TORONTO CITY CLERK

Consolidated Clause in Policy and Finance Committee Report 7, which was considered by City Council on September 25, 26 and 27, 2006.

27

Metropolitan Toronto Police Benefit Fund - Actuarial Valuation for Funding Purposes as at December 31, 2005, and Revised Actuarial Valuation for Funding Purposes as at December 31, 2004

City Council on September 25, 26 and 27, 2006, adopted this Clause without amendment.

The Policy and Finance Committee recommends that City Council adopt the recommendation of the Administration Committee contained in the communication (September 6, 2006) from the Administration Committee:

Recommendation:

The Administration Committee recommended to the Policy and Finance Committee that City Council adopt the staff recommendations in the Recommendations Section of the report (August 23, 2006) from the Treasurer.

Background:

The Administration Committee on September 5, 2006, considered the following:

(i) report (August 23, 2006) from the Treasurer providing staff comments and recommendations regarding the Actuarial Valuation for Funding Purposes as at December 31, 2005 and the Revised Actuarial Valuation for Funding Purposes as at December 31, 2004 for the Metropolitan Toronto Police Benefit Fund.

Recommendations:

It is recommended that:

(1) the "Revised Report on the Actuarial Valuation for Funding Purposes as at December 31, 2004" prepared by Mercer Human Resource Consulting with respect to the Metropolitan Toronto Police Benefit Fund, be received in substitution for the original such report received by Council in 2005;

(2) the "Report on the Actuarial Valuation for Funding Purposes as at December 31, 2005" prepared by Mercer Human Resource Consulting with respect to the Metropolitan Toronto Police Benefit Fund, be received, and that:

(a) the existing authorization for the City to make special annual payments of $11,389,200.00 to the Police Benefit Fund until 2009 to eliminate the Fund's solvency deficiency determined as of December 31, 2004, be modified by:

(i) reducing the payments for each of the years 2006 to 2009 to $4,940,400.00 subject to discontinuation as Council may determine, if any subsequent actuarial valuation indicates the existence of sufficient excess assets in the Police Benefit Fund;

(b) the City make additional special annual payments to the Police Benefit Fund, as recommended by the actuary of:

(i) $4,677,600.00 in each of the years 2006 to 2015 to eliminate the Fund's going-concern unfunded liabilities determine as of December 31, 2005; and

(ii) $865,200.00 in each of the years 2006 to 2010 to eliminate the Fund's solvency deficiency determined as of the same date;

subject in each case to discontinuation as Council may determine, if any subsequent actuarial valuation indicates the existence of sufficient excess assets in the Police Benefit Fund;

(c) the City designate the $6,448,800.00 excess special payments made in 2005 and the $906,000.00 in 2006 to be a contribution credit to be applied equally against the 2007, 2008 and 2009 funding requirements;

(3) recommendation (2) be forwarded to the Budget Advisory Committee for its consideration during the 2007 Budget Process;

(4) this report be forwarded to the Policy and Finance Committee for consideration; and

(5) the appropriate City officials be authorized to take the necessary action to give effect to the foregoing recommendations;

(ii) communication (June 23, 2006) from the Board of Trustees of the Metropolitan Toronto Police Benefit Fund advising that the Board on June 23, 2006, recommended to the Administration Committee that City Council adopt the following recommendations contained in the Recommendations Section of the revised report (May 2006) from Anil Narale, Mercer Human Resource Consulting, that:

(a) there be no improvements for active members at this time; and

(b) there be no improvements for retired members at this time; and

(iii) communication (July 20, 2006) from the Board of Trustees of the Metropolitan Toronto Police Benefit Fund advising that the Board on July 20, 2006, recommended to the Administration Committee that City Council adopt the following recommendations contained in the Recommendations Section of the report (July 2006) from Anil Narale, Mercer Human Resource Consulting, that:

(a) there be no improvements for active members at this time; and

(b) there be no improvements for retired members at this time.

(Report dated August 23, 2006, from the Treasurer,
addressed to the Administration Committee)

Purpose:

To provide staff comments and recommendations regarding the Actuarial Valuation for Funding Purposes as at December 31, 2005, and the Revised Actuarial Valuation for Funding Purposes as at December 31, 2004, for the Metropolitan Toronto Police Benefit Fund.

