Pension News

UBC Faculty Pension Plan
First Quarter 2007 Edition

Page 4:

"The decisions at retirement are challenging: retirees typically want their retirement income to be secure, flexible, and – not unreasonably – as large as possible. In choosing a retirement vehicle there are many trade-offs."

In this issue

LIF-type and RRIF-type Payments

In 2004 the Faculty Pension Plan (FPP) introduced two new options for retirement – LIF-type payments for locked-in (post-1992) funds and RRIF-type payments for non-locked-in (pre-1993) funds. Under these options, retirees have flexibility in the amount they can withdraw for retirement directly from the FPP. The 2nd Quarter 2004 Edition of *Pension News* provides a summary of the options. This article examines the payment patterns in more detail.

Why LIF-type and RRIF-type Payments?

Key objectives in retirement planning include ensuring that accumulated savings are sufficient to provide retirement income for life and also that resources are available for current, immediate needs. (See 2nd Quarter 2002 and 3rd Quarter 2004 Editions of *Pension News*.)

Life Income Funds ("LIFs") and Registered Retirement Income Funds ("RRIFs") are options that are available from financial institutions; LIF-type and RRIF-type payments are options that are available from the FPP. All four options provide flexibility in choosing the amount of annual income each year of retirement; all four allow retirees to participate in the financial markets (good or bad). In addition, the two FPP options allow retirees to continue to invest in the low-cost funds available from the FPP.

This article examines the range of annual income flexibility available from these retirement options as well as the impact of investment earnings and the financial markets.

The rules

Employment pension plans are regulated under the B.C. Pension Benefits Standards Act ("PBSA") and the federal Income Tax Act ("ITA"). These two sets of laws establish rules on how pension plans may allow benefits to be paid. The intent of the PBSA – which came into effect January 1, 1993 – is to ensure that when a member retires, the pension plan will make payments for the member's lifetime. Accordingly the PBSA has

maximum distribution rules for contributions made after January 1, 1993 to ensure that the account balance is not dissipated. The intent of the ITA is to ensure that funds are not indefinitely sheltered from tax in a pension plan, and that amounts are paid and taxed regularly – accordingly the ITA has **minimum** distribution rules for contributions.

LIFs and LIF-type payments allow members to withdraw amounts within the minimum prescribed under the ITA and the maximum prescribed under the PBSA for contributions after January 1, 1993. Within this band, the retiree has flexibility to choose the amount of withdrawal each year. All the while, the retiree can continue to invest the account balance in the financial markets.

RRIFs and RRIF-type payments are retirement income options that allow members to choose any amount in excess of the minimum prescribed under the ITA for contributions made before January 1, 1993, with no maximum.

The limits

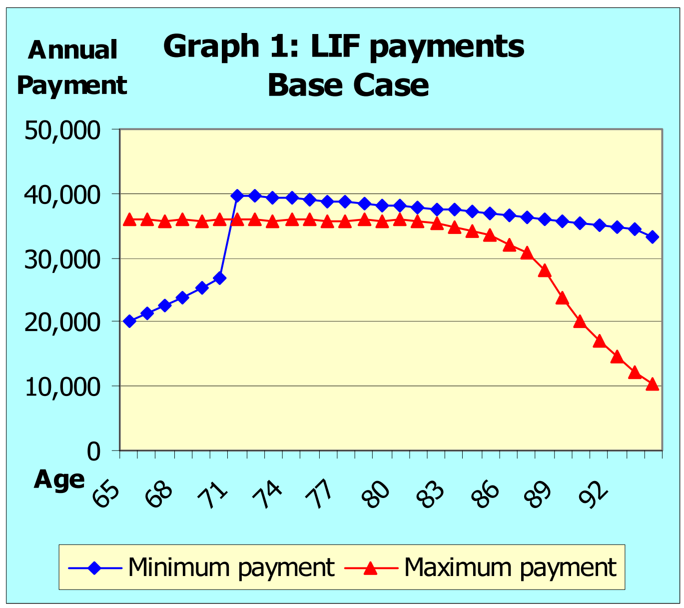
The following table shows the minimum and maximum percentages according to the legislation. The percentages depend on the retiree's age at the beginning of each calendar year; the minimum and maximum withdrawal in a year is equal to the percentage in the table applied to the account balance as of the beginning of the year. The maximum level may change depending on changes in interest rates. If the fund earns a higher percentage rate of return than the maximum withdrawal percentage in the table, the maximum percentage is increased to the fund rate of return.

