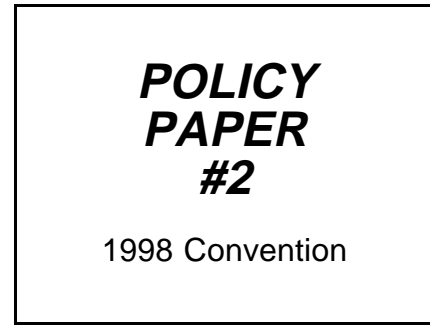


TO: UBCM Members

FROM: Member Services Committee
Mayor Pat Boname, Chair
Councillor Russ Gerard

DATE: August 20, 1998

RE: **'FINAL' REPORT ON THE REVIEW OF
THE MUNICIPAL PENSION PLAN**



1. OVERVIEW

This report delivers the final component of a review of the Municipal Pension Plan (MPP) first requested at the 1993 UBCM Convention. Earlier reports dealt with issues of funding, administration and governance. This report deals with the issue of the advantages and disadvantages of establishing a separate municipal pension plan.

It concludes that there are no financial advantages to establishing a separate plan (nor to establishing a separate group within the plan). While there may be some perceived governance advantages, they are difficult to determine conclusively.

Therefore, the recommendation to be considered by the members is:

That the report of the Member Services Committee on the advantages and disadvantages of a separate municipal pension plan be received and that direction of the 1993 Convention be considered completed.

2. BACKGROUND — HISTORY OF UBCM PENSION REPORTS

At the 1993 UBCM Convention, the following motion was endorsed:

Therefore be it resolved that the UBCM Executive be instructed to review and report on the state of the pension plan and the advantages and disadvantages of reestablishing the municipal sector with its own distinct pension plan.

While part of the resolution focused on a study of a separate plan, there were many other initiatives and proposals under consideration and these, because of their prominence, became the immediate priorities.

At the 1994 Convention an Interim Pension Report was presented at a workshop which provided the framework for the final 1995 report. The Interim report provided a history and description of the plan, recent events and status of the plan and the preliminary identification of current issues of the plan.

In March 1995 a comprehensive report, "Review of the Municipal Superannuation Plan: Status and Issues" was distributed to the UBCM members, the Government Finance Officers Association (GFOA), the Municipal Officers Association (MOA) and the GVRD Human Resources Advisory Committee.

At the 1995 Convention a report to the convention reviewed members responses to the Member Services Committee's review of the Municipal Superannuation Plan. The report made seven recommendations for further action.

At the 1996 Convention recommendations to proceed with the investigation of the "advantages and disadvantages of re-establishing the municipal sector with its own distinct pension plan"

- through a high level report on the policy issues; and
- through obtaining needed financial data from the Municipal Pension Board sub-committee were endorsed.

In the last year, the Member Services Committee has concentrated on the cost of setting up a new plan and setting up a separate group within the existing plan. This review was based on the Towers Perrin report (Appendix B) which addressed this issue. Discussions took place with the MOA/GFOA Pension Steering Committee regarding this review.

It is also important to reflect on some of the factors that may have underlain the original 1993 resolution. At that time, local governments:

- were concerned about the lack of input or consultation they had on the pension plan (there was no advisory or other structure),
- there was concern about growing unfunded liability and
- local governments wanted to "diversify" investment policies but there was resistance.

In short, nothing was changing, except the prospect of an increasing unfunded liability. However since that time there have been plan changes including governance, funding and the investment policy that have significantly changed the plan, which are outlined in the following section.

3. A DIFFERENT CONTENT: SUMMARY OF KEY CHANGES TO MSP

In the last five years there have been a number of changes to the plan including:

- Major changes to the governance structure.
- Funding policy implemented to manage plan's unfunded liability.
- Investment Policy revised to include additional asset classifications.
- Benefit improvements including early retirement provisions (reducing the early retirement reduction factor from 5% to 3%), recognition of additional service, indexing CPP offset and reduced pensions, group benefit improvements and the addition of dental coverage for retirees.
- Early Retirement Incentive Programs (ERIPS) effective in 1996.
- Vesting revised January 1, 1993 to five years of contributory service and January 1, 1998 to two years of contributory service.

- An appeals process established to determine if the plan rules were properly applied for a plan member.

a) Governance

Issues : In 1993, there was no effective governance structure.

Current Status : Today, we have an Municipal Pension Board that has a statutory basis.

The Municipal Pension Board is established consisting of 9 members appointed by the Lieutenant Governor in Council as follows:

- a) 3 persons nominated by the government;
- b) 4 persons representative of the plan members, nominated by the Municipal Employees Pension Committee;
- c) one person nominated by the Union of British Columbia Municipalities
- d) the commissioner.

