

Public Service Pension Plan

Funding Policy

June15, 2023

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SCOPE

The Board of Trustees of the Public Service Pension Plan (the “Board”) is responsible for administering the pensions and post-retirement benefits of the members of the Public Service Pension Plan. The pensions include the basic non-indexed pensions earned plus future indexing on a non-guaranteed basis. The trustees manage the financial position of the plan by setting the required contribution rate for the basic non-indexed pensions. The trustees manage the indexing of pensions by providing a level of inflation adjustment that is sustainable in perpetuity on a best estimate basis. The trustees manage the other benefits by adjusting the post-retirement benefits so that they are affordable given the funds available. This funding policy addresses the trustees’ approach to meeting their obligations in this regard.

The plan consists of a number of different accounts that support different benefits, with different guarantees, and therefore each account has different funding targets. The plan rules set out the current contribution rates for both members and employers, and the Joint Trust Agreement (JTA) specifies how changes in the various rates will be established and shared. The JTA also describes the responsibilities of the trustees and the plan partners, and the decision-making powers of each with regard to benefits and contributions. Therefore, these two documents provide an important framework within which the Trustees have developed this funding policy.

In addition, the plan has to comply with the requirements of the Income Tax Act (ITA) and due to the terms of the JTA it has to comply with the going concern funding requirements of the BC Pension Benefits Standards Act (PBSA), as those requirements existed prior to December 31, 2019. The plan actuary has to comply with the professional standards of the Canadian Institute of Actuaries (CIA). These additional compliance requirements are also taken into account in this funding policy.

The different components, the benefits they provide, and the funding target in each case are summarized below:

Component	Benefit	Nature	Funding Target
Basic Account	Non-indexed pensions	Guaranteed	Fully pre-funded
Inflation Adjustment Account (IAA)	Future indexing	Not guaranteed	Provide indexing, to a maximum of the increase in the CPI, at a level that is sustainable based on the available assets and contributions
Non-pension	EHB /Group Life	Not guaranteed	No funds, fully Pay-as- you-go

PLAN OVERVIEW

2.1 Benefit Levels

The plan provides a final average defined benefit pension, funded by member and employer contributions as determined by actuarial valuations. Subject to sufficiency of funds, pensions in payment may be increased to keep pace with inflation (see Section 4).

2.2 Risks

The plan has a low active to retired member ratio, and the ratio continues to fall.

The effect of the low and declining ratio of active to retired members includes:

- The plan pays out significantly more in pensions than it collects in contributions; and
- If the plan experiences an unfunded liability, the contribution rate increase required to amortize that unfunded liability is much higher than it would be if the ratio of active to retired members were much higher.

The main risks to the Basic Benefits are:

- a) poor investment performance;
- b) experience differing from actuarial assumptions; and
- c) volatility in contribution rates.

The main risk to the other benefits is that the funding levels for those other benefits, which are fixed by the plan partners, may become insufficient to provide the expected levels of benefits. As the ratio of active members to retired members continues to decline, the probability that the plan will be able to sustain extended health benefits at current levels will also decline. In addition to the above, excessive inflation is also a risk to the other benefits.

The Board mitigates these risks by:

- a) having an appropriate investment policy, which is reviewed annually, that limits the Board's exposure to excessive investment risk;
- b) doing a thorough asset allocation review after every actuarial valuation;
- c) having the actuary include provisions for adverse deviation in the actuarial assumptions to increase the probability that the plan will not have an unfunded liability and will meet its funding targets; and
- d) following other risk mitigation strategies identified in this policy.

BASIC ACCOUNT

3.1 Overview

- a) There is equal cost sharing by members and employers.

3.2 Actuarial Assessment

- a) Benefit security is the primary funding objective for the basic account. In addition, contribution stability is an important secondary objective.
- b) The joint trustee nature of the plan, its broad public sector base, and the extreme unlikelihood of the plan not continuing all contribute to benefit security; therefore, the valuation can give significant weight to the secondary objective of contribution stability. Accordingly, contributions should be set on the basis of a going concern valuation.
 - i) The plan is exempted from the *PBSA* with regard to solvency requirements. This is appropriate given the public sector nature of the plan. The plan rules and JTA do not contemplate wind-up in any way. Solvency should not be taken into account when setting contribution rates.
- c) Actuarial valuations will be carried out every 3 years. In addition, in the year before the next valuation is due, a projection of the valuation results at the next valuation date should be prepared on the basis of actual investment returns in the past two years and expected returns in the remaining year. The implications on valuation assumptions and results of changes in the economic environment should also be considered. The intent is to provide the trustees with an early warning as to the possible direction and magnitude of any required changes to contribution rates.
- d) The entry age funding method will continue to be used as the underlying actuarial funding method.
- e) Assumptions
 - Given the objective of contribution stability, a long-term view on assumptions is appropriate; assumptions should not be unduly influenced by short-term conditions and should take into account the expected long term returns on the plan's assets. However, this should be balanced by the overriding objective of benefit security.
 - The plan is maturing and therefore has a decreasing ability to absorb contribution volatility; the level of risk taking should take this, and the size of any contribution stabilization account, into account.

