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Frequently Asked Questions

Some companies rated by Standard & Poor's Ratings Services in Canada continue to experience rating pressure due to the size of their pension and other benefit obligations. Two years ago, we identified a group of companies that we felt could be sensitive to pressures from unfunded postretirement obligations. (Please see article, "Unfunded Postretirement Liabilities Could Pressure Select Canadian Corporates," published Aug. 6, 2003, on RatingsDirect, Standard & Poor's Web-based analysis credit system.) The following report summarizes the changes that have occurred in the past two years.

Frequently Asked Questions

How has the level of pension funding changed in recent years?

In general, the level of pension funding has not changed substantially in the past two years. Some companies demonstrated improvement, while others have continued to show some minor deterioration in the unfunded levels of their plans. Of the 17 companies originally surveyed, nine have demonstrated improvements in their funding levels while eight have shown some minor deterioration. Another company, ACE Aviation Holdings Inc. (formerly Air Canada), was added to the survey given its emergence from bankruptcy protection with a sizable pension deficit.

What has happened to asset returns and pension contributions in the past two years?

There have been good gains in returns on pension assets in the past two years. The average investment returns for the companies in this study were 9.8% in 2004 and 11.3% in 2003 (see table 2). These returns were materially above the estimated rates of return assumed by the companies and primarily reflected good performance in both fixed income and equity markets in the past two years.

At the same time, companies have increased their contributions to their pension plans (see table 1). Almost every company has increased its contribution to its pension plan in comparison with 2002.

If pension returns have been so strong and companies have increased their funding levels, why has there not been universal improvement?

The primary reason for the lack of improvement in pension returns is the decline in long-term interest rates. All companies in this study have had to lower their discount rates used in estimating the present value of their pension obligations. The decline in discount rates in the past two years has ranged from 25 bps to 100 bps. As the estimated pension obligation is very sensitive to changes in the discount rate, the effect is material. Other factors, such as actuarial adjustments, have also played a role in certain cases. Alcan Inc. was also affected by obligations assumed with the takeover of Pechiney S.A.

Has there been an effect on ratings in the past two years?

Post-retirement obligations have had an effect on some ratings. Stelco Inc. filed for bankruptcy protection in the fall of 2003. And although the company filed after a period of low steel prices, it has also cited a need to deal with its onerous post-retirement obligations. Other companies, such as Bombardier Inc. and Alcan have experienced declines in the ratings. In both cases, post-retirement obligations were not the direct factor in leading to the rating changes, but rather were viewed as contributory factors. In addition the outlook on Alliant Inc. was revised to negative in May 2005 due to increased competitive pressures, as well as increased post-retirement obligations and related funding requirements.

In other cases, required pension funding has acted as a constraint to potential credit improvement. Canadian Pacific Railway Co. (CPR) has had to materially increase its pension contribution over the past two years—potentially preventing this cash from being used for other uses, such as debt repayment. CPR's continuing pension deficit and unfunded benefit obligations continue to act as a constraint to the ratings on the company, which has offset its good operating performance through the past couple of years.

The ratings on Ace Aviation/Air Canada also continue to be somewhat constrained by the large deficit in its plans. Air Canada erased most of its balance-sheet debt during its bankruptcy reorganization, but its pension deficits survived. Interestingly, the amount of pension assets under management at ACE Aviation exceeds the balance-sheet assets of the airline itself! The future performance of its pension plans will be a key driver of the ratings on the company.

Have there been any changes to pensions on the regulatory front?

In May 2005, the Canadian Department of Finance launched consultations on the rules governing defined pension plans that operate under federal jurisdiction (this includes the railways and airlines). Currently, federal regulations require that firms with solvency deficits (that is assumptions are based on the plan being terminated) fund these deficits within five years; going concern deficits are to be funded over 15 years. Among items for consultation are ideas that could increase funding flexibility for companies that have a deficit in their defined benefit plans (perhaps by increasing the time period for funding pension deficits). There has been some precedent already in that Air Canada, in a concession obtained during its restructuring, has been allowed to fund its solvency deficit over 10 years instead of five years.

What are the continuing implications for corporate credit ratings?

Long-term interest rates have declined about 50 bps since the end of 2004. Should rates remain at this level,

it is likely that the funding deficits will increase in 2005 (barring strong equity returns for the balance of the year). In the longer term, the situation is unsettled; given the sensitivity of post-retirement obligations to interest rates, an increase in long-term interest rates could do much to increase the funding levels of these companies. An increase in interest rates, however, could very well have a materially negative effect on equity returns.

We will continue to monitor developments in pension funding for these companies and provide periodic updates as part of specific company reports.