Age	Min	Max
55	3%	6%
60	3%	7%
65	4%	7%
70	5%	8%
71	7%	8%
75	8%	9%
80	9%	12%
85	10%	16%
90	14%	20%
94	20%	20%

LIF-type payments – Base Case

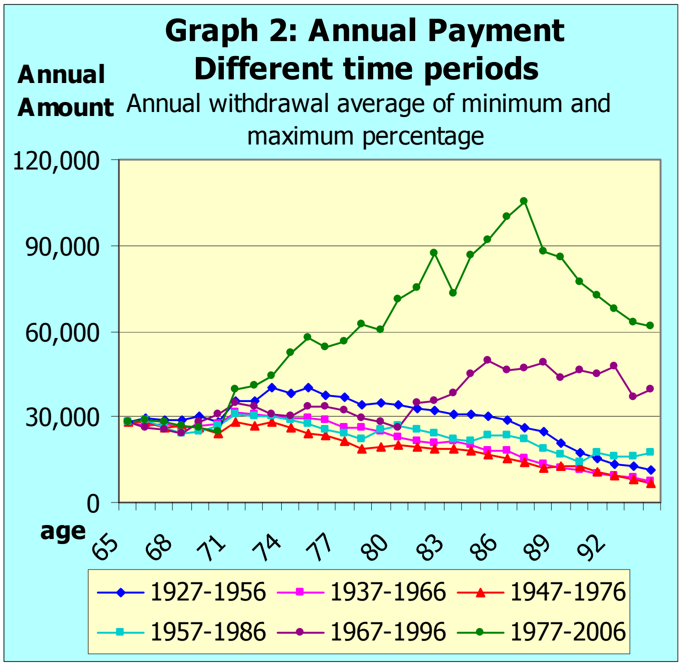
Because the amount of the LIF-type payment depends on the minimum and maximum percentage at each age, and because the value of the account depends on investment earnings, the analysis of the LIF-type option is complex. If a member retires at age 65 with a $500,000 account balance which has 6% investment earnings for 30 years in retirement, his account balance after 30 years will range from a low of $52,000 (if he takes the maximum withdrawal) to a high of $166,000 (if he takes the minimum withdrawal).

The payments under the maximum schedule, as shown in Graph 1, are steady at approximately $36,000 per year, and then decline after age 85. Graph 1 shows that the payment on the minimum schedule starts at $20,000, rises gradually, and starting at age 71, the annual payment under the minimum schedule exceeds the annual payment under the maximum schedule. The minimum schedule for RRIF-type payments is the same as for LIF-type payments; there is no maximum for RRIF-type payments.



Impact of Financial Markets

The financial markets have a substantial impact on the level of income that may be paid from a LIF-type payment. Graph 2 shows the payment schedules of a LIF-type option where the retiree chooses the average withdrawal (between the maximum and minimum) with results based on a mix of 60% Canadian equities and 40% bonds, as they performed over six 30-year periods. It should be noted that because of inflation, the purchasing power of a fixed amount of income was reduced by 50% or more during some of these periods.



Account balances after 30 years under the different market scenarios range from $7,000 to $62,000. The account balance and the annual withdrawal can vary widely – the period 1977-2006 in particular was very good. The period 1947-1976 started off very well, but finished off the worst.