- The IAA is funded by investment returns, and by member and employer contributions which are set by the partners. In addition, the plan rules permit the Board, at its discretion, to transfer to the IAA excess investment returns over the valuation investment return assumption on pensioner liabilities in the Basic account, i.e. on that part of the Basic account that covers pensions in payment. The actuary should recognize the impact of the excess investment return threshold and its linkage with indexing. However, when setting the investment return assumption, the actuary should focus on expected long-term investment returns and not allow the application of the excess investment return transfer rule to influence any decision on the return assumption.
 - The plan will continue with asset value/investment return smoothing over 5 years with the provision that the smoothed value of the assets be within 8% of the market value of the assets.
- f) Other than where exempted, the valuation and assumptions should be in accordance with the standards established by the CIA.

3.3 Basic Account Policy

- a) The JTA provides that if the actuarial valuation report indicates a requirement to increase contribution rates, the increase must be shared equally between plan employers and plan members. Likewise, if the actuarial valuation report shows that a contribution rate reduction is possible and the Board decides to implement one, any reduction will be shared equally between plan employers and plan members.
- b) While exempt under the *PBSA*, the JTA requires that the plan comply with the *PBSA* - going concern valuation requirements as those requirements existed prior to December 31, 2019, the JTA-B requirements i.e.:
- i) Pay the normal cost (NC) – i.e. the entry age normal cost
 - ii) If there is an unfunded liability (UL), this should be amortized over 15 years.
 - iii) If there is a surplus (S):
 - a surplus cushion equal to 5% of the liability must be retained, and
 - the remaining balance can then be amortized over not less than five years.

The contribution rate set according to the policy described below cannot be less than the JTA-B required rate.

- c) If there are excess assets, as defined in Amending Agreement No.2 to the JTA, the JTA allows the trustees to:

- i) establish a reserve for stabilizing contribution rates;
 - ii) transfer a portion of the excess assets to the Inflation Adjustment Account;
 - iii) equally reduce or eliminate the employer and plan member contributions for a period of time;
 - iv) make changes to the benefit provisions.
- d) Accordingly, and subject to 3 (b), the Basic Excess Asset allocation policy is:
- i) Firstly, transfer Basic Excess Assets to the IAA to improve the level of sustainable indexing, with the aim of providing 100% of CPI on the sustainable indexing basis, i.e. having no limit on the level of indexing provided,
 - ii) Secondly, stabilize the contribution rate by adjusting, or establishing, a rate stabilization reserve,
 - iii) Thirdly, provide benefit improvements or reduce basic contribution rates.

The actions to achieve these steps are described in sections 3.4 to 3.6 below.

3.4 Transfers to support indexing at full indexing

- a) If there are Basic Excess Assets, the first priority will be to transfer Basic assets to the IAA to improve the level of sustainable indexing.
- b) Basic Excess Assets will be transferred from the Basic Account to the IAA as follows:
 - i) Calculate the "Required Total Assets" as the total assets required to provide indexing at 100% of CPI (see section 4 on sustainable indexing).
 - ii) Calculate the "Plan Total Assets" as the sum of the Basic invested assets, the present value of Basic contributions currently required by the previous valuation, the IAA invested assets, and the present value of the IAA contributions.
 - iii) Transfer assets from the Basic Account to the IAA as follows:
 - If the Plan Total Assets are less than or equal to the Required Total Assets, transfer the entire Basic Excess Assets to the IAA.
 - If the Plan Total Assets are more than the Required Total Assets, transfer the portion of the Basic Excess Assets that is needed to ensure that sustainable indexing is 100% of CPI when taking into account the Plan Total Assets less the remaining Basic Excess Assets (after the transfer). At this point, the Plan Total Assets less the remaining Basic Excess Assets will be greater than or equal to the Required Total Assets, and the

remaining balance of Basic Excess Assets will not be needed to maintain indexing at 100% of CPI and can thus be used for other purposes.

- The remaining balance of the Basic Excess Assets may be used as described in 3.5 and 3.6 below.

