Pension Plan Update

LGMA Annual Meeting
May 19, 2010
Agenda

1. 2009 Year-End
2. 2009 Valuation
3. Plan Design: Solving the Catch 22
2009 Year-End
## 2009 Year-end (unaudited)

### Change in Net Assets (December 31, $000)

<table>
<thead>
<tr>
<th>Description</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Income</td>
<td>$(3,091,956)</td>
</tr>
<tr>
<td>Contributions</td>
<td>1,108,675</td>
</tr>
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<td>Net Inter-Plan Transfers</td>
<td>19,051</td>
</tr>
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<td>Pension Benefits Paid</td>
<td>(833,763)</td>
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<td>(48,009)</td>
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<td>(49,467)</td>
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<td><strong>Total Increase</strong></td>
<td>$(3,005,935)</td>
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## 2009 Year-end (unaudited)

### Change in Net Assets (December 31, $000)

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<tr>
<th>Description</th>
<th>2009</th>
<th>2008</th>
</tr>
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<tr>
<td>Investment Income</td>
<td>$2,206,597</td>
<td>$(3,091,956)</td>
</tr>
<tr>
<td>Contributions</td>
<td>1,224,302</td>
<td>1,108,675</td>
</tr>
<tr>
<td>Net Inter-Plan Transfers</td>
<td>2,689</td>
<td>19,051</td>
</tr>
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<td>Pension Benefits Paid</td>
<td>(909,348)</td>
<td>(833,763)</td>
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<td>Post Retirement Group Benefits</td>
<td>(53,720)</td>
<td>(48,009)</td>
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<td>Termination &amp; Refund Benefits</td>
<td>(90,887)</td>
<td>(91,629)</td>
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<td>Investment &amp; Administration Costs</td>
<td>(51,777)</td>
<td>(49,467)</td>
</tr>
<tr>
<td><strong>Total Increase</strong></td>
<td><strong>$2,327,856</strong></td>
<td><strong>$(3,005,935)</strong></td>
</tr>
<tr>
<td><strong>Investment Returns</strong></td>
<td>10.8%</td>
<td>(12.7)%</td>
</tr>
</tbody>
</table>

Municipal Pension Plan

20/07/2010
## 2009 Year-end (unaudited)

### Net Assets Available for Pension Benefits

<table>
<thead>
<tr>
<th>Description</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Investments</td>
<td>$24,255,530</td>
<td>$21,973,274</td>
</tr>
<tr>
<td>Contributions Receivable</td>
<td>47,613</td>
<td>37,652</td>
</tr>
<tr>
<td>Accrued Investment Income</td>
<td>27,326</td>
<td>3,031</td>
</tr>
<tr>
<td>Prepaid Expenses</td>
<td>7,099</td>
<td>5,427</td>
</tr>
<tr>
<td>Net Investment Settlements</td>
<td>(24,470)</td>
<td>(20,854)</td>
</tr>
<tr>
<td>Other Accounts Payable</td>
<td>(21,227)</td>
<td>(23,276)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>24,300,642</strong></td>
<td><strong>21,972,786</strong></td>
</tr>
<tr>
<td>Basic Account</td>
<td>20,236,616</td>
<td>18,058,554</td>
</tr>
<tr>
<td>Inflation Account</td>
<td>3,789,401</td>
<td>3,628,465</td>
</tr>
<tr>
<td>Retirement Annuity Account</td>
<td>247,625</td>
<td>285,767</td>
</tr>
</tbody>
</table>
Financial Status

Value of Plan continues to grow
- increased by 66% since 2002
- active membership growth
- higher contributions
- Investment Returns
Financial Indicators 2009

Pension Contributions continue to rise . . .

- Contributions ↑ 57%
- $1.2 million compared to $775 million in 2004
- reasons:
  - 2005 contribution increase
  - active membership ↑
  - salary base ↑
Financial Indicators 2009

... along with Pension payments ...

- Pension payments $\uparrow$ 53%
- $910$ million compared to $594$ million in 2004
- reasons:
  - retirees $\uparrow$
  - basic benefit $\uparrow$ 2%
  - indexing $\uparrow$
Financial Indicators 2006

... increasing pension payments as a percentage of regular contributions

Number of retired members will continue to grow as a result of increased retirements and aging membership

By 2014, retired members expected to increase from 55,000 to 78,000
Financial Indicators 2009

... increasing pension payments as a percentage of regular contributions

Number of retired members will continue to grow as a result of increased retirements and aging membership.

By 2014, retired members expected to increase from 55,000 to 78,000.

Should we be concerned?
Should We Be Concerned?