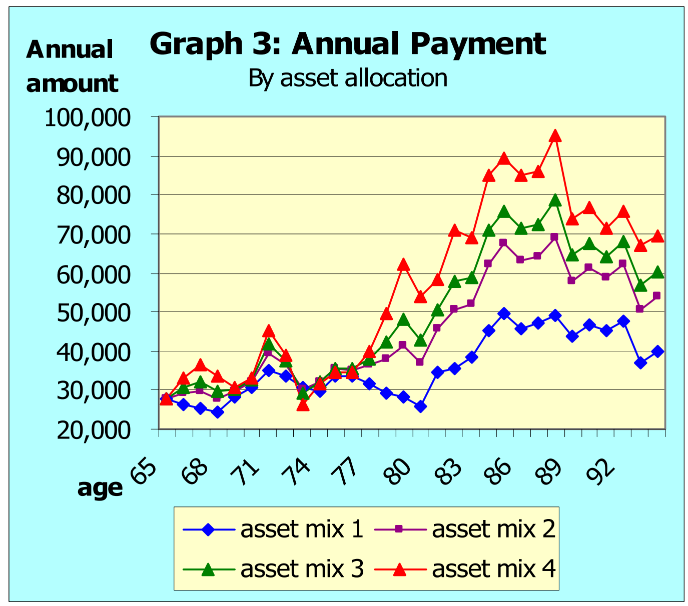
Impact of Asset Allocation

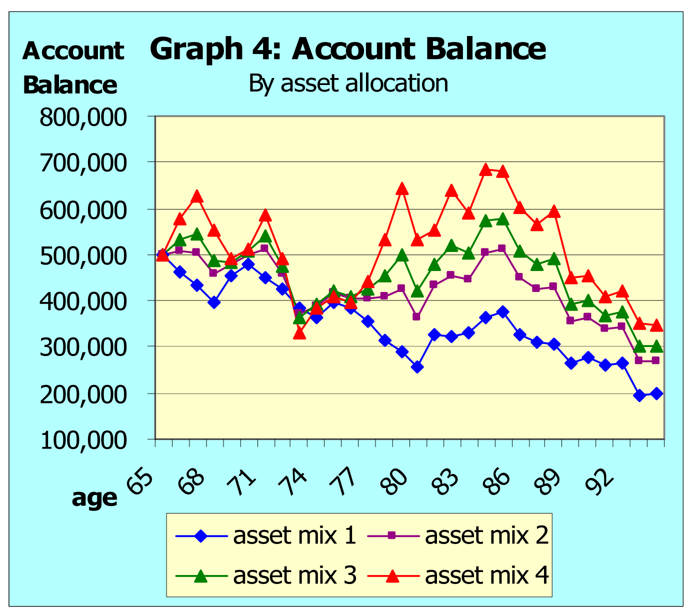
The specific impact of the market changes depends on the allocation of the account to different types of investments. For instance, Graph 2 was based on an allocation of 60% Canadian equities and 40% bonds.

Typically over the long term, the account will perform well with a higher equity content; however, over the short term, a higher equity content will lead to greater year-to-year volatility. The results will also vary depending on the level of foreign content. Graphs 3 and 4 examine the results of four different asset allocations:

	Asset Mix			
	1	2	3	4
Canadian equities	0%	20%	30%	50%
U.S. equities	0%	10%	15%	25%
International equities	0%	10%	15%	25%
Fixed income	100%	60%	40%	0%

The market scenario used is the period from 1967 to 1996 – roughly the "average" scenario of the six time-periods shown in Graph 2, and reflecting a period in which interest rates increased dramatically at the beginning of the period, and declined just as dramatically in the last half. The graphs show that with a higher equity content, the annual payments and account balances are higher, but the year-to-year fluctuations are more substantial than with lower equity allocations.

