Pension Watch

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The last edition... of Pension Watch we looked at Understanding Risk and Return. This edition looks at defining "Risk".

Defining "Risk"

What is investment risk? To the average person risk is most often defined as the probability of finishing with less money than what you had at the start. This can be referred to as capital loss risk. To investment professionals, risk is defined as the annual return variability associated with investing in different asset classes such as stocks, bonds and cash. This may be called variability risk.

There are also many other forms of risk that are of critical importance to the investor. For instance, let's define the savings rate risk as the risk of not saving enough money during your working lifetime to see you through your retirement years. Consider these statistics. Today's generation is living longer, retiring earlier and enjoying a much more active retirement life than any other generation. The average lifespan is now 78 as compared to 72, twenty-five years ago. The average retirement age is now 60 instead of 65. This means investors have to save enough money to last eighteen years as opposed to seven. And what about our government programs? With the influx of baby boomers into retirement life, reliance on government sponsored pension plans will no doubt decline in the next twenty years.

Purchasing power risk can be defined as not having earned enough on your investments to keep up with inflation – so that $1 invested today will still be worth $1 at retirement. The concept of returns after inflation is called "real returns" or "effective yields". For example, if an investment returns 15 per cent and the rate of inflation for the same period is five per cent, the real return or effective yield is 10 per cent (15% - 5%).

Market timing risk occurs when investors try to time the market by selling one investment to buy another. While market timing sounds like a good idea, there is little evidence that it works. Most people who try to time the market end up selling when they should buy and buying when they should sell. In other words, they buy when the prices are high and sell when the prices are low. The performance of the market in the short-term is too difficult to predict. Studies have shown that even the best investment professionals cannot time the market continuously.

So what does this mean to investors? It means that they need to be a lot more knowledgeable about their investment choices. They will need to know how much they need to save, how to establish investment objectives that are likely to meet their retirement needs and how to choose investment options that provide the necessary returns and accommodate their risk tolerance.

GLOSSARY

CAPITAL RISK LOSS: the risk of losing part or all of your initial capital.

VARIABILITY RISK: the risk associated with the annual returns generated in various asset classes.

SAVINGS RATE RISK: the risk of not saving enough money to meet your retirement needs.

PURCHASING POWER RISK: the risk that money invested today will be worth less in future years.

MARKET TIMING RISK: the risk of buying an investment when prices are high and selling when prices are low.

PERFORMANCE COMPARISON

For The Period: Ending Dec. 31, 2002	3 Months %	1 Year %	3 Year %	5 Year %	10 Year %
ACTIVELY MANAGED FUNDS					
Balanced Fund	6.0	-7.7	0.3	3.8	8.9
Canadian Equity Fund	8.2	-14.1	-1.8	3.4	10.5
Overseas Equity Fund (1) (2)	7.2	-18.4	N/A	N/A	N/A
U.S. Equity Fund (2)	6.1	-24.2	-12.6	-2.9	8.2
Dividend Income Fund (3)	8.0	-6.2	15.9	11.3	17.8
Short-Term Bond & Mortgage Fund	1.9	6.4	8.1	6.7	N/A
Bond Fund	2.6	9.6	9.6	7.4	9.2
Canadian Money Market Fund	0.7	2.5	4.2	4.5	4.8
CUMIS FUND					
Retirement Security Fund	5.9 (4)	6.0	6.5	6.9	7.5
PASSIVELY MANAGED FUNDS					
S&P/TSE Composite Index Fund (5)	7.5	-12.4	-6.3	1.4	N/A
U.S. Equity Index Fund (2) (6)	7.9	-22.5	-12.3	1.3	N/A
EAFE Equity Index Fund (2) (7)	6.6	-16.6	-14.6	-0.8	N/A
Universe Bond Index Fund (8)	2.2	8.8	9.1	7.0	N/A
Conservative Balanced Index Fund (9)	3.8	-2.8	1.0	4.3	N/A
Moderate Balanced Index Fund (10)	5.1	-6.4	-1.3	4.2	N/A
Aggressive Balanced Index Fund (11)	6.2	-10.5	-4.2	2.8	N/A
INDICES					
S&P/TSX Composite Index	7.5	-12.4	-6.3	1.3	9.1
S&P 500	8.0	-22.7	-11.9	1.4	11.8
MSCI EAFE	6.0	-16.6	-14.7	-0.9	6.3
ScotiaMcLeod Universe	2.3	8.7	9.0	6.9	8.9
30 Day T-bills	0.7	2.4	4.0	4.2	4.5

