

Special Communiqué

November 21, 2006

2006 Survey on the Impact of Pension Funds on Corporate Financial Results

About Us

Morneau Sobeco is a leading human resource consulting firm focusing on the design and delivery of compensation, retirement, and employee benefits programs. With over 1,000 professionals working in 12 cities across North America, we serve more than 1,000 clients.

In addition to its in-depth consulting practice, Morneau Sobeco is recognized for its expertise in the provision of integrated administrative solutions and for its vision in terms of progressive employee self-service tools.

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Morneau Sobeco releases the results of its *2006 Survey on the impact of pension funds on corporate financial results*.

Pension plan risk is only one of a number of risks that companies face. Until recently, investors did not pay much attention to the potential impact a pension plan might have on corporate financial results. However, since the 2001 – 2002 stock market meltdown, financial analysts and rating agencies have been taken pension plans into consideration in their analyses.

Pension plan size in relation to company size is one of the measurements used to estimate the impact that a pension plan could have on corporate financial results. Morneau Sobeco's survey of 100 major Canadian public corporations shows that this ratio did not change significantly during the three-year period ending December 31, 2005. Pension fund assets still account for an average of 18% of total company assets compared to 14% three years ago. The median went from 7% to 8% for the same period.

When one examines pension fund assets in relation to shareholder equity, there has also been some changes: pension fund assets represent an average of 70% of shareholder equity compared to 40% three years ago while the median went from 24% to 30%.

Methodology

Morneau Sobeco has developed a reference index to illustrate the potential impact that a pension plan could have on corporate financial results. The index was built by examining the financial statements of 100 of Canada's largest corporations that have Defined Benefit (DB) pension plans.

The pension plan for each company was compared to four key financial data. The bigger the plan in relation to these financial data, the greater the potential risk is for the company. The index was calculated by grouping results based on certain weightings for these four key financial data:

- > EBITDA
- > Shareholder equity
- > Market capitalization
- > Company assets

Depending on the methodology used, a company receives a rating between 0 and 1,000. The higher the rating, the greater the impact of pension plan fluctuations is on the company's financial results. Since the median result is 100, a company that was rated 1,000 would not only be much more at risk than all other companies, but the risk would be such that the financial situation of the company could be seriously compromised if there was a significant deterioration in the pension plan financial position.

Poor stock market returns in 2001 – 2002, the changes made by the Canadian Society of Actuaries concerning life expectancy, and the steady decrease in interest rates are events that have had a negative impact on the financial situation of DB plans and thus indirectly on the companies that sponsor them.

Stepping away from aggregate results, however, it becomes apparent that results vary greatly from one company to another depending on the relative size and maturity of the pension plan. For example, 5% of companies surveyed had pension plan assets that exceeded 70% of the company's total assets.

For many companies, this means that the pension fund could have an important impact on net income and cash flow. For some, the impact may be so great that any significant deterioration in the plan's financial position could endanger the company's financial stability.

According to our survey, a 10% loss in a pension plan (e.g. an actual return of -3% combined with an expected return assumption of 7%) would reduce EBITDA by just 2% on average. This should reassure investors. When we examine the situation more closely, some companies are much more at risk than others; in some cases, the same 10% pension plan loss could generate a decrease of 20% or more of EBITDA. Note that for 8% of the companies surveyed, EBITDA would be reduced by more than 5%.

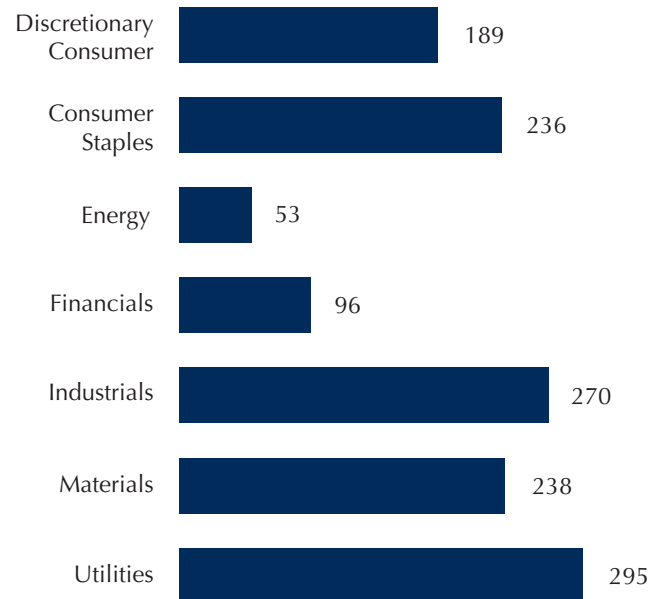
One of the major risks faced by a plan sponsor is investment risk. Many pension funds invest a significant portion of fund assets in equities. Since the expected long-term return on equities is higher than for bonds, plan cost should be reduced over the long term. However, actuarial liability, whether for solvency or accounting purposes, is measured based on the current yield of a bond portfolio. Consequently, even though the equity investment strategy would make it possible to reduce costs over the long term, the return on equity investments in the short term could be significantly lower than the yield from bonds. In fact, that is what happened so dramatically in 2001 – 2002, resulting in significant underfunded liabilities.

The Morneau Sobeco Index

The Morneau Sobeco Index sheds light on this situation. It allows a sponsor to measure the financial risk that the pension plan represents for the sponsor's company in comparison to other companies. The sponsor can then take this additional information into account in formulating plan investment policy, or even plan design.

To find out how your company would rate using the methodology explained in this communiqué, please contact one of our consultants.

Average Results by Industry for All Companies



For additional information, please contact your Morneau Sobeco consultant.