3.5 Rate Stabilization Policy

The next priority is to stabilize the contribution rate. Two different circumstances need to be considered:

- I. The current contribution rate is above the entry age normal cost and the established amortization rates are higher than is required after the transfer from Basic to IAA to support indexing has been allowed for, i.e. there was an unfunded liability, but actuarial gains since the last valuation means that the contribution rate could be reduced.
- II. The current contribution rate is at or below the entry age normal cost and there is a surplus after the transfer from Basic to the IAA support indexing has been allowed for.

Circumstance I: Current contribution rate is above the entry age normal cost and the established amortization rates are higher than required.

In this circumstance, the remaining balance of the Basic Excess Assets represents "excess assets" as defined in Amending Agreement No. 2 of the JTA.

- a) If the JTA-B required rate is less than the entry age normal cost, the policy outlined in Circumstance II will be followed.
- b) If the current contribution rate is 1%¹ of pay or less above the entry age normal cost, an additional rate stabilization account transfer will be established such that the required contribution rate is equal to the current contribution rate, i.e. the contribution rate will not reduce.
- c) If the current contribution rate is more than 1% of pay above the entry age normal cost, the board will establish a rate stabilization account such that the required contribution rate is the higher of the JTA-B minimum rate or the rate that is 1% higher than the entry age normal cost and the contribution rate will be reduced to the required contribution rate, provided that doing so does not cause the sustainable indexing level to fall below 100% of CPI.
- d) If the smoothed value of assets is greater than the market value of assets, the contribution rate will not be reduced by more than the reduction calculated as per (b) and (c) above but using the market value of assets rather than the smoothed value of assets.

¹ Based on an illustrative Entry Age Normal Cost of 16% of salaries, a 1% change represents a change in the dollar amount of contribution of around 6%, which would be split 3% members/3% employers.

Illustrative Examples

	Illustration (b)	Illustration (c)
Current rate	17.00%	18.00%
EANC	16.50%	16.50%
JTA-B Required rate	16.75%	16.75%
Resulting rate	17.00%	17.50%

Circumstance II: Current Contribution rate is at or below the entry age normal cost and there is a surplus, or the JTA-B required rate is less than the entry age normal cost.

In this circumstance, the first priority is to stabilize the contribution rate.

- a) Calculate the contribution rate amortizing the surplus over 25 years.
- b) Repeat subsection (a) but with a 15 year amortization of the surplus. This will produce a lower contribution rate than in subsection (a) as the surplus is being used up more rapidly.
- c) The above is to be done at each valuation using rolling 25/15 year periods, on an open group basis.
- d) As long as the total current contribution rate is between the rates calculated in subsection (a) and subsection (b), i.e. between the 15 year amortization rate and the 25 year amortization rate, then the current contribution rate will continue unchanged, i.e. the surplus in excess of the JTA-B minimum surplus is effectively used as a contribution stabilization reserve.
- e) If the current contribution rate is greater than the (higher) rate with a 25 year amortization of surplus (i.e. the rate calculated in subsection (a)) then there is an excess basic surplus.
- f) If the current contribution rate is less than the (lower) rate calculated with a 15-year amortization of surplus (i.e. the rate calculated in subsection (b)), then the total rate must be raised to the level of the rate calculated in subsection (b).
- g) Thus there is a "neutral" contribution zone where no change is made to the current rates if they fall within the 15 to 25 year surplus band; if they fall below the 15 year (lower) band, then an increase is needed; if they are larger than the 25 year (higher) band, there is excess surplus, and other uses may be considered for the excess. The idea is to increase contributions gradually to the normal cost level before the surplus is fully used up, so as to prolong intergenerational equity and to prevent a very large "cliff"-like increase. See the graphical illustration in Appendix 1.

In applying the rate stabilization policy, consideration will also be given to the size of the asset smoothing cushion and projections of the expected trend in future contribution rates. In the case where the market value of assets is significantly below the smoothed value of assets it is possible that while the current contribution rate is adequate per the above framework, a significant increase is likely at the next

valuation. In this case the Board will consider whether it is preferable to increase the contribution rate immediately to offset partially the increase that has been deferred (in the absence of offsetting future investment gains) to the next valuation as a result of the asset smoothing process.