(1) Overseas Equity Fund merged with Euro-Pacific Equity Fund March 9, 2001
(2) Subject to Canada Customs and Revenue Agency Foreign Content Limit of 30%
(3) Only available under group RSP and DPSP contracts
(4) Annualized
(5) Fund Inception: October 1999. Performance prior to November 1999 is for TSE 300 Equity Index Fund
(6) Fund Inception: January 2000. Performance prior to February 2000 is for Barclays U.S. Equity Index Fund - Canada
(7) Fund Inception: June 1999. Performance prior to July 1999 is for EAFE Equity Index Fund B
(8) Fund Inception: October 1999. Performance prior to November 1999 is for Universe Bond Index Fund
(9) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset mix and index returns
(10) Fund Inception: June 1999. Performance prior to July 1999 is modeled using the benchmark asset weights and index returns
(11) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset weights and index returns

NEWS FROM THE GOVERNMENT

Manitoba LIRA/LIF/LRIF administrative requirements

In 1992, the Manitoba Pension Commission introduced a revised Regulation for the purpose of expanding portability and retirement options to the Locked-In Retirement Account (LIRA) and Life Income Fund (LIF). The Locked-In Retirement Income Fund (LRIF) was introduced through an amendment to the regulation, which came into force on August 14, 1998.

Over the past few years, a number of issues have arisen concerning the administration of LIRAs, LIFs and LRIFs. Each topic below is followed by points, which clarify related issues, and expands upon provisions that must be followed when dealing with LIFs, LIRAs or LRIFs.

Beneficiary Requirements

Upon a member or former member's death, prior to the purchase of a life annuity, the surviving spouse or common-law partner is automatically the primary beneficiary, unless the spouse or partner has received or is entitled to receive a division of benefits due to the break-up of the marriage or common-law relationship. As the primary beneficiary under the Act, the surviving spouse or partner of a member or former member takes priority over any other designated beneficiary. LIRA funds payable to a surviving spouse or partner are locked-in, whereas LIF and LRIF funds are available in a lump sum.

Upon the death, prior to the purchase of a life annuity, of the owner of a LIRA, LIF or LRIF who is a former or surviving spouse or partner of a member or former member, the balance in the fund may be paid to the designated beneficiary, or estate, in a lump sum. If the owner of a LIRA whose funds originate from a division of assets or death benefits remarries or enters into a common-law relationship, the spouse or partner is not automatically entitled to survivor benefits.

Written Notice When Transferring Funds

When transferring funds to a LIRA, LIF or LRIF, the plan administrator or the financial institution, as the case may be, is required to provide clear written advice to the financial institution that is to receive the funds. Such advice should indicate that the funds to be transferred are locked-in and must be administered accordingly, and the transferor should be satisfied that the receiving institution has acknowledged the nature of the locked-in funds, prior to releasing the funds. It is the responsibility of the party transferring the funds to determine the form the written advice and acknowledgement will take. At a minimum, such advice should include the source of the funds, reference to the funds being locked-in, and the jurisdiction under which the funds are locked-in.

Transferring Funds Between Institutions

When locked-in monies are transferred from a pension plan to a LIRA, LIF or LRIF, only companies listed on the Superintendent's List of Financial Institutions are eligible to hold locked-in pension funds.

Break-Up of the Marriage or Common-Law Relationship

Upon the division of a couple's family assets, either by court order or written agreement, the spouse or common-law partner automatically becomes entitled to 50% of the pension benefit earned during the period of the marriage or common-law relationship. The administrator of the pension plan, under which the pension benefits were earned, must be contacted in order that the spouse's or partner's share of the pension can be calculated.
In the event that the plan administrator cannot be located, or is unable to calculate the spouse's or common-law partner's share of the pension, the parties may wish to retain an actuary at their own expense to calculate the spouse's or partner's share in the manner prescribed by the Act and Regulation. Otherwise, the spouse's or partner's share of the pension is assumed to be 50% of the present value of the LIRA, LIF or LRIF fund.