Financial Implications and Impact Statement:

In compliance with the requirements in the Regulations under the Ontario *Pension Benefits Act* relating to elimination of funding shortfalls in pension plans, and in light of the actuarial valuations performed for the calendar years 2003 to 2005, the streams of special payments to the Metropolitan Toronto Police Benefit Fund that began in 2004 and 2005 are to be continued, subject to reduction in one of the 2005 streams by $6,448,800.00 because of an overestimate of liabilities relating to survivor benefits, and two additional streams of special payments are to begin in 2006. Details of the total payments for 2006 and future years are provided in the following chart.

Metropolitan Toronto Police Benefit Fund Funding Requirements
January 1, 2006 - December 31, 2015

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Going-Concern Funding (amortized over 10 years)										
2004 Valuation	$225,600	$225,600	$225,600	$225,600	$225,600	$225,600	$225,600	$225,600	$225,600	
2005 Valuation	$4,677,600	$4,677,600	$4,677,600	$4,677,600	$4,677,600	$4,677,600	$4,677,600	$4,677,600	$4,677,600	$4,677,600
Subtotal	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,677,600
Solvency Funding (amortized over 5 years)										
2003 Valuation	$691,200	$691,200	$691,200							
2004 Valuation	$4,940,400	$4,940,400	$4,940,400	$4,940,400						
2005 Valuation	$865,200	$865,200	$865,200	$865,200	$865,200					
Subtotal	$6,496,800	$6,496,800	$6,496,800	$5,805,600	$865,200					
Total Required	$11,400,000*	$11,400,000	$11,400,000	$10,708,800	$5,768,400	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,677,600
Less Credit		$2,451,600	$2,451,600	$2,451,600						
Revised Total	$11,400,000	$8,948,400	$8,948,400	$8,257,200	$5,768,400	$4,903,200	$4,903,200	$4,903,200	$4,903,200	$4,677,600

*$12,306,000.00 budgeted as per previously filed valuation

The 2006 Non-Program Expenditure Budget was based on the actuary's projections before the overestimate of spousal benefits was discovered, and provided for $12,306,000.00 which is $906,000.00 in excess of the amount suggested by the actuary for 2006, after correcting for the overestimate. The figures in the chart are the result of spreading these excess payments ($6,448,800.00 plus $906,000.00) evenly over years 2007 to 2009.

The Deputy City Manager and Chief Financial Officer has reviewed this report and concurs with this financial impact statement

Recommendations:

It is recommended that:

(1) the "Revised Report on the Actuarial Valuation for Funding Purposes as at December 31, 2004" prepared by Mercer Human Resource Consulting with respect to the Metropolitan Toronto Police Benefit Fund, be received in substitution for the original such report received by Council in 2005;

(2) the "Report on the Actuarial Valuation for Funding Purposes as at December 31, 2005" prepared by Mercer Human Resource Consulting with respect to the Metropolitan Toronto Police Benefit Fund, be received, and that;

   (a) the existing authorization for the City to make special annual payments of $11,389,200.00 to the Police Benefit Fund until 2009 to eliminate the Fund's solvency deficiency determined as of December 31, 2004, be modified by:

      (i) reducing the payments for each of the years 2006 to 2009 to $4,940,400.00 subject to discontinuation as Council may determine, if any subsequent actuarial valuation indicates the existence of sufficient excess assets in the Police Benefit Fund;

   (b) the City make additional special annual payments to the Police Benefit Fund, as recommended by the actuary of:

      (i) $4,677,600.00 in each of the years 2006 to 2015 to eliminate the Fund's going-concern unfunded liabilities determine as of December 31, 2005; and,

      (ii) $865,200.00 in each of the years 2006 to 2010 to eliminate the Fund's solvency deficiency determined as of the same date;

   subject in each case to discontinuation as Council may determine, if any subsequent actuarial valuation indicates the existence of sufficient excess assets in the Police Benefit Fund;

   (c) the City designate the $6,448,800.00 excess special payments made in 2005 and the $906,000.00 in 2006 to be a contribution credit to be applied equally against the 2007, 2008 and 2009 funding requirements;

(3) recommendation (2) be forwarded to the Budget Advisory Committee for its consideration during the 2007 Budget Process;

(4) this report be forwarded to the Policy and Finance Committee for consideration; and

(5) the appropriate City officials be authorized to take the necessary action to give effect to the foregoing recommendations.