- **Basic Pension Benefits are guaranteed**
  - Basic Account valuation ensures that contribution rates will fund benefits – no matter how many actives or retirees
  - however, more retirees suggest more conservative investment policies, lower investment return assumptions and pressure on contribution rates

- **Inflation Benefit is not guaranteed**
  - more retirees draw increased amounts from the Inflation Adjustment Account, drawing down balances to provide inflation protection to future retirees

- **Post Retirement Group Benefits are not pre-funded**
  - Plan has limits on the funds available to subsidize PRGB subsidies . . . However this allocation of IAA funds ultimately limits the inflation protection that can be provided
As the number of retirees and the cost per retiree increases:
- the amount of overall subsidy and
- the amount of subsidy per member will begin to decline.
However, once the policy limit has been reached, funding will be tied to inflation contribution level.
Post Retirement Group Benefit Costs

How do we compare?

- **College:**
  - no MSP subsidies
  - EHB/Dental subsidies for members only

- **Public Service:**
  - MSP subsidies up to 50%
  - funding policy limit of 80% of ER Inflation contributions or about 50% of total contribution for EHB ($250 per family)
  - voluntary enrolment in dental

- **Teachers:**
  - no MSP subsidies
  - effective Jan 2012, eliminate all PRGB subsidies in favour of inflation protection
  - voluntary enrolment in dental
What about Inflation Protection?

- Funded through the Inflation Adjustment Account
  - full CPI adjustments since 1982
- Provides significant value to retirees

<table>
<thead>
<tr>
<th>Pension Date</th>
<th>Original Lifetime Annual Pension*</th>
<th>Indexing Added</th>
<th>2009 Pension</th>
<th>Increase because of Indexing</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1988</td>
<td>$20,000</td>
<td>$13,563</td>
<td>$33,563</td>
<td>68%</td>
</tr>
<tr>
<td>January 1994</td>
<td>$20,000</td>
<td>$7,033</td>
<td>27,033</td>
<td>35%</td>
</tr>
<tr>
<td>January 1999</td>
<td>$20,000</td>
<td>$5,396</td>
<td>$25,396</td>
<td>27%</td>
</tr>
</tbody>
</table>
What about Inflation Protection?

- Contribution rate insufficient to sustain full indexing
  - 1.2% of salary is 40% of the estimated cost
  - IAA funding shortfall > $5.0 billion
- If no action is taken, full indexing will continue until the IAA is exhausted . . .
What about Inflation Protection?

Projections for Inflation Protection

Inflation protection will continue only to the extent of current year contributions.
What about Inflation Protection?

- Contribution rate insufficient to sustain full indexing
  - 1.2% of salary is 40% of the estimated cost
  - IAA funding shortfall > $5.0 billion
- If no action is taken, full indexing will continue until the IAA is exhausted
  - then indexing will be reduced to current contributions
  - Less than 20 years away based on actuarial projection
- Intergenerational equity issue
  - all members contribute
  - not all members will receive the full benefit throughout their retirement
What about Inflation Protection?

- In simple terms
  - Increase funding
  - Decrease money going out

- Partners control contributions
  - No support for increased contribution rates especially in face of potential unfunded liability

- Trustees:
  - do not control funding
  - have most control over money going out
What about Inflation Protection?

Possible approaches

- Retain current account structure and operation

- Provide Indexing from the IAA based on a “target”
  - \( \text{Indexing} = X\% \) of CPI
  - \( \text{Indexing up to} \ Y\% \)
  - \( \text{Indexing of} \ X\% \) of CPI, up to a maximum of \( Y\% \)

- Assess and reset target at each valuation

- Target = maximum long term “level” indexing taking into account available assets and available contributions
2009 Actuarial Valuation Preview
Basic Account Actuarial Valuation

Defined Benefit Portion: the Basic Account

- Most important indicator of the financial health of the Basic Account
  - are there sufficient assets to pay promised pensions?
  - do contribution rates need to be adjusted?

- Valuation undertaken every three years:
  - last valuation as of December 31, 2006
  - next valuation will be as of December 31, 2009

- Independent actuary appointed by board
Basic Account Actuarial Valuation

\[ \text{Actuarial value of basic account assets} \quad \text{less} \quad \text{Actuarial value of basic account liabilities} \quad = \quad \text{Surplus or Unfunded liability} \]

- Investment income
- Future member contributions
- Future employer contributions
- Pensions in pay
- Value of future pensions for current active & inactive members
- Other future expenses

Assumptions:
- Investment returns
- Salary escalation rate
- Mortality and termination rates
- Retirement ages
Basic Account Actuarial Valuation

Basic Account was 102% funded in 2006

What factors to consider?

- changing demographics
- investment returns below actuarial assumption
- other economic assumptions
  - inflation
  - salary increases
- impacts of asset smoothing

Employers and member contribution rates increased by 0.99% of salary to amortize unfunded portion
Basic Account Actuarial Valuation

What to expect?