Pension Waiver Form Requirements Under LIFs or LRIFs

The member or former member and their spouse or common-law partner must both complete a "Pension Waiver Form" allowing the member to choose an alternative form of pension payment to the Joint and Two-thirds pension required by the Act. The plan administrator, or financial institution administering the LIRA, is responsible for ensuring the waiver is executed prior to the funds being released.

A Pension Waiver Form is also required when funds are transferred from a LIF or LRIF to purchase a life annuity on behalf of a member or former member. It is the responsibility of the financial institution administering the LIF or LRIF to ensure the waiver is executed in the event the annuity being purchased provides for no survivor benefits to the spouse or common-law partner or lesser survivor benefits than the required Joint and Two-thirds.

Some financial institutions may request that a copy of the executed Pension Waiver Form accompany any transfer documents for members or former members purchasing a LIF, LRIF or Life Annuity.

Minimum Calculation Under LIFs or LRIFs

Institutions may use the spouse's or common-law partner's age, or any method permissible by Canada Customs & Revenue Agency. In the case of the LIF, if the use of a spouse's or partner's age results in a minimum value greater than the maximum, then the owner's or purchaser's age must be used.

Maximum Calculation Under LIFs

For the LIF maximum, institutions may only use owner's or purchaser's age.

Manitoba LIRA, LIF and LRIF amended January 1, 2003

Amendments were made effective January 1, 2003, to the Pension Benefits Regulations regarding the LIRA, LIF and LRIF. The amended regulation includes the following key changes:

- The interest rate used to calculate the LIF maximum has been modified and a simplified formula with prescribed annuity factors has replaced the old formula for calculating the maximum.
- The annual maximum withdrawal amount available to a LIF or LRIF owner, who is between ages 54 and 65, has been increased by permitting the owner to apply to the financial institution for a temporary income.
- The requirement for a LIF owner to purchase an annuity at age 80 has been removed.
- The requirement to prorate the maximum withdrawal in the first or initial year has also been removed under both the LIF and LRIF.

Government Retirement Programs - 2003

Old Age Security
(First Quarter of 2003)

Basic Benefits	GIS max. single	GIS max. married	Spouse's Allowance	Widow/Widower
$453.36	$538.80	$350.95	$804.31	$887.98

	Canadian Pension Plan 2003	Canadian Pension Plan 2002	Quebec Pension Plan 2003	Quebec Pension Plan 2002
YMPE				
Basic Exemption	**39,900.00**	**39,100.00**	**39,900.00**	**39,100.00**
Contribution Rate	**3,500.00**	**3,500.00**	**3,500.00**	**3,500.00**
- employee	4.95%	4.7%	4.95%	4.7%
- employer	4.95%	4.7%	4.95%	4.7%
- self-employed	9.9%	9.4%	9.9%	9.4%
Annual contribution (maximum)				
- employee	1,801.80	1,673.20	1,801.80	1,673.20
- employer	1,801.80	1,673.20	1,801.80	1,673.20
- self-employed	3,603.60	3,346.40	3,603.60	3,346.40
Retirement benefit (maximum)	**801.25/mo**	**788.75/mo**	**801.25/mo**	**788.75/mo**
Death benefits				
- lump sum	2,500.00	2,500.00	2,500.00	2,500.00
- spouse maximum under				
55	444.96	437.99/mo	670.76	660.24/mo
65	444.96	437.99/mo	700.06	695.37/mo
- spouse maximum over 65	480.75	473.25/mo	480.75	473.25/mo
- orphan (per child)	186.71	183.77/mo	59.28	58.35/mo
Disability benefits				
- contributor (maximum)	971.26	956.05/mo	971.23	956.02/mo
- child (per child)	186.71	183.77/mo	59.28	58.35/mo

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