EAST HANTS

STAFF REPORT
CAO Department

Subject:	***Results: Tri-Annual Actuarial Review – December 31, 2022***
To:	Corporate & Residential Services Committee
Date Prepared:	April 8, 2023
Related Motions:	C20(198) Direction given to staff to engage for December 31 2022 pension valuation C21(89) DECEMBER 2020 PENSION COST CERTIFICATE C22(43) DECEMBER 2021 PENSION COST CERTIFICATE
Prepared by:	Kim Ramsay, CPA, CMA, CAO
Approved by:	Kim Ramsay, CPA, CMA, CAO

Summary

Preliminary results have been received for the December 31st, 2022 annual actuarial review of the pension plan; this review is required by legislation due to our plan's funded ratio on a solvency basis being less than .85 at December 31, 2021. The actuary was also asked to calculate the cost of an upgrade.

As part of the motion to approve the Pension Cost Certificate report in 2021, and in keeping with prior decisions of Council, Council had approved upgrading the definition of average earnings (to December 31, 2019 earnings) for those employees who were retiring between January 1, 2020 and September 30, 2023 only. These special payments, as they arise, are funded through the pension reserve fund. A recommended continuation of this commitment is included in this report.

This report outlines the preliminary results of the actuarial valuation and seeks Council approval to finalize and file the valuation with the Superintendent of Pensions. The deadline for filing is September 30th, 2023.

Financial Impact Statement
The decrease to the current service cost to the employer is estimated at 2.66% of payroll, or $71,839 (from 2019 valuation). The Special Payments required will be contributed into the Plan from the existing Pension budget/reserve as follows: 2023: $171,619; 2024: $188,297; 2025: $204,975.

Recommendations
Approve the filing of the December 31, 2022 Pension Plan Actuarial Report (draft attached to the agenda).

Recommended Motion
The Corporate and Residential Services Committee recommends that Council authorize:

1) The final December 31, 2022 actuarial valuation be filed based on the results as outlined in the report to Corporate & Residential Services Committee, dated April 8, 2023, ***Results: Tri-Annual Actuarial Review – December 31, 2022;***
2) Pension payments as required by legislation are approved for payment into the Plan;
3) The definition of average earnings for service prior to January 1, 2023, be upgraded to December 31, 2022 earnings, with no pension being greater than the best five years income of the employee, for those employees who are retiring between May 1, 2023 and September 30, 2026 only, and that these special payments, as they arise, be funded through the pension reserve fund;
4) The employer contribution rate be 5.32% for contributions on earnings after January 1, 2023 and adjusted by future cost certificates/pension valuations as legislation requires;
5) The Actuary be asked to do the standard upgrade calculation as part of the December 2025 actuarial review. This calculation will upgrade the definition of average earnings (to redefine average earnings

to December 31, 2025 earnings with no pension being greater than the best five years income of the employee); and,

6) That Plenus Consultants be appointed as the Actuary for the Municipality of East Hants pension plan.

Background

The Municipality of East Hants has a defined benefit pension plan. The contract specifies what employees will receive as a pension when they retire. In this type of plan employees contribute a specified percentage of their income into the plan and the employer (MEH) contributes whatever funds are necessary to fund the pensions promised. As such the risk of this type of plan is provided at the risk of the employer. If market losses occur, the employer must, by law, contribute more to the plan to keep it solvent. If the market does well, the employer's contribution will decrease. This is a common type of plan in government and large employers.

There is both Federal and Provincial law that governs how pensions work. The laws cover many things including what amendments can be made to the plan, how employees are kept informed, when extra money must be paid into the plan, etc. Under provisions of this legislation a review must be done of the plan every three years by an Actuary. They do a calculation based on a number of assumptions as to whether there are sufficient funds in the plan to fulfill the contract.

Some Particulars of the East Hants Plan:
1. Benefit – 2% x years service x average career income
2. Contributions – Employees: 6.5% Employer: 7.98% (effective Jan. 2022); 5.32% (effective January 2023)
3. Normal Retirement Date - 65 yrs
4. Earliest Retirement - Age + Service = 80 and Minimum 50 yrs old
5. Penalty for early retirement - 0.5% per month

In July 2020, Council passed motion C20(198) authorizing staff to engage the Actuary to perform the Tri-annual Actuarial Valuation as at December 31, 2022. Through the motion Council authorized:

1) The final December 31, 2019 actuarial valuation be filed based on the results as outlined in the report to Corporate & Residential Services Committee, dated July 15th, 2020, Results: Tri-Annual Actuarial Review – December 31, 2019;

