STAFF REPORT
ACTION REQUIRED

Supplementary Report to GM31.19 "Metropolitan Toronto Police Benefit Plan – Actuarial Report as at December 31, 2013"

Date:	July 7, 2014
To:	City Council
From:	Treasurer
Wards:	All
Reference Number:	P:\2014\Internal Services\ppeb\cc14008ppeb (AFS19989)

SUMMARY

This supplementary report is being submitted to City Council to:

a) advise that a recent decision made by the Metropolitan Toronto Police Benefit Fund (MTPBF) Board of Trustees at its meeting held on June 20, 2014, as well as an upcoming decision to be made by the Board of Trustees at its meeting scheduled for September 10, 2014, may affect the MTPBF's:

   i. 2012 Actuarial Valuation received by Government Management Committee at its meeting held on May 13, 2013 (re: GM22.5 "Metropolitan Toronto Police Benefit Fund – Actuarial Report as at December 31, 2012"); and

   ii. 2013 Actuarial Valuation submitted to City Council for its July 8, 2014 meeting (re: GM31.19 "Metropolitan Toronto Police Benefit Fund – Actuarial Report as at December 31, 2013),

   including modifications to the schedule of special payments, as set out in each of those Valuations, that the City as the sponsor of the MTPBF is legislatively required to satisfy, by either making each such payment or covering it by a Letter of Credit;

b) amend the recommendations contained in GM31.19 in order to request additional funding from the Employee / Retiree Benefits Reserve Fund in the event that at its September 2014 meeting the MTPBF Board of Trustees make a decision to file the 2012 Actuarial Valuation with the Financial Services Commission of Ontario (FSCO), which will in turn amend the special payments that the City is legislatively

required to make to the Plan, or cover by way of Letter of Credit, to fund the solvency deficit. There will be no net impact on the City's operating budget since special payments and/or the cost of any associated Letters of Credit will be funded from the Employee / Retiree Benefits Reserve Fund.

RECOMMENDATIONS

The Treasurer recommends that the recommendations contained in GM31.19 be deleted and replaced with the following:

1. City Council receive the "Report of the Actuarial Valuation for Funding Purposes as at December 31, 2013" (Attachment 2 of GM31.19) prepared by Mercer Human Resource Consulting with respect to the Metropolitan Toronto Police Benefit Fund (MTPBF).

2. If, at its meeting scheduled to be held on September 10, 2014, the Board of Trustees of the MTPBF reaffirms its original decision to file the 2013 Actuarial Valuation as presented in Attachment 2 of GM31.19, that:

   a) City Council approve the special contributions already made to the Fund in 2014 in the amount of $2.548 million, being equal to the 2013 unsmoothed solvency (wind-up) shortfall, as the only statutorily required special contribution to the Fund in 2014, until such time as the Financial Services Commission of Ontario (FSCO) requires, if it ever does, the City to take steps under the *Pension Benefits Act* (PBA) to eliminate the part of the $37.250 million smoothed solvency deficiency shown in the 2013 Actuarial Valuation which is in excess of the 2013 wind-up shortfall;

   b) In the event that FSCO directs that the City must take steps under the PBA to eliminate all of the $37.250 million smoothed solvency deficiency shown in the 2013 Actuarial Valuation, City Council:

      i. to the extent that FSCO regards the catch-up payment to the MTPBF as consisting of "arrears", authorize the Treasurer to cover the originally scheduled special contributions shown in Appendix A of this supplementary report from January 1, 2014 up to such date in 2014 on which the City may be so directed by FSCO, including interest, after allowing for the $2.548 million special contribution already made in 2014, to a maximum of $11.6 million, as long as the Canada Revenue Agency (CRA) has confirmed that such contributions will not constitute a breach of the *Income Tax Act* (ITA) regulations;

      ii. authorize the Treasurer to arrange for the issuance to the Fund's Board of Trustees of an automatically renewing 1-year Letter of Credit in accordance with the Regulations under the PBA to cover such part of the catch-up payment, including interest, as FSCO does not regard as "arrears", together with the remainder of the special contributions as they would have come due to a maximum of $41.486 million, as per Appendix A of this supplementary report;

iii. authorize the Treasurer to arrange for reduction in the face value of any such Letter of Credit to match any reduction in the smoothed solvency deficiency shown in any subsequent Actuarial Valuation of the MTPBF filed with FSCO;

iv. approve a Non-Program Operating Budget increase of $12,983 gross and $0 net funded from the Employee/Retiree Benefits Reserve Fund for $12,983 to cover the cost of the Letter of Credit in 2014.