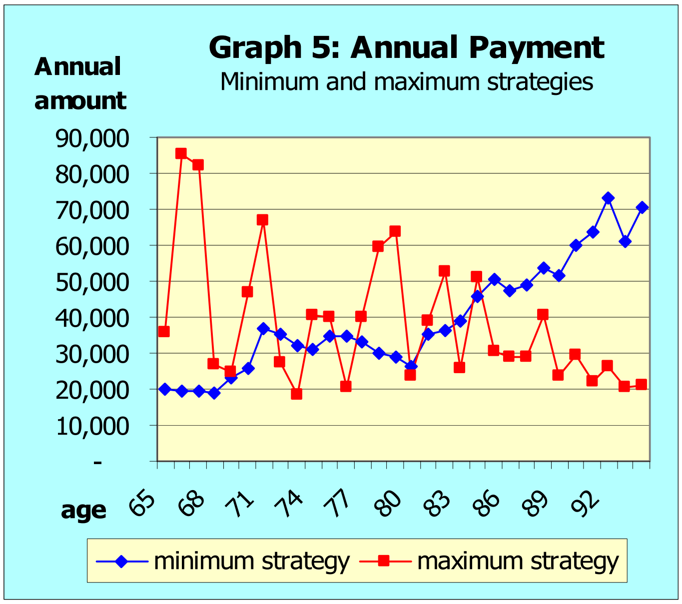


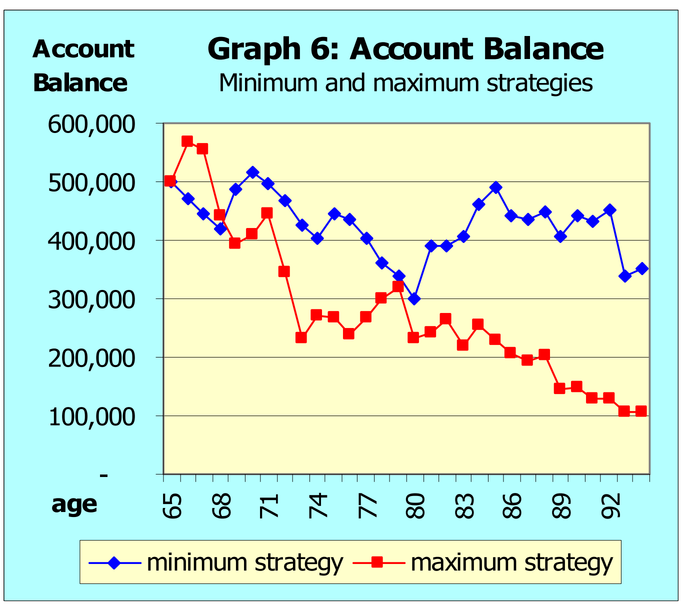


Pension News
UBC Faculty Pension Plan
First Quarter 2007 Edition

Minimum and Maximum Strategies

The final set of graphs show the results of two strategies – the "minimum strategy" is one in which the LIF-type payments are made at the minimum percentage, with the assets invested very conservatively in 100% fixed income (asset mix 1). The "maximum strategy" is one in which the LIF-type payments are made at the maximum percentage, with the assets invested 100% in equities (asset mix 4).





Graph 5 shows that the "maximum strategy" would have delivered some very high annual income amounts in certain years. In those years, the investment returns from the equity markets were much higher than the maximum percentage withdrawal using the PBSA table, so the maximum percentage is increased to the fund rate of return. As shown in the graphs, the "maximum strategy" would have delivered much more volatile payments and accounts balances than the "minimum strategy." The "minimum strategy" led to a more stable account balance, with a final balance of $352,500, and rising income as the minimum percentages increased.

The decision

The decisions at retirement are challenging: retirees typically want their retirement income to be secure, flexible, and – not unreasonably – as large as possible. In choosing a retirement vehicle there are numerous trade-offs.

The analysis in this article demonstrates the flexibility of LIF- and RRIF-type payments, which may be useful for new retirees who intend to travel extensively or purchase retirement property. However, for the individuals who live to very advanced ages (more than 100) – and there are more and more of them – the payments will eventually become very small. The analysis in this article also demonstrates that taking some risk by investing in stocks should increase retirement income, but also increases volatility.

As always, we recommend that members approaching retirement seek advice from a financial advisor in choosing their retirement income options.

This article was prepared by Satanove & Flood Consulting Ltd. Comments should be sent to: fpp@hr.ubc.ca

2007 Adjustment to the Variable Payment Life Annuity (VPLA)

Aon Consulting has calculated the changes in the VPLA values for 2007.

Option	Increase in Value
4% VPLA	8.84%
7% VPLA	5.78%

The increases were effective with the April 1, 2007 retirement payment.

Updated List of Financial Planners Available

Choosing a financial advisor is not an easy matter, so Aon Consulting was hired by the Plan to provide a list of financial planners based on the following criteria:

1. Certified Financial Planner (CFP) or Registered Financial Planner (RFP) designation

These are recognized Canadian qualifications, which indicate a good base of education and training.

2. Minimum three years experience and engaged in financial planning as their primary vocation

Advisors should have a reasonable base of experience, and build on that through ongoing focus on financial planning. Individuals who perform financial planning as a small part of their overall work were excluded.

3. Compensated for financial planning services exclusively on a fee-only basis

Financial planners work under a number of different forms of compensation including fee-only, commissions, fee and commissions, and other combinations. Your retirement decisions may involve choosing between investments and retirement vehicles offered by the UBC Faculty Pension Plan and those offered by outside firms.

If a financial planner is paid through commissions on investment or retirement income products, then that planner will get paid only if you take your money outside the FPP. A financial planner in that situation has a potential conflict of interest in advising you on these decisions. This criterion limits the list to advisors who are not exposed to such potential conflicts. If a planner on the list offers other services on a commission basis, e.g., assistance with implementation or ongoing monitoring of your financial plan, please be aware that this could reintroduce potential conflict with respect to funds that you can choose to manage inside or outside the FPP.

4. Resident in British Columbia

This ensures planners are geographically accessible to Faculty Plan members.