	Unfunded 2004 (C\$)	Unfunded 2002 (C\$)	Change in discount rate (2002 vs. 2004) (bps)	Average investment return (2003-2004) (%)	Change in employer contribution (Average of 2003-2004 less 2002)
Abitibi-Consolidated Inc.	779.0	791.0	50.0	10.6	31
Alcan Inc.*	2,916.0	1,421.0	50.0	15.0	67
Aliant Inc.	438.0	298.0	50.0	13.0	70
Ace aviation Holdings Inc.¶	1,534.0	1,155.0	75.0	10.0	148
Bombardier Inc.*§	1,926.0	1,736.7	44.0	8.2	280
CHC Helicopter Corp.**	103.7	31.6	89.0	2.7	N.A.
Canadian National Railway Co.	84.0	61.0	75.0	10.1	35
Canadian Pacific Railway Co.	604.3	457.3	75.0	10.6	214
Dofasco Inc.	(7.0)	(48.4)	25.0	12.4	(6)
Falconbridge Ltd.*¶¶	181.0	176.6	100.0	7.9	39
Inco Ltd.*	776.0	805.0	100.0	11.8	108
Norbord Inc. (formerly Nexfor Inc.)*	12.0	125.0	93.0	11.6	N.M.
Noranda Inc.*¶¶	167.0	210.0	99.5	11.9	56
Norske Skog Canada Ltd.	102.1	96.4	50.0	7.9	4
Nortel Networks Ltd.	2,180.0	1,801.0	60.0	11.1	187
Quebecor World Inc.	400.9	405.4	70.0	12.5	56
Stelco Inc.§§	875.0	650.0	50.0	11.8	32
Teck-Cominco Ltd.	61.0	142.0	75.0	12.0	32

*Figures in U.S. dollars. ¶2002 represents Air Canada. §Fiscal year end January. Results in 2002 originally reported in Canadian dollars; converted to U.S. dollars at the applicable year-end exchange rate. **Fiscal year-ended April 30. ¶¶2002 Results originally reported in Canadian dollars; converted to U.S. dollars at the applicable year-end exchange rate. §§Under creditor protection as of Jan. 29, 2004. N.M.--Not Meaningful.

	Abitibi Consolidated Inc.			Alcan Inc.*			Aliant Inc.			Ace Aviation Holdings Inc.¶		
	2004	2003	2002	2004	2003	2002	2004	2003	2002	2004	2003	2002
Rate of return (actual return/average plan assets) (%)	9.3	11.9	(3.6)	10.6	19.5	(5.9)	10.5	15.6	(5.6)	9.0	14.4	(6.8)
Expected return on plan assets, pension plans	7.5	7.8	8.0	7.0	7.1	7.1	7.5	7.5	7.5	7.5	7.5	8.0
Discount rate for benefit obligations	6.0	6.3	6.5	5.3	5.6	5.8	6.3	6.8	6.8	6.0	6.0	6.5
	Bombardier Inc.*§			Canadian National Railway Co.			Canadian Pacific Railway Co.			CHC Helicopter Corp.**		
	2005	2004	2003	2004	2003	2002	2004	2003	2002	2004	2003	2002
Rate of return (actual return/average plan assets) (%)	8.0	8.5	(15.4)	11.1	9.2	(0.3)	10.2	11.1	(1.8)	12.0	(8.9)	(1.9)
Expected return on plan assets, pension plans	7.4	7.4	8.0	8.0	8.0	9.0	8.0	8.0	8.0	6.7	7.3	7.2
Discount rate for benefit obligations	5.4	5.6	5.8	5.8	6.0	6.5	6.0	6.3	6.8	5.6	5.8	6.5
	Dofasco Inc.			Falconbridge Ltd.*			Inco Ltd.*			Norbord Inc.* (formerly Nexfor Inc.)		
	2004	2003	2002	2004	2003	2002	2004	2003	2002	2004	2003	2002
Rate of return (actual return/average plan assets) (%)	12.2	12.6	2.8	8.8	7.1	7.2	9.3	14.3	(6.3)	8.1	15.1	(6.7)
Expected return on plan assets, pension plans	7.5	7.5	8.0	7.0	7.0	7.0	8.0	8.5	9.0	7.8	8.0	8.0
Discount rate for benefit obligations	6.5	6.8	6.8	5.8	6.3	6.8	6.0	6.5	7.0	5.7	6.1	6.6
	Noranda Inc.*			Norske Skog Canada Ltd.			Nortel Networks Ltd.*			Quebecor World Inc.*		
	2004	2003	2002	2004	2003	2002	2004	2003	2002	2004	2003	2002
Rate of return (actual return/average plan assets) (%)	9.6	14.2	(0.5)	10.7	5.0	(4.7)	9.4	12.8	(5.7)	10.4	14.7	(11.9)
Expected return on plan assets, pension plans	7.2	7.2	7.0	7.5	7.5	7.5	7.4	7.8	7.8	7.8	8.2	8.2
Discount rate for benefit obligations	5.8	6.3	6.8	6.0	6.3	6.5	5.7	5.8	6.3	6.0	6.0	6.7

