MEMO – AMALGAMATED TRANSIT UNION LOCAL 615

DATE: September 9, 2016

TO: Jim Yakubowski, Amalgamated Transit Union Local 615

FROM: Optimum Consultants & Actuaries Inc.

SUBJECT: General Superannuation Plan for City of Saskatoon Employees (the "Plan")
Analysis of the Plan's Financial Situation and Proposed Modifications

Enclosed are our comments and analysis with respect to the funded status of the General Superannuation Plan for City of Saskatoon Employees (the "Plan") and the modifications proposed by the City of Saskatoon (referred to as the "City"). Our understanding is that Amalgamated Transit Union Local 615 ("ATU") is the only remaining group out of eight that has not adopted the terms of the proposed modifications by the City.

Going Concern Financial Situation of the Plan

The following table summarizes the going concern financial situation of the Plan shown in the actuarial valuation reports prepared by AON and reflecting the 2014 and 2015 plan modifications proposed by the City. Going concern valuation requires an actuary to reflect a sufficient Provision for Adverse Deviations ("PfAD") in the liabilities. Besides the PfAD, a smoothing of assets technique was also applied to the going concern results which provide for an additional level of conservatism in the 2012-2015 results.

	Going concern valuation – Plan modifications for all groups			
(in millions of $)	**Dec. 31, 2012**	**Dec. 31, 2013**	**Dec. 31, 2014**	**Dec. 31, 2015**
Assets				
Market value	555.0	654.0	711.7	746.9
Smoothing	(10.4)	(58.2)	(61.0)	(41.4)
PV future contributions	263.1	281.8	-	-
Total	807.7	877.6	650.7	705.5
Liabilities				
Service accrued	569.9	617.9	674.9	724.7
Future service	202.6	210.0	-	-
PfAD	34.6	49.7	37.7	40.4
Total	807.1	877.6	712.6	765.1
Surplus/(Deficit)	0.6	-	(61.8)	(59.6)
Funding ratio	100%	100%	91.3%	92.2%

(in millions of $)	Going concern valuation – Plan modifications for all groups Dec. 31, 2012	Dec. 31, 2013	Dec. 31, 2014	Dec. 31, 2015
Financial Assumptions				
Discount rate	7.00%	6.90%	6.70%	6.45%
Provision for adverse deviations (% of best estimate liabilities)	5.0%	6.7%	5.6%	5.6%
Margins/Service accrued	7.8%	17.5%	14.6%	11.3%
Actuarial cost method	Attained age	Attained age	Projected unit credit	Projected unit credit

Note that the actuarial cost method was also changed in the December 31, 2014 actuarial valuation from the Attained Age method to the Projected Unit Credit method. The prior Attained Age method provided an excess surplus to the funded position of the Plan, as the present value of future contributions were greater than the present value of future service benefits. Had the actuarial cost method not changed, the Plan would be in a surplus position in 2014 and 2015, if we assume that the present value of future contributions minus the present value of future service benefits were in the same range ($60M-$70M) as in 2012 and 2013. The actuarial cost method change was likely implemented in response to the plan change from a defined benefit plan to a target benefit plan. A target benefit plan requires an actuarial costing method that provides a more accurate picture of the actual accrued liabilities.

The actuarial cost method change increased the plan's deficit by $71.8M (210.0 - 281.8) as at December 31, 2013. Had the actuarial cost method not changed, the plan would be in a surplus position in 2014 and 2015.

The provisions for adverse deviations and assets smoothing techniques (collectively referred to as "Margins") utilized are relatively conservative versus the minimum acceptable range required by the actuarial standards and provincial regulators. The Margins range from 17.5% to 11.3% as a percentage of accrued liabilities. For purposes of stabilizing the required future contributions, the above conservative Margins are appropriate, but one should not use these results to negotiate benefit reductions.

The going concern valuation results are not an appropriate basis to use for negotiating purposes due to the level of conservatism in the Margins.

The discount rate utilized to determine the best estimate liability is typically the 50th percentile long term expected return on assets, whereby there is a 50% probability of obtaining the expected investment return rate. We believe that the 40th percentile rate, with a 60% probability of obtaining the expected investment return rate, provides a sufficient PfAD (may be subject to regulatory requirements provided by the Pension Superintendent). The Pension Superintendent has not provided any guidance with respect to specific margins to use. The following table illustrates the going concern valuation results reflecting the 40th percentile PfAD and the actual market value of assets:

	Going concern valuation plan - Modifications for all groups	
(in millions of $)	**Dec. 31, 2014**	**Dec. 31, 2015**
Assets		
Market value	711.7	746.9
Liabilities		
Service accrued	674.9	724.7
PfAD (40th percentile)	33.4	45.6
Total	708.3	770.3
Surplus/(Deficit)	3.4	(23.4)
Funding Ratio	100.5%	97.0%
Financial Assumptions		
Discount rate	6.70%	6.45%
Provision for adverse deviations (% of best estimate liabilities)	4.9%	6.3%
Actuarial cost method	Projected unit credit	Projected unit credit

Applying less conservative Margins, the Plan would be approximately 100% funded at the end of 2014 and 2015. This financial position also recognizes the changes of various assumptions and method changes which have increased liabilities and decreased assets over the last four years:

- → Lower discount rates (7% to 6.45%)
- → Improvements in mortality (UP94 Generation to CPM Private - life expectancy increases)
- → Actuarial cost method change (Attained age to Projected unit credit)

Applying less conservative Margins, which should meet the minimum regulatory requirements, would result in a going concern funded status of approximately 100% at the end of 2014 and 2015.