Overall, advisors who meet the above criteria should be able to assist you in making your pension decisions in the context of an overall financial plan. Implementation of a personal financial plan often involves the purchase of financial products and services which are bought and sold on a commission basis. Insofar as your decisions involve purchases of products and services, a 100% fee-only financial planner from the list may not be able to execute them. In that case, you will likely have to implement your plan with the help of other service providers, e.g. your banking and brokerage contacts.

For more information about financial advisors, read the article "Choosing a Financial Advisor" in the 2nd Quarter 2003 Edition of *Pension News*.

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Pension News

UBC Faculty Pension Plan

First Quarter 2007 Edition

Financial Planners (continued)

Caveats

The criteria are aimed at decisions concerning the Faculty Pension Plan. Broader criteria may be appropriate for general financial planning purposes.

The criteria are suggestions only, not recommendations. You may use your own personal criteria for selecting your financial advisor.

If you would like the list of financial planners prepared by Aon Consulting, please contact fpp@hr.ubc.ca or call 604-822-8100.

Voluntary Contributions

Did you know that voluntary contributions are allowed in the Faculty Pension Plan? Any member whose annual pensionable earnings are less than $142,000 may be eligible to make voluntary contributions.

Take advantage of the calculator on the FPP website to calculate what your contribution room may be.

Performance of Funds for periods ending March 31, 2007

	3 Months	1 year	3 years	5 years	10 years
Balanced Fund - gross	1.89%	11.57%	10.87%	8.82%	8.36%
Balanced Fund - net	1.80%	11.19%	10.44%	8.38%	7.94%
Composite Index 1	1.93%	10.33%	10.06%	8.34%	n/a
Canadian Equity Fund - gross	3.67%	14.03%	18.83%	14.49%	11.37%
Canadian Equity Fund - net	3.56%	13.56%	n/a	n/a	n/a
Composite Index 2	2.41%	11.68%	17.24%	13.03%	n/a
Foreign Equity Fund - gross	0.86%	13.47%	10.03%	4.39%	5.85%
Foreign Equity Fund - net	0.77%	13.00%	n/a	n/a	n/a
Composite Index 3	1.46%	14.27%	9.47%	4.80%	n/a
Bond Fund - gross	1.07%	5.14%	4.64%	6.40%	6.83%
Bond Fund - net	1.02%	4.94%	4.42%	6.15%	6.58%
Composite Index 4	0.95%	4.74%	4.84%	6.86%	n/a
Short Term Investment Fund - gross	1.07%	4.25%	3.17%	3.02%	4.51%
Short Term Investment Fund - net	1.03%	4.07%	2.97%	2.81%	4.21%
SCM 91-day T-Bill Index	1.03%	4.19%	3.07%	2.98%	3.74%

Composite Index 1: *33% SCU, 10% S&P/TSX Capped, 5% S&P/TSX, 5% S&P/TSX 60, 15% S&P 500, 15% MSCI-EAFE, 2% SC 91-Day TB, 10% IPDCPI, 5% SC Real Return Bonds*

Composite Index 2: *50% S&P/TSX Capped, 25% S&P/TSX, 25% S&P/TSX 60*

Composite Index 3: *48% S&P 500, 48% MSCI-EAFE, 4% SC 91-Day TB*

Composite Index 4: *86.8% SCU, 13.2% SC Real Return Bonds*

Composition of Funds as at March 31, 2007

	Market Value ($ Millions)	% of Fund
Balanced Fund		
Equities - Canada	233.0	21.0%
Equities - U.S.	155.8	14.1%
Equities - EAFE	163.6	14.8%
Absolute Return Hedge Fund	21.2	1.9%
Real Estate - Canada	111.2	10.1%
Fixed Income	364.8	32.9%
Real Return Bonds - Canada	48.1	4.3%
Cash & Short term	9.8	0.9%
Total Balanced Fund	1,107.5	100.0%
Canadian Equity Fund	70.5	100.0%
Foreign Equity Fund		
Equities - U.S.	19.9	46.9%
Equities - EAFE	20.9	49.3%
Absolute Return Hedge Fund	1.6	3.8%
Total Foreign Equity Fund	42.4	100.0%
Bond Fund		
Fixed Income	20.5	88.4%
Real Return Bonds - Canada	2.7	11.6%
Total Bond Fund	23.2	100.0%
Short Term Investment Fund	28.8	100.0%