000



CSS+CPP - Starting Salary \$80,000



CSS+CPP - Starting Salary \$100,000



Appendix C - CPP as a share of Total Retirement Income

Assuming a complete working history, with CPP contributions at the maximum throughout the employee's career, the maximum Canada Pension is limited to 25% of final five-years Yearly Maximum Pensionable Earnings (the YMPE is \$46,300 in 2009). The maximum CPP pension is therefore currently \$908.75 per month, regardless of the employee's pre-retirement income in excess of the YMPE.

This means that the amount payable by CPP will form a smaller and smaller portion of the employee's total retirement income as their annual pre-retirement income increases beyond the YMPE. For example in the chart below, the portion of the retirement income received from CPP for an employee earning \$40,000 annually and contributing 6%/6% would be approximately 19.65% of the employee's final five-years earnings, with the balance (84.05%) being the employee's CSS pension. At \$60,000 the CPP percentage drops to 13.48%, at \$80,000 it drops further to 10.11% and at \$100,000, the CPP pension is only expected to be 8.09% of the employee's final five-year average earnings.

Because the CPP does not accrue on earnings in excess of the YMPE, it is necessary for higher income workers to save more for retirement on their own. This can be achieved by making additional voluntary contributions to CSS or by saving in individual registered plans such as RRSP's and Tax Free Savings Accounts (TFSA's).