3. If, at its meeting scheduled to be held on September 10, 2014, the Board of Trustees of the MTPBF directs the Actuary (Mercer Human Resource Consulting) to amend the 2013 Actuarial Valuation to make the unsmoothed solvency (wind-up) deficiency for purposes of the federally permitted limit on employer contributions equal to the smoothed solvency deficiency under the PBA Regulations by making an assumption as to potential future *ad hoc* cost-of-living adjustments, as allowed under clause 147.2(2)(c) of the ITA, City Council:

a) to the extent that FSCO regards the catch-up payment to the MTPBF as consisting of “arrears”, authorize the Treasurer to cover the originally scheduled special contributions shown in Appendix A of this supplementary report from January 1, 2014 up to such date in 2014 on which the City can reasonably act on the Board of Trustee decision, including interest, after allowing for the $2.548 million special contribution already made in 2014, to a maximum of $11.6 million;

b) authorize the Treasurer to arrange for the issuance to the Fund's Board of Trustees of an automatically renewing 1-year Letter of Credit in accordance with the Regulations under the PBA to cover such part of the catch-up payment, including interest, as FSCO does not regard as “arrears”, together with the remainder of the special contributions as they would have come due to a maximum of $41.486 million, as per Appendix A of this supplementary report;

c) authorize the Treasurer to arrange for reduction in the face value of any such Letter of Credit to match any reduction in the smoothed solvency deficiency shown in any subsequent Actuarial Valuation of the MTPBF filed with FSCO;

d) approve a Non-Program Operating Budget increase of $12,983 gross and $0 net funded from the Employee/Retiree Benefits Reserve Fund for $12,983 to cover the cost of the Letter of Credit in 2014.

4. If, at its meeting scheduled to be held on September 10, 2014, the Board of Trustees of the MTPBF direct the Actuary (Mercer Human Resource Consulting) to amend and file the 2012 Actuarial Valuation with a one (1) year deferral of new solvency contributions, City Council:

a) to the extent that FSCO regards the catch-up payment to the MTPBF as consisting of “arrears”, authorize the Treasurer to cover the originally scheduled special contributions shown in Appendix B of this supplementary report from January 1, 2014 up to such date in 2014 on which the City can reasonably act on the Board of Trustees decision, including interest, after allowing for the $2.548 million special contribution already made in 2014, to a maximum of $12.153 million;

b) authorize the Treasurer to arrange for the issuance to the Fund's Board of Trustees of an automatically renewing 1-year Letter of Credit in accordance with the Regulations under the PBA to cover such part of the catch-up payment, including interest, as FSCO does not regard as “arrears”, together with the remainder of the special contributions as they would have come due to a maximum of $44.002 million, as per Appendix B of this supplementary report;

c) authorize the Treasurer to arrange for reduction in the face value of any such Letter of Credit to match any reduction in the smoothed solvency deficiency shown in any subsequent Actuarial Valuation of the MTPBF filed with FSCO;

d) approve a Non-Program Operating Budget increase of $13,566 gross and $0 net funded from the Employee/Retiree Benefits Reserve Fund for $13,566 to cover the cost of the Letter of Credit in 2014..

Financial Impact

Given that the Board of Trustees of the MTPBF at its meeting held on June 20, 2014 directed the Actuary to amend the 2012 Actuarial Valuation for final consideration by the Board at its meeting scheduled for September 10, 2014, with a view to instructing that same be filed with FSCO, staff cannot advise City Council with certainty on the final outcome of the Board's decision before Council's last meeting scheduled for August 2014. There are three possible outcomes. The impact of each of these scenarios is presented below. Given that any special payments and/or the cost of associated Letters of Credit to eliminate a solvency deficiency in any pension fund are funded from the City's Employee / Retiree Benefits Reserve Fund, the net impact under all three (3) scenarios on the City's approved operating budget is nil.

