

Indexation

Each May, we will indicate the extent to which our monthly pension income will be adjusted for inflation. What follows below is a precise account of how this amount is determined.

With regard to indexation, our Plan is conservative in two ways. The Plan recognizes that inflation at 2% is a (targeted) reality. Moreover, adjustments are made only if the Plan performs well, so that the adjustments do not erode the capital base of the Plan and compromise the defined-benefits objective of the Plan. This conservatism is captured by a “structural” parameter that plays an important role in the calculations that follow.

1. The empirical input to any year’s calculations begins with the inflation rate. This number is simply the change in the CPI index. The target rate (set by the Bank of Canada) is 2%. That the target has not been met after so many years of 2% (and less!) inflation has spawned much policy discussion. From our perspective, what counts is that the purchasing power of our pensions is effectively discounted by the CPI rate.

2. We next assess Plan performance in two ways:

- The average Plan nominal return over the last five years is first calculated. We subtract an imposed threshold of 5%. This 5% number is one of the “structural parameters” referred to above.
- The average real Plan return over two years is determined; real return is the nominal return minus the CPI rate

3. The first step in the computation of the Plan’s indexation figure deals with the portion of inflation that is greater than 2%. The maximum adjustment to this portion of inflation is bounded by the post-threshold rate of return. In other words, the post-threshold rate determines what is available to deal with inflation over 2%. If the Plan hasn’t performed well enough, the difference (in % terms) could be covered by Plan performance in future years. Effectively, this is added to a running total that is owed us and could be paid by good Plan performance in future years.

4. Concerning the first 2% of inflation. Here the computation parallels the previous calculation but is based on the two-year average of real returns. We now subtract our “structural” 5% to arrive at a number that could be positive or negative. It is added to a second running total. This total is what is available to meet the first 2% of inflation.