Discussion : The Board is responsible for:
- making recommendations to government on contribution rates, funding policy, administration budget and staffing levels, benefits changes and investment policy.
- seeing that Plan rules are consistently and accurately applied, establishing an effective appeal process and appointing the Plan actuary to prepare the valuation report.

The Board, which has direct access to the Treasury Board, assumed several roles previously performed by Cabinet, Ministers or the Superannuation Commissioner. With the establishment of the new board there has been the potential for a far more meaningful and active board.

Evaluation : The governance structure has made major advances since the original resolution was endorsed. Although there have been significant governance changes since 1993, there is further work underway by the Joint Pension Board Governance Committee, indicating that the governance structure of the plan will continue to evolve.

Currently a succession study is underway to determine if the current plan arrangement should be revised, i.e. if the Superannuation Commissioner should be the trustee, board chair and pension plan administrator for each of the four statutory public sector pension plans.

A possible move towards Joint Trusteeship of the plan is also under consideration.

b) Funding and Investment Policy

- Issues* : Local governments were concerned about the growing unfunded liability. Some of the reasons that it was growing were:
- no funding policy and
 - the existing investment policy
- Current Status* : Today we have achieved both with the establishment of a funding policy and an investment policy.
- Discussion* : Funding Policy - Bill 53 put a funding policy into legislation which established a trigger (an increase in the Unfunded Liability as a percentage of payroll) in the statute that requires changes in the employer statutory contribution rates if the policy is not being met.

Bill 53 established an orderly process for addressing any future change in the financial health of any public sector pension fund. The Plan's funding policy is the level of contribution rate required to fully pay for the benefits earned by individual new Plan members over their working lifetime plus the additional contribution rate required to hold the Plan's unfunded liabilities constant when expressed as a percentage of annual payroll.

The transitional funding policy is to maintain current contribution rates for as long as the plan's financial experience continues to improve, that is, the unfunded liability continues to decrease as a percentage of annual payroll. Contribution rates will increase if the unfunded liability rises as a percentage of payroll. Contribution rates will decrease if a plan develops a surplus. Contribution rate changes would be in accordance with the long-term funding approach and would consist of the employer contributions to be set by the plan actuary at a rate required to meet the funding policy described above.

When contributor rates have been achieved consistent with the previous two points, any future increase in the unfunded liability as a percentage of annual payroll will be removed by contribution rate increases that amortize the increased unfunded liability over 15 years. To maintain stability, changes in contribution rates will be phased in so as not to exceed 0.25 percent per year.

Any pension plan surplus will be removed by reducing employer contribution rates to amortize the surplus over 15 years.

The Municipal Pension Plan's unfunded liability as a percentage of annual payroll, as at the December 31, 1991 Actuarial Valuation, was approximately 49.6%. This percentage reduced to 36% as at December 31, 1994, the last Actuarial Valuation. There is currently a valuation underway effective December 31, 1997, and the report will be available later this year. Preliminary reports indicate that the Unfunded Liability, as a percentage of payroll, will again reduce.

Investment Policy - While not directed by Bill 53, the Municipal Pension Plan simultaneously adopted as a "linked" decision the move to a diversified investment policy strategy which included investments in such asset classes as corporate and government bonds, Canadian and foreign equities and real estate. The strategy was implemented slowly and has increased the rate of return for each pension fund while at the same time decreased the risk involved in investing in any one asset class.

Evaluation : The measures taken in the last few years have had a dramatic turnaround. The unfunded liability has been reviewed; prospects are good to possibly eliminate it within the next few years and the unheard-of prospect may soon be entertained of what to do about a surplus.

Concerns about investment and funding policy have been addressed. Future considerations will be to monitor the precise investment policy and to seek direction if a surplus is prospective.

As stated earlier, the rationale for the 1993 resolution included concern about the lack of input or consultation, concern about the growing unfunded liability and the investment "diversification" issue.

4. CURRENT ACTIVITIES

Changes to the MPP continue this year. Presently under study or considered by the Municipal Pension Board are governance and a rate study.

Governance - Currently the Superannuation Commissioner is the trustee, board chair and pension plan administrator. In the 1996 review by the comptroller General of the roles and responsibilities of the Superannuation commissioner, it was recommended that the boards should make recommendations to the minister regarding the necessary legislative changes to resolve the potential conflict of interest between the commissioner's three roles.

Recent legislation requires that a person nominated by the government be designated as chair of the MPP and removes the commissioner of municipal superannuation from the board.