<u>Scenario A (Filing Current 2013 Actuarial Report)</u>

If at its September 2014 meeting the MTPBF Board of Trustees reaffirms its decision to file the 2013 Actuarial Valuation as presented in Attachment 2 of GM31.19, the financial implications will be those presented in GM31.19, except that to the extent that the Regulations under the PBA permit any part of the catch-up payment to be covered by a Letter of Credit. The Employee/Retiree Benefits Reserve Fund will be required to bear the part of the fee for the Letter associated with the additional catch-up payments included in the face value of the Letter. The financial implications and fees will be the same as identified below under Scenario B, or possibly less.

Scenario B (Filing an Amended 2013 Actuarial Valuation Report with Revised Assumptions)

If at its September 2014 meeting the MTPBF Board of Trustees directs the Actuary (Mercer Human Resource Consulting) to amend the 2013 Actuarial Valuation to make the unsmoothed solvency (wind-up) deficiency for purposes of the federally permitted limit on employer contributions equal to the smoothed solvency deficiency under the PBA Regulations by making an assumption as to potential future *ad hoc* cost-of-living adjustments, as allowed under clause 147.2(2)(c) of the ITA (thus avoiding any conflict between the ITA Regulations and those under the PBA), it is recommended that that solvency deficiency of $37.250 million be eliminated by:

i. first paying the part, if any, of the catch-up amount (to make up for the missed payments called for in the amortization schedule from January 1, 2014, to the deadline date for the filing of the Valuation Report) which FSCO regards as “arrears” and therefore ineligible for coverage by a Letter of Credit; and

ii. then providing a Letter of Credit to the Fund's Board of Trustees in the amount of the non-arrears portion of the 2014 catch-up payment plus the remaining scheduled special contributions as they accrue from time to time.

Under such an arrangement, the initial face value of the Letter would be equal to the sum of the eligible portion of the catch-up payment and the amount of the first special contribution covered by it. The Letter would also provide for automatic increases in its face value in step with the subsequent scheduled amounts. The maximum total value of the Letter of Credit will be $41.486 million reflected on the last line of the amortization schedule attached as Appendix A of this supplementary report augmented by the non-arrears portion of the missed special payments, less any special payments in fact made in the period between January 1, 2014 and the catch-up payment deadline date.

The issuance of a Letter of Credit will cost the City a fee of approximately 0.50% *per annum* of the Letter's face value, which is the lowest rate that is charged by chartered banks to their customers who have the best credit ratings. Assuming that the first regular payment covered by the Letter is payment number 10 (*i.e.*, October 2014) as shown in Appendix A of this supplementary report, the cost for providing the Letter of Credit in its first year will therefore be approximately $12,983 with a maximum cost of approximately $0.567 million over the 5- year period (average of $0.113 million per year) if the face value of the Letter ever reaches the maximum. Funding for the cost of the Letter of Credit would be from the Employee / Retiree Benefits Reserve Fund.

However, the Letter of Credit will allow the City to earn approximately 1.5% to 2 % per annum on the funds that it can continue to retain and invest as a result of no longer being required to make special payments. The net financial benefit to the City would be approximately 1% to 1.5% (or approximately $0.415 million to $0.622 million, at the maximum face value) per year based on current interest-earning levels.

If the CRA's current objections can be overcome, and City Council's preference is to issue cash payments over five (5) years to satisfy its requirement under the Ontario legislation to eliminate the smoothed solvency deficit without making use of a Letter of Credit, the City would under Scenario B be required to make the following special payments: $14,189,653 (inclusive of interest of $191,653) for the solvency deficiency in 2014, $9,014,400 in 2015, and $5,664,000 in each of the years of 2016 to 2018.

Funding of $12,987,600 to cover these special annual payments has been included in the 2014 Non-Program Operating Budget in the Employee/Retiree Benefits Reserve Fund. Should City Council not approve the Letter of Credit, staff must request City Council to authorize an increase to the 2014 Non-Program Operating Budget of $1,202,053 gross, $0 net funded from the Employee / Retiree Benefits Reserve Fund, as a result of the new annual special payment requirements resulting from the 2013 Actuarial Valuation.