Background:

The Metropolitan Toronto Police Benefit Fund, whose terms are set forth in By-law No.181-81 of the former Metropolitan Toronto Corporation as amended, is one of five pre-OMERS pension plans for which the City is sponsor. As at December 31, 2005, it covers 16 officer members, 1,582 retired officers and 650 survivor pensioners.

The Fund's Actuary, Mercer Human Resources Consulting, conducts an annual actuarial valuation of the Fund's assets and liabilities. Included in the agenda material accompanying this report are copies of the Actuary's Report on the Actuarial Valuation of the Fund for Funding Purposes as at December 31, 2005 and Revised Actuary's Report on the Actuarial Valuation of the Fund for Funding Purposes as at December 31, 2004. At its meeting of June 23, 2006, the Fund's Board of Trustees adopted the Revised Actuary's Report for 2004, and requested that it be forwarded to the Administration Committee for consideration together with the then forthcoming Actuary's Report for 2005, the recommendations in which the Board of Trustees subsequently adopted at its meeting of July 20, 2006.

The *Ontario Pension Benefits Act* requires that a pension plan be valued from two separate points of view: on a going-concern basis (under which it is assumed that the plan will continue to operate) and on a solvency basis (as if the plan had been wound up on the year-end valuation date).

Revised Report on the Actuarial Valuation for Funding Purposes as at December 31, 2004:

In his original Valuation Report for the year ended December 31, 2004, the Actuary had stated that the Fund had "going-concern unfunded liabilities" of $1,710,000.00 and "solvency deficiencies" of $52,159,000.00 and upon his recommendation, the City commenced special payments effective January 1, 2005, of $18,800.00 per month for 10 years with respect to the going-concern unfunded liabilities and $1,006,700.00 per month for five years with respect to the solvency deficiency.

During the completion of the 2005 Actuarial Valuation, it was discovered that because of a programming error, the liability for survivor pensions in the 2004 valuation had been calculated on the basis of 100 percent of the member's pension instead of the assumed 75 percent survivor pension entitlement. This led to a stated solvency liability of $52,159,000.00 rather than the $24,029,000.00 and a stated minimum special annual payment to the Fund for five years by the City as plan sponsor in the amount of $11,389,200.00 rather than $4,940,400.00.

The Actuary has prepared and filed a Revised Actuarial Valuation for Funding Purposes as at December 31, 2004, showing the revised figures for the 2004 solvency deficiency and associated minimum required payments. All other data and information remain unchanged from the original report.

Report on the Actuarial Valuation for Funding Purposes as at December 31, 2005:

During 2005, going-concern unfunded liabilities increased from $1.7 million to $37.8 million while solvency deficiencies decreased by $447,000.00 to $23.6 million. The change in the going-concern unfunded liability was primarily due to changes in the actuarial assumptions on investment returns and mortality made by the Actuary, lower than expected investment performance and the attainment by pensioners of greater ages than in the past.

The *Pension Benefits Act* requires that any unfunded liability on a going-concern valuation be eliminated within at least 15 years. The actuary advised in his 2005 Valuation Report that the unfunded liability of $37,830,000.00 which existed as at December 31 of that year, should be amortized over 10 years by means of annual payments of $4,903,200.00 in monthly instalments of $408,600.00 from January 1, 2006 to December 1, 2014 reducing to $389,800.00 in 2015. If a subsequent going-concern valuation shows a smaller unfunded liability than the present value of the scheduled payments, the scheduled payments may be terminated earlier, reduced, or a combination of the two may be applied.

