CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Services and Taxation Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	December 10, 2020
SUBJECT/REPORT NO:	Hamilton Street Railway Pension Plan Valuation at January 1, 2020 (FCS20066) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Barb Howe (905) 546-2424 Ext. 5599
SUBMITTED BY: **SIGNATURE:**	Rick Male Director, Financial Services, Taxation and Corporate Controller Corporate Services Department

RECOMMENDATION

That the January 1, 2020 actuarial valuation for the Hamilton Street Railway Pension Plan per Appendix “C” to Report FCS20066 be received for information.

EXECUTIVE SUMMARY

The January 1, 2020 valuation indicates that the plan has a $17.5 million deficit on a going concern basis compared to a $21.2 million deficit at January 1, 2017. Significant legislated changes have occurred since the last valuation which now requires that a going concern valuation include the full cost of future indexing and a Provision for Adverse Deviation. These two changes increased the going concern liabilities by $37.4 million however the impact of the change was minimized by the gains in experience and changes in valuation assumptions.

On a solvency basis, the plan currently has a deficit of $5.3 million compared to a $26.1 million deficit at January 1, 2017. And on a windup basis the plan has a $104.5 million deficit compared to the previous $125.7 million deficit.

Since the solvency ratio is currently .98 (.88 – 2017) there are no solvency concerns and consequently no solvency funding is required. Further, since the solvency ratio is not less than 0.85, the next valuation will not be required until January 1, 2023.

However, the going concern deficit of $17.5 million will require annual special payments of $1.9 million starting January 1, 2021. The cost of this payment has been provided for in the current budget.

Alternatives for Consideration – Not Applicable

FINANCIAL – STAFFING – LEGAL IMPLICATIONS

Financial:

Going Concern Funding Requirements

Under the new funding rules, a going concern valuation must now include 100% of the future cost of indexation. Although under the old rules, the valuation may exclude this indexation, the City of Hamilton (City) chose to fund 66-2/3%. The additional cost to fund 100% of the indexation has added $20.3 million to the going concern liabilities. In addition, the new rules require that a Provision for Adverse Deviation (PfAD) be included in the valuation. The objective of PfAD is to reflect the level of risk in the plan's funding and investment policy. The PfAD has added $17.1 million to the liabilities. However, the $37.4 million in liabilities was offset by gains in the plan such that the going concern deficit only decreased from $21.2 million (2017) to a $17.5 million deficit at January 1, 2020.

Under the new funding rules the $17.5 million deficit can be funded over 10 years instead of 15 years with a "fresh start" each valuation and deferred to start 12 months from the valuation date. This means that deficit payments required under the previous valuation end December 31, 2020 and are re-amortized over another 10 years resulting in a new all-inclusive annual special payment requirement of $1.9 million starting January 1, 2021.

Further, an adjustment is allowed in the first valuation period if the new funding requirements exceed the amount that would have been required under the old funding rules. A portion of the additional cost can be exempted from the required contributions so that the increase is phased in over the three year period. The table below shows the annual required special payments less the exempted portion for each year:

	2020	**2021**	**2022**
Going Concern Special Payment	$2,470,800	$1,956,000	$1,956,000
Less: Exempted Amount	(1,328,400)	(185,000)	(66,500)
Minimum Required Contribution	$1,142,400	$1,770,200	$1,889,500

Appendix "A" to Report FCS20066 contains a more detailed breakdown of the HSR annual special payments required during the period 2020-2022.

Solvency Funding Requirements

On a solvency basis, the plan is in a $5.3 million deficit position at January 1, 2020 compared to a deficit of $26.1 million in 2017. The current solvency ratio is 98% compared to 88% (2017). Under the previous funding rules plans were required to fund to a 100% level but under the new rules, funding is only required to a level of 85%. Since the solvency ratio exceeds 85%, no solvency funding is required during the valuation period.

Funding Source

Although the special payment for 2020 to fund the going concern liability is only $1.1 million, as at October 2020 an amount of $3.1 million had already been paid based on the requirements of the previous valuation. This has resulted in an excess contribution of $2 million for 2020. This excess contribution was unavoidable since current legislation does not allow plan administrators to suspend contributions required based on the funding requirements of a previous valuation pending the outcome of a current valuation. In addition, excess contributions cannot be refunded, nor applied to the required special payments of the remaining two years of the valuation period. Therefore the excess contribution will be applied to the next valuation.

An amount of $6.87 million has been provided for in the current budget. Since the windup status of the plan is currently a deficit of $104.5 million, it is recommended that we maintain the $6.8 million budgeted amount over the valuation period and transfer the excess above the required minimum special payments to the Pension Reserve. By doing so the estimated balance in the reserve will grow from $3.3 million to an estimated $16.7 million by December 31, 2022. Appendix “B” to Report FCS20066, illustrates in greater detail the funding requirements and the growth of the pension reserve.

Staffing:

None

Legal:

Under legislation, an actuarial valuation must be filed within nine months of the valuation date. For valuations dated December 31, 2019 and January 1, 2020, the regulators have introduced COVID measures to assist plan administrators, by extending the filing deadline from September 30, 2020 to December 31, 2020.

The 2020 valuation was filed in November 2020 so that special payments based on the previous valuation could be suspended and therefore no further payments would be required for 2020

HISTORICAL BACKGROUND

As a result of a court ordered settlement approved on December 22, 2008, between the ATU 107 and the City, all members of the HSR plan were enrolled in the OMERS plan effective January 1, 2009, with future service accruing in the OMERS plan and past service remaining in the HSR plan. All new employees hired on or after January 1, 2009, became members of the OMERS plan. As a result, the HSR plan has become a closed plan. In addition, the settlement provided the following enhancements to the HSR plan:

a) 100% indexing, equivalent to that provided by OMERS; and
b) an additional six months of credited service for all qualifying members.