<u>Scenario C (filing a Revised Actuarial Valuation as at December 31, 2012)</u>

If, at its September 2014 meeting the MTPBF Board of Trustees directs the Actuary (Mercer Human Resource Consulting) to amend and file the 2012 Actuarial Valuation with a one (1) year deferral of recalculated solvency contributions, the estimated financial implications will be a solvency wind-up deficiency of $88.0 million and a smoothed solvency deficiency of $51.0 million. However, given that the City continued to make monthly payments in 2013 under the amortization schedule set out in the 2010 Valuation Report and given that the 2012 Valuation will be prepared with a one (1) year deferral, the remaining deficiency at the beginning of 2014 would, over the 5-year amortization period, require an increase in payments totalling only $2.50 million, plus interest, more than those required by the 2013 Valuation Report.

The City has made special payments for 2014 of $2.548 million on the basis of the 2010 valuation before halting further payments in order to comply with the federal limit on employer contributions.

Under the PBA and the ITA, Scenario C will require the City to make special payments commencing in 2014 to eliminate the original 2012 “smoothed” solvency deficiency of $51.0 million (*i.e.*, as it stood before taking into account the monthly payments actually made in 2013 under the amortization set out in the 2010 Valuation Report) over a period not exceeding five (5) years. In this case there would be no conflict between the contributions required by the PBA Regulations and the contribution limit imposed by the ITA Regulations as interpreted by the CRA.

It is being recommended that if the 2012 Valuation Report is filed, the solvency deficiency shown in it be eliminated by:

i. satisfying the catch-up obligation for 2014 by covering it through a Letter of Credit to the Fund’s Board of Trustees to the extent permitted by PBA Regulations and paying any remainder in cash; and

ii. providing a Letter of Credit to the Fund's Board of Trustees in the amount of the remaining scheduled special contributions as they accrue from time to time as described in the original report (re: GM31.19).

Because of the 2013 payments, the yearly dollar amount under Scenario C will be only about $0.5 million greater than under Scenarios A or B.

Under such an arrangement, the initial face value of the Letter would be equal to the sum of the eligible portion of the catch-up payment and the amount of the first special contribution covered by the Letter. The Letter would also provide for automatic increases in its face value in step with the subsequent scheduled amounts. The maximum total value of the Letter of Credit will be $44.002 million reflected on the last line of the amortization schedule attached as Appendix B to this supplementary report which includes the non-arrears portion of the missed special payments, less the $2.548 million special payments already made in 2014 under the 2010 amortization schedule.

The percentage-based fee for issuance of a Letter of Credit is discussed above under Scenario B. Assuming that the first regular payment covered by the Letter is payment number 10 (*i.e.* October 2014) as shown in Appendix A to this supplementary report, the cost for providing the Letter of Credit in its first year will therefore be approximately $13,566, with a maximum cost of approximately $0.598 million over the 5-year period (average of $0.120 million per year) if the face value of the Letter reaches the scheduled maximum. Funding for the cost of the Letter of Credit would be from the Employee / Retiree Benefits Reserve Fund.

However, the Letter of Credit will allow the City to earn approximately 1.5% to 2 % per annum on the funds that it can continue to retain and invest as a result of no longer being required to make special payments. The net financial benefit to the City would be approximately 1% to 1.5% (or approximately $0.440 million to $0.660 million, at the maximum face value) per year based on current interest-earning levels.

If City Council's preference is to issue cash payments over five (5) years to satisfy its requirement under the Ontario legislation to eliminate the smoothed solvency deficit without making use of a Letter of Credit, the City would under Scenario C be required to make the following special payments: $14,701,456 (inclusive of interest of $201,456) for the solvency deficiency in 2014, $9,500,000 in 2015, and $6,100,000 in 2016 to 2018.