For the solvency valuation, the Actuary smoothes out the assets and liabilities of the plan in accordance with the legislation. At the end of 2005, the smoothed solvency liabilities of $688.4 million exceeded the smoothed solvency assets of $671.2 million and therefore there existed a solvency deficiency of $23.6 million after adjustment for contribution credit of $6.4 million. In comparison, at the end of 2004, there was a solvency deficiency of $24.0 million. The change in the solvency position since the last valuation was due primarily to the recognition of investment losses in previous years under the smoothing methodology and also by the increase in liabilities caused by a decrease in solvency interest rates offset by the special payments made during the year.

The *Pension Benefits Act* obliges the City as plan sponsor to eliminate solvency deficiencies within five years of the date that they are determined. The 2003 actuarial valuation revealed an initial solvency deficiency of $3.0 million which the City, on the Actuary's advice, elected to eliminate by special annual payments of $691,200.00 from 2004 to 2008. The December 31, 2004, valuation revealed an additional solvency deficiency of $21.6 million which the City, on the Actuary's advice, elected to eliminate by special annual payments of $4,940,400.00 from 2005 to 2009. The 2005 valuation revealed an additional solvency deficiency of $3,804,000.00 which the Actuary is advising be funded by special annual payments of $865,200.00 from 2006 to 2010. If the solvency position as determined at any future year-end improves, such payments may be terminated earlier.

<u>Comments</u>:

Investments by the Fund in the year 2005 returned 11.8 percent before expenses, being the third consecutive year that the Fund has seen positive returns after two years of negative or near-negative returns. While this rate was below that of the Ontario Municipal Employees Retirement System (OMERS), whose return was 16 percent, it was consistent with the other City sponsored pension plans. The major reason for the Fund's lower return as compared to OMERS is the ability of OMERS to invest in infrastructure, real estate, private equity placements and other vehicles that are either unavailable to the Fund because of its smaller size or inappropriate in light of the closed nature of the plan. The Fund has a higher proportion of bond holdings which underperformed equities.

The improved investment performance is reflected in the investment gains which have not yet been recognized in the actuarial value of assets.

The City has elected to fund solvency deficiencies in the Police Benefit Fund at the minimum rate permitted by the Regulations under the *Ontario Pension Benefits Act (PBA)*, and going-concern unfunded liabilities over 10 years rather than the maximum 15 permitted by those Regulations, reserving the right to cancel or amend future payments if subsequent valuations decrease or eliminate the unfunded liabilities or deficiencies.

The rationale for this funding strategy is that a solvency valuation simulates the cost of winding up the plan by comparing the current market value of the plan's assets with the cost to settle the pension obligations by purchasing annuities at the current long term interest rate. As such it is very dependent upon interest rates on the specific valuation date.

As interest rates have declined to near historical lows over the past five years, the Fund's solvency liabilities have soared resulting in solvency deficiencies. While the City could make a special payment of the full amount of the deficiency, if long-term interest rates rise to more traditional levels, the solvency deficiency will reduce or correct itself. If the full deficiency had been paid off, rising interest rates such as we have seen in 2006 would put the Fund into a solvency surplus position however the same provincial legislation which requires the sponsor to fund any deficiencies does not permit the withdrawal of surplus by the sponsor.

Similarly the going-concern valuation compares the smoothed actuarial value of assets to the actuarial liabilities based upon mortality and investment return assumptions. Improvements in the market value of assets are taken into account over a four-year period. The market value of assets is currently $47 million above the actuarial value of assets. If during the next three years expected investment returns of 5.5 percent are achieved, this $47 million will be taken in account, reducing the going-concern unfunded liabilities accordingly. All of the unfunded liability could have been paid off immediately, but when positive investment returns from 2002, 2003 and 2004 are fully taken into account, the Fund may be in a going-concern surplus position. The same provincial legislation which requires the sponsor to fund any deficiencies does not permit the sponsor to withdraw any going-concern surplus.

The $6,448,800.00 excess special payments made in 2005 at the rate of $11,389,200.00 per year as a result of the erroneous 2004 solvency valuation as compared to the corrected $4,940,400.00 per year could be designated either as an "increased" 2005 special payment, or as a "contribution credit". To be consistent with the funding philosophy and in light of rising interest rates in 2006 and unrecognized market gains which may reduce or eliminate the solvency deficiency and unfunded liability, it would be most prudent to designate the excess as a contribution credit to be applied against future funding requirements as suggested in Recommendation 2(c).