It should be noted that it is a common practice in a business organization to separate the responsibilities of the chair and the chief executive or operating officer. The Interplan Governance Committee (comprised of members of all four statutory public sector pension boards - colleges, teachers, public service and municipal) is currently reviewing options for the separation of each/some of these roles.

Rate Study - A study of the plan's rate structure has been undertaken to examine the costs to simplify the employer contribution rate structure and remove the doubling of contributions with age.

The current complex MPP employer contribution formula has been in place, since the plan began in 1958. Its purpose at the time was to help ensure that each employer's pension costs were appropriate for its particular employee group. This approach causes individual employer costs to vary significantly between employers and from year to year; is administratively complex; can lead to difficulties in plan analysis and has the potential for promoting age bias.

The current rates are structured on a "doubling" basis - the rates applicable within 15 years of normal retirement age (over age 45 for police and firefighters and over age 50 for other occupational groups) are double the rates applicable prior to that age.

Although a change in the rate structure would be plan neutral, the change would not be employer neutral. Rates for some employers would increase and for others decrease. A transitional phased-in approach is one option for consideration.

5. REPORT ON ADVANTAGES AND DISADVANTAGES OF A SEPARATE PLAN

To restate, the original terms of reference were:

Therefore be it resolved that the UBCM Executive be instructed to review and report on the state of the pension plan and the advantages and disadvantages of reestablishing the municipal sector with its own distinct pension plan.

As we have stated in previous sections, this central assignment was postponed because of the developments in other areas, the significant potential for advances, and in

retrospect, the advances that were made. That said, the Committee turned its attention this year, given the availability of data at very low cost to complete the assignment.

Financial Issues : The original question was whether the municipal sector was subsidizing the other sectors. When the MPP was established, it was all local government employees. Currently the composition has changed markedly. Yet the contribution rates with exception of police and fire remain the same for all employers of the Municipal Pension Plan.

The question that arises is if one group of employers is subsidizing another.

Methodology : The consulting actuary, Towers Perrin, estimated the financial and actuarial implications of establishing a separate plan (or contribution group) for the Municipal sector (basic account only) based on the level contribution requirements (non-doubling basis) calculated by the current plan's actuary as of December 31, 1994. The level contribution funding method, calculates the required contribution rates as the sum of:

1. the normal actuarial cost of pension entitlements accruing during the year calculated using the entry age normal actuarial cost method, plus
2. the past service contribution required to maintain the plan's unfunded liability (calculated using the entry age normal actuarial cost method) as a constant percentage of payroll.

Conclusion : The conclusion of the financial analysis is that there are no advantages to either:

a) separate plan

To establish a separate plan, the consulting actuary estimates that there would be an increase of .30% in the level contribution funding requirement (as a % of payroll).

b) separate group

Although there would be an estimated decrease of .17% in the level contribution funding requirement (as a % of covered payroll) to have a separate contribution group established for the Municipal sector under the current plan, it may not be considered a significant enough advantage to proceed.

Other Issues : There are other governance issues that might be associated with a separate municipal plan. These might include enhanced ability to:

- revise contribution rates
- influence investments, benefits and the funding policy and

- improve on plan administration

Conclusion : Because of the absence of real financial advantages, this aspect was not pursued at this time. The plan may need to be revisited as a result of possible moves toward joint trusteeship. The evaluation of joint trusteeship would need to be addressed not just by UBCM, but as a joint process.

Discussions/

Consultations: The conclusions are shared by the MOA/GFOA representatives on the UBCM Employer Pension Advisory Group.

6. CONCLUSIONS

- After a long period of stagnation, there has been significant change in the way the MPP is funded, governed, investments are made, since 1993.
- Importantly, a significant motivating factor in the early 1990s, the growing unfunded liability, has reversed. The 1994 actuarial report showed an improvement and this trend is expected to be reflected in the 1997 year-end evaluation.
- The direction of the 1993 Convention, diverted for pragmatic reasons, has been completed.
- This does not mean the UBCM considers its involvement complete. Through its seat on the Board, and the increasingly responsible work of the Board, there is a priority to improving UBCM member relationships, awareness and understanding on pension issues.
- That consistent with earlier recommendations, the UBCM Executive will move to clarify the "municipal" roles and responsibilities with the overall governance system. As well, through representation on the Municipal Pension Board, to work towards improving the level of service to the clients with specific emphasis on the timing of information provided on pension issues.

7. RECOMMENDATIONS

That the report of the Member Services Committee on the advantages and disadvantages of a separate municipal pension plan be received and that direction of the 1993 Convention be considered completed.

APPENDICES

- A. Executive Summary of 1995 Report and Summary of 1995 Convention Recommendations
- B. Towers Perrin Report
- C. UBCM Representation on the Municipal Pension Board
- D. Pension Time-line

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