We have also estimated the Plan's going concern position as at December 2012 and 2013 had no plan modifications been adopted (for all the plan participants).

	Going concern valuation – No plan modifications	
(in millions of $)	**Dec. 31, 2012**	**Dec. 31, 2013**
Assets		
Market value	555.0	654.0
Smoothing	(10.4)	(58.2)
PV future contributions	240.8	258.0
Total	785.4	853.8
Liabilities		
Service accrued	569.9	617.9
Future service	212.8	220.6
PfAD	34.6	49.7
Total	817.3	888.2
Surplus/(Deficit)	(31.9)	(34.4)
Funding ratio	96.1%	96.1%
Assumptions		
Discount rate	7.00%	6.90%
Actuarial cost method	Attained age	Attained age

The plan's funded status would have been 96.1% at the end of 2012 and 2013.

If we eliminate the smoothing of assets as at December 31, 2013, the Plan's funded status would have been 102.6% (a surplus of $23.8M) before any plan modifications.

Best Estimate Financial Situation of the Plan

The figures below show the best estimate financial position of the Plan on a mark to market basis and reflect the 2014 and 2015 plan modifications proposed by the City. The Plan's financial position reflects no provision for adverse deviation in the liabilities and no smoothing of assets (as reported in the Plan's financial statements audited by Deloitte).

	Mark to market valuation – Modifications for all groups			
(in millions of $)	**Dec. 31, 2012**	**Dec. 31, 2013**	**Dec. 31, 2014**	**Dec. 31, 2015**
Financial situation				
Assets	555.0	654.9	711.3	746.9
Liabilities	569.9	600.9	674.9	724.7
Surplus/(Deficit)	(14.9)	54.0	36.4	22.2
Financial Assumptions				
Discount rate	7.00%	7.00%	6.70%	6.45%

Given that the negotiations were being held in late 2013 and early 2014, the surplus position of the Plan as at December 31, 2013, $54M, should have been disclosed by the City, as quarterly updates of the Plan's funded status can easily be provided by the actuaries within a month of quarter end.

Negotiations should not have been based on out-dated figures (December 31, 2012 deficit of $14.9M versus a December 31, 2013 surplus of $54M).

The Margins are used to stabilize the required contributions by providing a safety cushion to offset unfavourable plan demographic experience and investment returns. Audited financial statements require the disclosure of the best estimate financial position of the Plan whereby the Margins are not reflected. Given that the Margins are set by the Board of Trustees, the going concern basis typically reflects a conservative bias and does not represent the best estimate financial position of the Plan.

For negotiation purposes, the mark to market basis is a more appropriate basis given that it reflects a more accurate picture of the Plan's financial position. Under this basis, the Plan is in a surplus position of $22.2M as at December 31, 2015 (after reflecting the proposed modifications).

Given the surplus situation in 2013-2015, it seems as the City took advantage of out-dated 2012 results to attempt to change the employee benefit promise from a defined benefit to a target benefit plan.

The table below provides an estimate of Plan's financial situation on a mark to market basis and assuming that no plan modifications were adopted for all the participants in 2014 and 2015. The Plan assets would be slightly lower as both the employee and employer proposed contribution increases were excluded. The accrued liabilities would be slightly higher to reflect the exclusion of the 2015 proposed benefit reductions.

	Mark to market valuation – No plan modifications	
(in millions of $)	**Dec. 31, 2014**	**Dec. 31, 2015**
Financial situation		
Assets	710.3	743.7
Liabilities	674.9	729.4
Surplus/(Deficit)	35.4	14.3
Assumptions		
Discount rate	6.70%	6.45%

Had no modifications been adopted, the plan's financial situation on a mark to market basis would still reveal a surplus in the range of $10M-$15M as at December 31, 2015.

Proposed Target Benefit Plan

As the name indicates, a "target" is a goal that one aims to achieve. In that respect, it is not guaranteed. Therefore, if there is an experience downturn, benefits might be reduced, contribution rate may be increased or both could happen at the same time.

In the Memorandum of agreement, tabled by the City on September 28, 2015, it is clearly indicated that all benefit changes would only apply to future service. Nevertheless, that means that the participants would relinquish the guarantee currently offered under the current Defined Benefit Plan. This would transfer substantial risks to the active Plan participants.

Potential consequences of implementing a target benefit pension plan

→ Reduction of future pension benefits for both contributing participants and pensioners could happen with any negotiating leverage.

→ Investment risk would be completely shifted from the City to vulnerable pensioners with limited financial capacity to absorb reductions in income and to participants who could suffer contribution increases.

Conclusion

Given the surplus situation in 2013-2015 on a mark to market basis, it seems as the City took advantage of out-dated 2012 valuation results to attempt to change the benefit promise from a defined benefit to a target benefit plan.

If we reflect the actual market value of assets as at December 31, 2013, the Plan's funded status would have been 102.6% (a surplus of $23.8M) before reflecting any Plan modifications to all the groups.

A target benefit plan transfers the investment risk to the participants (similar to defined contribution plans). Future service benefits can be reduced, if future investments are not sufficient to fund these benefits. This will likely create an inter-generational inequity, given that future generations will contribute more and receive lower benefits.

Taking on additional costs should not mean accepting additional risks such as those associated with a target benefit plan. Capping the employer contributions is an extreme design change that should be considered only if the Plan was in severe financial turmoil, which is not the case for the Plan.

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