There is also a further provision whereby spousal benefits would be enhanced to 66-2/3% when an actuarial filing does not produce a deficit on either a going concern or solvency basis.

Each valuation requires the plan to be valued using three different methods:

(i) Going Concern Basis – this valuation assumes that the plan will continue indefinitely. Consequently, to calculate funding requirements, an actuary selects an interest rate for the pension fund based on an assumed long-term average return. Any funding deficiencies must be eliminated through payments made over a period of 10 years. Under current legislation, post retirement indexation is included from the going concern valuation as well as a provision for adverse deviation.

(ii) Solvency basis – is intended to calculate the funding required to pay for all benefits if the plan were to wind up on the valuation date. To determine solvency funding requirements, an actuary selects a rate that is an approximation of the annuity purchase rate. On a solvency basis the plan must be at least 85% funded. If the funded status falls below this level, then solvency special payments are required for the unfunded portion below 85%. The unfunded portion can be eliminated through payments made over a period of 5 years. Under current legislation, post retirement indexation can be excluded from the solvency valuation.

(iii) Wind-up Basis – similar to the solvency basis, this valuation assumes that the plan would be wound up at the valuation date, but includes all benefit obligations, such as post-retirement indexing.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

This valuation is the first valuation reflecting the new funding rules under Regulation 250/18 which came into effect May 1, 2018.

Key changes to the funding rules include:

Effective Date: The new funding rules apply to actuarial valuation reports dated on or after December 31, 2017.

Solvency Funding: A pension plan is required to be funded at 85% (previously 100%) on a solvency basis. If the funded level is less than 85%, then solvency special payments are required and must be amortized over a five-year period. In addition, these payments must begin one year after the date of the valuation report.

Going Concern Funding: A pension plan must still be funded at 100% on a going concern basis however now it must include the estimated cost of indexation in the going concern liabilities. In addition, the amortization period has been reduced from 15 years to 10 years with a fresh start each valuation and any special payments required will commence one year after the date of the valuation report. Further, the going concern valuation must include a **Provision for Adverse Deviation (PfAD).**

Provision for Adverse Deviation (PfAD). Under Reg. 250/18, the PfAD is a formula that is applied to the going concern liabilities. It is the sum of three percentages:

(a) a fixed percentage depending on whether the plan is a closed plan,
(b) a percentage depending on the asset mix of the plan, as allocated between fixed and non-fixed income in accordance with the plan's Statement of Investment Policies and Procedures (SIPP).
(c) a percentage reflecting the excess of the pension plan's going concern discount rate over a benchmark discount rate.

Although the cost of indexation must be included in the going concern liabilities, it may be excluded when determining the value of the PfAD.

Restrictions on Benefit Improvements: Restrictions on plan amendments that would negatively impact the funding of a plan have been introduced. Immediate funding will trigger if the pension plan is not funded at 80% on both a solvency and going concern basis. The additional unfunded liability associated with the benefit improvement must be funded on a going concern basis over 8 years rather than 10 years.

Plan Documents and Member Communications: As a result of the new rules, changes will be required to a number of plan documents, including the Plan Text and Statement of Investment Policies and Procedures (SIPP). Moreover, additional disclosures will need to be made to members and former and retired members in the annual and biennial statements.

RELEVANT CONSULTATION

Actuaries from the firm Aon Hewitt prepared the January 1, 2020 Actuarial Valuation.

ANALYSIS AND RATIONALE FOR RECOMMENDATION

The following chart provides a synopsis of the plan position and membership as of January 1, 2020, as compared to January 1, 2017:

	($ in millions)	
	2020	**2017**
Going Concern Basis		
Value of Assets	$211.2	$193.5
Less: Accrued Liabilities	$211.6	$214.7
Actuarial Surplus/(Deficit) before PfAD	$ (0.4)	$(21.2)
Less: Provision for Adverse Deviation (PfAD)	$ 17.1	NA
Actuarial Surplus(Deficit)	$(17.5)	$(21.2)
Solvency Basis		
Value of Assets[1]	$211.0	$193.3
Less: Solvency Liabilities	$216.3	$219.4
Solvency Surplus/(Deficit)	$(5.3)	$(26.1)
Solvency Ratio	.98	.88
Windup Basis		
Value of Assets[1]	$211.0	$193.3
Less: Wind-up Liabilities	$315.5	$319.0
Wind-up Surplus/(Deficit)	$(104.5)	($125.7)
# of active members	315	388
# of retired or deferred	639	625

[1] includes windup expenses of $200,000.

The 2020 annual payment of $1.1 million to fund the going concern liability of $17.5 million can be funded from the current budgeted amount of $6.87 million. And by maintaining the budgeted amount over the valuation period will allow the pension reserve to grow to fund towards to the windup deficit of $104.5 million.

ALTERNATIVES FOR CONSIDERATION

None.

ALIGNMENT TO THE 2016 – 2025 STRATEGIC PLAN

Community Engagement and Participation
Hamilton has an open, transparent and accessible approach to City government that engages with and empowers all citizens to be involved in their community.

Economic Prosperity and Growth
Hamilton has a prosperous and diverse local economy where people have opportunities to grow and develop.

APPENDICES AND SCHEDULES ATTACHED

Appendix “A” to Report FCS20066 HSR Schedule of Amortization Payments.
Appendix “B” to Report FCS20066 HWRF and HSR Funding 2020-2022.
Appendix “C” to Report FCS20066 HSR Actuarial Valuation at January 1, 2020.

BH/dw