- based on
  - *investment returns realized in recent years*
  - *economic and demographic assumption changes*
- an unfunded liability is a strong possibility
- asset smoothing will delay the negative impact on the 2009 valuation putting further pressure on the 2012 valuation
  - *the future does not look promising for steady contribution rates*
Basic Account Actuarial Valuation

- **2009 Valuation Report** will be considered by the Board of Trustees in September 2010
- The **Joint Trust Agreement** requires that:
  - any surplus be put towards achieving the transitional financial arrangements
  - any unfunded liability be funded through a contribution rate increase . . .
    
    . . . divided equally between members and employers.
- The outcome will be communicated to members and employers as soon as possible
Plan Design Issues

Solving a Pension Plan Catch 22
Through Plan Design Changes
Transition Provisions

- The Joint Trust Agreement imposes *transitional financial arrangements*
  - Contribution rate increases shared equally
  - Stage 1:
    - eliminate any unfunded liability
    - rebalance member and employer rates at 13.15%
    - improve accrual rate to 1.35/2% from 1.3/2%
    - 10 year guarantee for normal form pension
  - Stage 2:
    - $500 million to IAA
    - $500 million to Rate Stabilization Reserve

- All must be achieved before any benefit changes can be made
Transition Provisions

- Until Stage 1 of transition is complete, contribution rates cannot move into the **RED** zone
  - rate cannot be < 16.14% unless it can go down to 12.42%
  - if enough surplus, rate will decline to 12.42%
  - After Stage 1 benefit improvements the rate will be 13.15%
- The **RED** zone can expand over time if valuations produce unfunded liabilities
Transition Provisions

- As the contribution rate increases, the cost of getting to transition increases
  - 2000 = $1.07 billion
  - 2006 = $3.05 billion

- And Stage 2 is also required before rates can decrease
  - $1.0 billion

- Basic Account is in a spiral from which it cannot escape:
  - higher costs lead to
  - higher rates lead to
  - higher costs of transition
Transition Provisions

- Very little likelihood of achieving a surplus large enough to achieve transition
  - 0% in 2009
  - 1% in 2012
  - 7% in 2015

- Much higher likelihood of higher contribution rates and larger RED zone
  - Almost certain in 2009
  - 35% by 2012
  - 47% by 2015

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<tr>
<th>Rate</th>
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<tr>
<td>16.14%</td>
<td>Current Rate</td>
</tr>
<tr>
<td>15.02%</td>
<td>Normal Cost</td>
</tr>
<tr>
<td>13.15%</td>
<td>Rebalancing Target</td>
</tr>
<tr>
<td>12.42%</td>
<td>Rebalancing Rate before transition, benefit improvements</td>
</tr>
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Transition Provisions

- Why is it important to achieve?
  - Lower contribution rates for members and employers
  - Ability to adjust pension benefits
  - Strengthened IAA with greater inflation protection certainty
  - More flexible contribution rate setting structure
    - *rates can move up and down*
Benefit Options: What is Possible?

- Board worked with Actuary to model benefit changes that might be achieved if the *Transitional Arrangements* went away and if two benefit subsidies were eliminated:
  - Remove Bridge Benefit
    - benefits only those who retire early
  - Remove Early Retirement Benefits
    - right to retire early maintained but without subsidy

- In both cases, savings were reallocated to more universal benefit improvements
  - Higher accrual rate
  - Improve IAA funding
Benefit Options: What is Possible?

- **Eliminate Bridge Benefit**
  - contribution rate declines by 2.54% (1.66%) of salary

- **Eliminate Early Retirement Subsidies**
  - penalty increased to 6% before age 65
  - contribution Rate declines by 7.25% (4.28%) of salary
  - penalty increased to 6% before age 60
  - contribution rate declines by 1.65% (0.82%) of salary
Benefit Options: What is Possible?

- **Available Benefits**
  - **Accrued and Future**
    - 2%/2% G 10 Pension plus >3.0% of salary to IAA
  - **Future Only**
    - 1.95%/2% SL Pension
Benefit Options: What is Possible?

- **Impacts**
  - Accrual rate increase has significant impact on total pension for all members
    - *Each 0.05% increase in rate*
      - $45,000 => 3.8% increase in lifetime pension
      - $90,000 => 1.5% increase in lifetime pension
    - *Impact the same for all members on the portion of pension under the YMPE*
  - Removal of Bridge Benefit and Early Retirement subsidies has more impact on members with longer service and members who intend to retire early
    - *Members who retire early now receive a pension of greater actuarial value than those who do not*
    - *Offset would be increased accrual rate which applies for the life of the pension, not just the early retirement period*
Benefit Options: What is Possible?

- **Impacts**
  - Increased contributions to the IAA
    - Improved sustainability for inflation adjustments
    - Defer point at which account is exhausted
Benefit Options: What is Possible?

- The Board has begun a discussion with the Plan Partners about the willingness to consider revisions to the Joint Trust Agreement that would allow the Board to further consider these types of options
  - not likely a quick discussion
  - full consultation with members, member representatives, employers and other stakeholders