2) Pension payments as required by legislation are approved for payment into the Plan;

3) The definition of average earnings for service prior to January 1, 2020, be upgraded to December 31, 2019 earnings, with no pension being greater than the best five years income of the employee, for those employees who are retiring between January 1, 2020 and March 31, 2021 only, and that these special payments, as they arise, be funded through the pension reserve fund;

4) The employee contribution rate be reviewed and amended in the Plan to be 5.5% for contributions on earnings after January 1, 2021 and 6.5% for contributions on earnings earned after January 1, 2022, with all related filings to be reviewed and submitted by the CAO;

5) The Actuary be asked to do the standard upgrade calculation as part of the December 2022 actuarial review. This calculation will upgrade the definition of average earnings (to redefine average earnings to December 31, 2022 earnings with no pension being greater than the best five years income of the employee); and,

6) That Plenus Consultants be appointed as the Actuary for the Municipality of East Hants pension plan. Staff have received the preliminary results of the Actuarial Valuation as of December 31, 2019.

Further, Motion C21(89) in March 2021 extended the upgrade period to September 2023:

> *… That the definition of average earnings for service prior to January 1, 2020, be upgraded to December 31, 2019 earnings, with no pension being greater than the best five years income of the employee, for those employees who are retiring between January 1, 2020 and September 30, 2023, and that these special payments, as they arise, be funded through the pension reserve fund; …*

This report outlines the results and seeks Council approval to proceed with recommendations.

Discussion

New Funding Rules

Prior to the 2019 valuation, new funding rules came into effect in Nova Scotia. A summary of the key rules that impact the Pension Plan are as follows:

- An amount in excess of going concern liabilities needs to be funded. The excess is known as a PfAD (Provision for Adverse Deviation). The level of PfAD increases with the level of risk in the Plan's investment portfolio (asset mix), i.e., more fixed income investments would mean a lower PfAD. For the East Hants plan the PfAD is 4.50% so the Municipality is required to fund 104.5% of the going concern liabilities of the Plan;
- Where new funding rules (PfADs) result in increased contribution requirements, the higher contribution requirements will be phased in over a 5-year period starting from the first valuation filed on or after December 31, 2019. The Special Payments outline in this report have been calculated with these phase in values;
- Going forward, actuarial valuations need to be filed every three years regardless of the plan's transfer ratio (previously if the transfer ratio was less than 0.85, annual valuations were required). The next valuation that will need to be filed will be as of December 31, 2025;
- In years where an actuarial valuation is not prepared, a cost certificate must be prepared and filed with the Superintendent of Pensions. A cost certificate provides estimated valuation results by using actual assets and approximate liabilities (liabilities are rolled forward from the most recent full valuation). The next cost certificate would need to be filed on December 31, 2023 values (in Spring of 2024). Based on the results in the cost certificate, the Superintendent has the power to order a full valuation;
- As a government entity, East Hants continues to be exempt from solvency funding requirements.

December 31, 2022 Actuarial Report

The December 2022 Actuarial calculations have been done and the results are known. The preliminary results are attached to the Committee agenda; the final report will be attached to the Council agenda by the evening of Council. In order to file these results with the Superintendent of Pensions, Council needs to approve the submission. The report is due by September 30th, 2023.

There are various assumptions made throughout the actuarial review process. Staff have validated, with the advice of the Actuary, the assumptions being used in the report. Based on the advice of the Actuary, the December 2022 Actuarial Review has been prepared with a 6.0% assumption of return, up from 5.45% in 2019. This recommended increase is primarily related to expected interest rates being 2-2.5% higher on bonds, which is targeted at 40% of the Plan's asset mix.

Council approved a restructuring of the investment portfolio in 2018, this has been implemented and was fully transferred over by October 2018. For 2020, 2021 and 2022 the rates of return for the plan assets were 7.95%, 9.52% and -8.13%, respectively. The Plan outperformed the expected 5.45% return in 2020 and 2021. The losses in 2022 were seen in most DB plan investment portfolios (our Plan did better than the average DB Pension Fund in Canada by about 15bps), with those more heavily invested in infrastructure/real estate faring better than those plans more heavily invested in fixed income and equities such as the East Hants Plan. The numbers in this report are as at December 31, 2022.

1) Contribution Requirements

The minimum contribution requirement for the Municipality (prior to any benefit improvements) is being decreased from 7.98% to 5.32% of payroll for current service. This is due to an increase in the interest rate assumption (how much the plan assets will grow due to interest earned on assets) and due to a lower average age of Plan participants (from 44 in 2019 to 40 years old in 2022).