	Stelco Inc.¶¶			Teck Cominco Ltd.			Average					
	2004	2003	2002	2004	2003	2002	2004	2003	2002			
Rate of return (actual return/average plan assets) (%)	10.9	12.6	(2.8)	10.5	13.5	(2.5)	9.8	11.3	(4.0)			
Expected return on plan assets, pension plans	7.5	7.8	7.8	7.3	7.5	7.5	7.4	7.6	7.7			
Discount rate for benefit obligations	5.8	6.0	6.3	6.0	6.5	6.8	5.9	6.1	6.6			

Source: Company Annual Reports as of Dec. 31. *Figures in U.S. dollars. ¶2002-2003 represents Air Canada. §Fiscal year end Jan. 31. **Fiscal year-ended April. ¶¶Under creditor protection as of Jan. 29, 2004.

Table 3 Post Retirement Obligations										
Annual Report (as at Dec. 31, 2004)										
	Abitibi Consolidated Inc.	Alcan Inc.*	Alliant Inc.	Air Canada	Bombardier Inc.*§	Canadian National Railway Co.	Canadian Pacific Railway Co.	CHC Helicopter Corp.**	Dofasco Inc.	
Pension obligation	3,771.0	11,384.0	1,794.1	11,207.0	5,247.0	13,137.0	6,827.0	543.9	1,088.1	
OPEB obligation	219.0	1,050.0	184.6	842.0	328.0	319.0	469.4	0.0	554.1	
Plan assets - pension plans	2,992.0	8,468.0	1,355.9	9,673.0	3,321.0	13,053.0	6,222.7	440.2	1,095.1	
Plan assets - OPEB	0.0	2.0	0.0	10.0	0.0	0.0	12.1	0.0	1.1	
Unfunded pension obligation	779.0	2,916.0	438.3	1,534.0	1,926.0	84.0	604.3	103.7	(7.0)	
Unfunded OPEB	219.0	1,048.0	184.6	832.0	328.0	319.0	457.3	0.0	553.0	
Unfunded obligations (total)	998.0	3,964.0	622.9	2,366.0	2,254.0	403.0	1,061.6	103.7	546.0	
Pension obligation as a % of total assets***	38.2	33.4	55.6	94.2	32.0	56.7	62.3	31.7	28.6	
Adj. total debt/capital (%)	73.7	55.2	59.5	95.2	81.8	42.7	61.4	68.5	29.9	
Total debt/capital (%)	65.7	48.1	45.5	93.8	62.6	40.9	49.7	60.8	19.4	
	Falconbridge Ltd.*	Inco Ltd.*	Norbord Inc.*	Noranda Inc.*	Norske Skog Canada Ltd.	Nortel Networks Ltd.*	Quebecor World Inc.*	Stelco Inc.¶¶	Teck Cominco Ltd.	
Pension obligation	969.0	3,049.0	51.0	2,035.0	335.4	8,285.0	1,020.1	3,807.0	1,036.0	
OPEB obligation	286.0	999.0	4.0	373.0	178.2	719.0	66.1	1,362.0	229.0	
Plan assets - pension plans	788.0	2,273.0	39.0	1,868.0	233.3	6,105.0	619.2	2,932.0	975.0	
Plan assets - OPEB	22.0	0.0	0.0	30.0	0.0	51.0	0.0	11.0	0.0	
Unfunded pension obligation	181.0	776.0	12.0	167.0	102.1	2,180.0	400.9	875.0	61.0	
Unfunded OPEB	264.0	999.0	4.0	343.0	178.2	668.0	66.1	1,351.0	229.0	
Unfunded obligations (total)	445.0	1,775.0	16.0	510.0	280.3	2,848.0	467.0	2,226.0	290.0	
Pension obligation as a % of total assets***	18.9	28.2	3.7	21.0	11.9	45.9	15.5	N.M.	17.0	
Adj. total debt/capital (%)	40.2	50.4	46.3	55.0	52.1	75.2	59.1	N.M.	22.6	
Total debt/capital (%)	35.9	35.0	45.3	50.8	46.0	51.7	54.3	N.M.	18.2	

*Figures in U.S. dollars. ¶Total assets has been adjusted by capitalizing operating leases. §Fiscal year end Jan. 31. **Fiscal year-ended April. ¶¶Under creditor protection as of Jan. 29, 2004. ***Total assets include capitalized operating leases. N.M.--Not Meaningful.

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