Funding of $12,987,600 to cover these special annual payments has been included in the 2014 Non-Program Operating Budget in the Employee/Retiree Benefits Reserve Fund. Should City Council not approve a Letter of Credit, staff must request City Council to authorize an increase to the 2014 Non-Program Operating Budget of $1,714,456 gross, $0 net funded from the Employee / Retiree Benefits Reserve Fund, as a result of the new annual special payment requirements resulting from the revised 2012 Actuarial Valuation.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

ISSUE BACKGROUND

The MTPBF Board of Trustees, as the administrator of the Fund, has a fiduciary responsibility to direct and manage the affairs of the Fund and its pension plan, including decisions regarding financial reporting and approval of actuarial valuations, in accordance with the applicable legislation, the governing By-law, and in the best interests of the plan members and beneficiaries. City Council, as plan sponsor, is responsible for funding any deficiencies in the Fund and has authority over the provisions of the pension plan including the authority to approve improvements to the plan design and cost-of-living increases.

DECISION HISTORY

At its meeting held on April 30, 2014 the Board of Trustees for the MTPBF approved the smoothed solvency valuation report attached as Attachment 2 to GM31.19.

At its meeting held on June 16, 2014, Government Management Committee approved a report (May 30, 2014) from the Treasurer (re: GM31.19 "Metropolitan Toronto Police Benefit Plan – Actuarial Report as at December 31, 2013") presenting the 2013 Actuarial Report approved by the Board of Trustees at its meeting of April 30, 2014 and recommending special payment arrangements to fulfill Council's legislative requirement to fund the solvency deficit identified in that Actuarial Report.

At its meeting held on June 20, 2014, the MTPBF Board of Trustees approved a motion requesting the Actuary to provide the Board with the financial implications of preparing and filing with FSCO a revised Actuarial Valuation Report as at December 31, 2012, with a one (1) year deferral of the new solvency contributions for the Board's consideration at its next meeting scheduled for September 10, 2014.

COMMENTS

Following the Board's approval of the 2013 Actuarial Valuation on April 30, 2014, the Treasurer submitted a report to the June 16, 2014 Government Management Committee meeting (re: GM31.19) recommending special payment arrangements to fulfill Council's legislative obligation to fund the smoothed solvency deficit of $37.250 million as identified in the 2013 Valuation Report. GM31.19 also provided information regarding and recommendations concerning:

i. a conflict between the PBA Regulations regarding special payments and the limitations under the ITA Regulations as interpreted by the CRA; and

ii. the emergence of the Letter of Credit option recently made available to the City by the Province under the PBA Regulations.

Subsequent to the GMC meeting held on June 16, 2014, the Board of Trustees, at its meeting held on June 20, 2014, adopted a motion directing the Actuary to:

a) have further discussions with FSCO and the CRA to ascertain what progress has been made in resolving the conflict between the PBA Regulations and those under the ITA, and what options may be available to resolve the conflict; and

b) prepare a revised 2012 valuation report, with a one (1) year deferral of the revised solvency contributions, and provide an overview of the financial implications and status of the Fund as at December 31, 2012.

In addition, the Board of Trustees adopted a motion to engage an outside law firm to provide a legal opinion as to the City's ability under the PBA and its Regulations to utilize Letters of Credit as an option to fulfil its obligation to fund solvency deficiencies.

In approving the above motions, the Board of Trustees did not rescind the previous motion adopted at its April 30, 2014 meeting (which was confirmed at its meeting on May 28, 2014) that directed the Actuary to file the smoothed Actuarial Report, as at December 31, 2013. As the Actuary has not yet filed that Report with FSCO, the new motions passed on June 20, 2014 have created a conflict in the instructions provided to the Actuary.

The responses to the above requests are expected to be provided to the Board of Trustees at its meeting on September 10, 2014 for final review and decision. As the authority and responsibility for approving and filing actuarial valuations rest with the Board of Trustees, and given that a final decision by the Board of Trustees will not be made until its meeting scheduled for September 10, 2014, this supplementary report identifies three (3) possible scenarios that may arise based on the decision(s) of the Board of Trustees at its upcoming meeting in September. Under the PBA Regulations, a valuation report must be filed with FSCO by September 30, 2014.

Although the detailed results will not be known until the September 10, 2014 meeting, the Actuary has provided some preliminary information to the Board of Trustees (including the Treasurer), which is the basis of this supplementary report.