Council is currently budgeting 10.5% for pension contributions, with unspent funds being transferred to reserve at each year end (in order to fund pension plan special payments related to retirements, upgrades and plan deficits).

The Pension Reserve balance at March 31, 2023 was approximately $942,983. Council's 2023-2024 budget was prepared with a 10.5% pension budget and it will continue to be recommend to Council to place unspent pension and other benefits into this reserve as financial results permit.

2) Plan Funding

The Plan's financial status on a **funding (going concern) basis** assumes that the Plan will continue in operation indefinitely. The funding valuation of the Plan on a funding basis shows the Plan's deficit at $1,691,180 which includes an adjustment of $642,595 for PfAD (4.5% of the liabilities at December 31, 2022).

Pension legislation requires deficits on a going concern basis to be funded through annual special payments. The special payment required for 2022 was $126,570. The required special payment, funded through the Pension Reserve Fund, for the next 3 years are as follows:

2023	$ 171,619
2024	$ 188,297
2025	$ 204,975

This will be evaluated again at December 31, 2025.

The Plan's financial status on a **solvency basis** assumes that the Plan winds up on the valuation date (December 31, 2022) with all benefits being settled. This assumes that anyone with a pension benefit or who is eligible for a benefit would have an annuity purchased for them and that anyone who is active in the plan, but not eligible to retire, would have a lump sum paid to them.

The total solvency deficit at December 2022 has been calculated at $3,052,365 (2019: $6,636,997). This is the amount that the Municipality would have to come up with if Council chose to wind up the plan, effective December 31, 2022.

Pension Regulations exempt municipalities who have defined benefit pension plans from solvency deficiency funding (with conditions). The Plan's transfer ratio (percentage of the deficit that is currently funded), on a solvency basis, is 0.82 (2019: 0.60); under the solvency deficit conditions, any plan with a ratio less than .85 is required to do cost certificate at the next annual date, in this case December 31, 2023.

3) Upgrade

The Municipalities pension plan is a career average plan (in the pension contract). However, given that Council has consistently approved upgrading the definition of average earnings for those retiring from the Plan, it is in practice a final average earnings plan.

As requested, the Actuary has calculated the cost to upgrade benefits to December 31st, 2022 so that service prior to January 1, 2023 is based on highest average five-year earnings to that date. The cost of the benefit improvement for all members of the plan on a solvency basis is $1,460,000.

Recommendation: Based on the current financial position of the Pension Plan and the current reserves held by the Municipality, staff recommend the definition of average earnings for service prior to January 1, 2023, be upgraded to December 31, 2022 earnings (up from 2019 as this is a tri-annual review), with no pension being greater than the best five years income of the employee, for those employees who are retiring between May 1, 2023 and September 30, 2026 only, and that these special payments, as they arise, be funded through the pension reserve fund. Extending the date to September 30, 2026 brings certainty to those looking to plan for retirement prior to the December 31, 2025 valuation being filed. This upgrade is consistent with prior decisions of Council. These special payments, as they arise, will be funded through the pension reserve fund.

4) Employee Contributions

The employee contributions into the East Hants plan had been 5% for at least 20 years until 2020. In 2020 Council amended the employee contribution rate to 5.5% for contributions on earnings after January 1, 2021 and 6.5% for contributions on earnings earned after January 1, 2022.

The 2022 review did not look at the impact of increasing employee contributions to the Plan.

5) December 2025 Actuarial Review

The next actuarial review of the pension plan is required at the end of December 2025. This review will determine whether the plan has a surplus or deficit and therefore whether the employer contribution has to be increased or can be decreased. This will be the tri-annual review where we will look at resetting the average earnings to the 5-year average earnings for the period ended December 31, 2025. In the interim, cost certificates will be prepared when legislated.

Alternatives

Council must file the December 31, 2022 Valuation Report. The assumptions are determined by the Actuary in conjunction with staff however the assumptions are subject to approval by the Superintendent of Pensions. All assumptions in this report are based on our Actuary's experience.

Conclusion

Council is being asked to file the attached valuation as at December 31, 2022 and proceed with a cost certificate for December 31, 2023. A full valuation report will be prepared based on direction of Executive Committee and will be posted to the Council agenda prior to the meeting (full report may not be ready at the time the agenda is posted).

Recommendations

Approve the filing of the December 31, 2022 Pension Plan Actuarial Report as attached and the recommendations outlined in the discussion section of the report.