Conclusions:

The 2005 valuation results of the Fund outlining its financial position and the results of its operations for the year ended December 31, 2005, show that on a going-concern basis it is in a deficit position of $37.8 million. This deficit could be eliminated in 10 years with the payment of $4,677,600.00 annually or more quickly with larger payments. However since there are unrecognized gains in the market value of assets of $47 million which will be taken into account over the next three years, it is advisable to follow a near-minimum funding strategy.

The 2005 valuation also reveals a solvency deficiency of $23.5 million and states that minimum required payments of $6,496,800.00 in 2006 will eliminate it over a five-year period (the maximum permitted under the Act).

Since the solvency as well as the funding position may change over the period of funding it is proper that the City retain the right to cancel payments once the solvency deficit has been eliminated.

Contact:

Ivana Zanardo, Director,
Pension, Payroll and Employee Benefits,
Tel: 416-397-4143, Fax: 416-397-0835;
e-mail: izanardo@toronto.ca

(Communication dated June 23, 2006, addressed to the
Administration Committee from the Board of Trustees of the
Metropolitan Toronto Police Benefit Fund)

Recommendation:

The Board of Trustees of the Metropolitan Toronto Police Benefit Fund recommends to the Administration Committee that City Council adopt the following recommendations contained in the Recommendation Section of the revised report (May 2006) from Anil Narale, Mercer Human Resource Consulting, that:

(a) there be no improvements for active members at this time; and
(b) there be no improvements for retired members at this time.

Action taken by the Committee:

The Board of Trustees of the Metropolitan Toronto Police Benefit Fund requested:

(1) the Deputy City Manager and Chief Financial Officer to report to the Administration Committee on this matter at its meeting on Tuesday, September 5, 2006; and

(2) that this matter be forwarded to the Administration Committee for consideration together with the forthcoming Actuarial Valuation Report for 2005.

Background:

The Board of Trustees of the Metropolitan Toronto Police Benefit Fund on Friday, June 23, 2006, considered the communication (June 9, 2006) from Anil Narale, Mercer Human Resource Consulting, forwarding the revised actuarial valuation report (May 2006) prepared as at December 31, 2004, reflecting a correction that was noted this year.

Anil Narale, Mercer Human Resource Consulting, addressed the Committee.

(Communication dated July 20, 2006, addressed to the
Administration Committee from the Board of Trustees of the
Metropolitan Toronto Police Benefit Fund)

Recommendation:

The Board of Trustees of the Metropolitan Toronto Police Benefit Fund recommends to the Administration Committee that City Council adopt the following recommendations contained in the Recommendation Section of the report (July 2006) from Anil Narale, Mercer Human Resource Consulting, that:

(a) there be no improvements for active members at this time; and
(b) there be no improvements for retired members at this time.

Action taken by the Committee:

The Board of Trustees of the Metropolitan Toronto Police Benefit Fund requested the Deputy City Manager and Chief Financial Officer to report to the Administration Committee on this matter at its meeting on Tuesday, September 5, 2006.

Background:

The Board of Trustees of the Metropolitan Toronto Police Benefit Fund on Thursday, July 20, 2006, considered the communication (July 11, 2006) from Anil Narale, Mercer Human Resource Consulting, forwarding the actuarial valuation report (July 2006) for the Metropolitan Toronto

Police Benefit Fund as at December 31, 2005, recommending no improvements for active or retired members at this time.

Anil Narale, Mercer Human Resource Consulting, addressed the Committee.

(A copy of the Metropolitan Toronto Police Benefit Fund – Revised Report on the Actuarial Valuation for Funding Purposes as at December 31, 2004, and Metropolitan Toronto Police Benefit Fund - Report on the Actuarial Valuation for Funding Purposes as at December 31, 2005, appended to the report dated August 23, 2006, from the Treasurer, were distributed to all Members of Council with the September 18, 2006, agenda of the Policy and Finance Committee and copies are also on file in the office of the City Clerk, City Hall.)