<u>Scenario A (Board of Trustees Reaffirms its April 30, 2014 decision to file the Current 2013 Actuarial Report attached to GM31.19)</u>

If at its September 2014 meeting the MTPBF Board of Trustees reaffirms its original decision of April 30, 2014 to file the 2013 Actuarial Valuation as presented in Attachment 2 of GM31.19, there will be no change required in the information, financial implications and recommendations presented in GM31.19 other than with respect to the use of the Letter of Credit to cover at least part of the catch-up payment, as provided in the Financial Impact section of this supplementary report. Given the recent information obtained by the Actuary during his conversation with the CRA, it is not anticipated that the MTPBF Board of Trustees will reaffirm its April decision.

Scenario B (Filing an Amended 2013 Actuarial Valuation with Revised Assumptions)

As part of the preliminary information provided by the Actuary, the Board of Trustees were advised that in discussions with the CRA, the Actuary identified, and the CRA confirmed and is supportive of, an option that is available under the *Income Tax Act* (clause 147.2(2)(c)) to revise the Actuarial Valuation Report as at December 31, 2013, to include an assumption for future cost-of-living increases when the Fund is in a surplus position. If the 2013 Valuation Report is revised to include a cost-of-living assumption, both the wind-up deficit and the smoothed solvency deficit would be the same at $37.250 million, thus removing the conflict between the PBA Regulations and the CRA's interpretation of the ITA Regulations. Under the revised 2013 Valuation Report the potential maximum solvency deficiency for which the City would be responsible would remain at $37.250 million as described in GM31.19.

Scenario C (filing a Revised Actuarial Valuation as at December 31, 2012)

On a preliminary basis, the Actuary also provided the Board of Trustees with the estimated financial implications of preparing and filing a revised Actuarial Valuation Report as at December 31, 2012 with a one-year deferral of the new solvency contributions. The Actuary has estimated that the funded status of the Plan under such a revised 2012 Valuation would be a solvency wind-up deficit of $88.0 million and a smoothed solvency deficit of $51.0 million. As a result, should the Board of Trustees at its September 2014 meeting decide to file the revised 2012 valuation report, the City would be responsible for making or covering the following special contributions in order to eliminate the smoothed solvency deficiency of $51.0 million: $14.7 million (including interest) in 2014; $9.5 million in 2015; and $6.1 million in 2016 to 2018.

The full details of the revised 2012 and 2013 valuation reports will be made available by the Actuary to the Board of Trustees at its meeting on September 10, 2014.

Given the shortened Committee and Council schedule in 2014, and the fact that the Board of Trustees' decision on which Actuarial Valuation will be filed will not be made until September 10, 2014, approval is required for this additional potential scenario, of filing a revised 2012 valuation report, with a one (1) year deferral of the new solvency contributions.

Use of the Letter of Credit – Revised Interpretation

In the GMC report GM31.19 staff advised that under the Regulation, the employer is not permitted to use a Letter of Credit to fund any special payment requirements that are in arrears and staff interpreted the term arrears to mean any payments that were owed back to January 1, 2014, based on the 2013 valuation report.

However, after further researching the PBA Regulations, the City Solicitor's Office has determined that the catch-up amount payable to the Fund (including interest), which results from the new valuation report (*i.e.* , the 2013 valuation report or the revised 2012 valuation report, with one (1) year payment deferral) that is filed indicating an increase in the required special payments, may also be covered by a Letter of Credit except to the extent that FSCO regards the City as being in arrears as to the monthly payments under the 2010 amortization which were suspended in early 2014 once the contribution limit under the ITA Regulations as shown in the 2013 Valuation Report was reached, as long as the Letter is provided sufficiently in advance of the due date (*i.e.* , within 60 days after the Valuation Report is filed with FSCO).

As such, it is recommended that the Treasurer be authorized to use a Letter of Credit to cover all applicable payments, including any catch-up payments, that are not considered to be "arrears" by FSCO, regardless of which scenario is approved by the MTPBF Board of Trustees at their meeting on September 10, 2014.

CONTACT

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SIGNATURE

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Giuliana Carbone
Treasurer

ATTACHMENTS

Appendix A: 2013 Metropolitan Toronto Police Benefit Plan 5-Year Amortized Special Payment/Letter of Credit (LOC) Schedule

Appendix B: 2012 Metropolitan Toronto Police Benefit Plan 5-Year Amortized Special Payment/Letter of Credit (LOC) Schedule