Illustrative Examples

	Illustration (f)	Illustration (d)	Illustration (e)
Current rate	15.00%	15.50%	16.30%
EANC	16.50%	16.50%	16.50%
15 year amortization rate	15.25%	15.25%	15.25%
25 year amortization rate	16.25%	16.25%	16.25%
Resulting rate	15.25%	15.50%	Review options for surplus

3.6 Other use of surplus

- a) If there is any excess basic surplus remaining after adjusting the rate stabilization reserve and making any transfers to the IAA to support indexing at the target level, the trustees may consider one or more of the following:
- i) An additional transfer to the RSA to deal with future market losses in the light of the relatively low number of actives per retiree. In particular, the Board will consider whether there is any amount in the Basic account that arose from excess investment returns that were not transferred to the IAA, either as a deliberate decision by the Board, or as a result of a transfer to the IAA under section 3.4 above, and this amount will be transferred to a rate stabilization account;

In no event will a transfer be made if it would trigger a contribution rate increase. In other words, if the accumulated excess investment returns exceed the excess basic surplus remaining, at most the excess basic surplus would be transferred.

Where such a transfer is made, the cumulative balance of excess investment returns will be reduced to reflect the amount of the transfer.

- ii) Reduce the contribution rate;
- iii) Increase benefits;
- iv) Make a further transfer to the IAA account to increase the target level of indexing or strengthen the likelihood of maintaining the target level;
- v) Leave in the Basic Account.

- b) When considering any of the above actions, indexing must be maintained at the current maximum sustainable indexing level. No action that reduces the maximum sustainable indexing level will be implemented.
- c) The treatment of surplus is subject to ITA rules.
- d) Benefit increases can arise either as a result of excess basic surplus or as a result of a decision by the plan partners to increase the benefits and meet the cost either by making a lump sum payment or increasing the contributions. When considering a benefit increase arising as a result of a decision by the plan partners, the trustees will consider the attendant cost of indexing and request that an appropriate amount be allocated to the IAA account to meet this cost.

3.7 Operation of Rate Stabilization Account (RSA)

- a) A rate stabilization account was established at the 2018 valuation. The RSA will be maintained in the Basic Account as a notional account. At each future valuation the RSA will be reported separately from the balance of the Basic Account assets and shall be excluded from the Basic Account assets when calculating the Basic Account funded position and required Basic contribution rates.
- b) Interest will be credited annually at the smoothed investment return rate as calculated by the actuary.
- c) The RSA balance will be reported in the notes to the financial statements, even if the account is drawn down to a zero balance.
- d) At each future valuation, the balance in the RSA will be drawn down to the extent needed to limit a contribution increase otherwise required.

Firstly, the resulting contribution rates will be recalculated assuming the full balance of the RSA is drawn down, and the required contribution rate will be set as the highest of the current contribution rate, the JTA-B rate and the rate assuming amortization of surplus over a 15 year period. If the current rate is the highest rate, then the draw down from the RSA will be limited to the transfer needed to keep the required Basic contribution rates unchanged, using the greater of 15 year and JTA-B amortization.

Consideration will also be given to the size of the asset smoothing cushion and projections of the expected trend in future contribution rates. In the case where the market value of assets is significantly below the smoothed value of assets it is possible that while the resulting contribution rate after the RSA draw down is adequate per the above framework, a significant increase is likely at the next valuation. In this case the Board will consider whether it is preferable to increase the contribution rate immediately to offset partially the increase that has been deferred (in the absence of offsetting future investment gains) to the next valuation as a result of the asset smoothing process.

No draw down will be made if it results in no change to the required contribution rate (this would occur where the transfer does not result in a surplus larger than the required JTA-B 5% cushion).

- e) Transfers of surplus to the RSA will be considered under section 3.6(a)(i) provided that the total balance in the RSA after the transfer does not exceed the amount required in the RSA in order to keep the likelihood of the Basic Contribution Rate being equal to the entry age normal cost at 80% over a period of 15 years following the valuation in question (the Maximum RSA Amount).

If the transfer of surplus would cause the RSA balance to exceed the Maximum RSA Amount, surplus will be transferred so that the RSA balance equals the Maximum RSA Amount and the remainder will be available for the other uses outlined in section 3.6(a).

In other words, the maximum amount in the RSA will be the amount required to achieve an 80% likelihood that the required plan contributions will be no higher than the entry age cost for at least 15 years.

INFLATION ADJUSTMENT ACCOUNT

4.1 Overview

- a) Cost of living increases are funded by the assets in the IAA. When an increase is approved by the Board, the capitalized cost of the increase is transferred from the IAA to the Basic Account.
- b) The contributions to the IAA are fixed by agreement and do not change depending on the funded position of future indexing.
- c) The level of indexing provided is partially dependent on the sufficiency of the funds in the IAA.

4.2 Objectives

- a) The target is indexing at 100% of the increase in CPI, where the increase in CPI is measured as defined in section 73 of the plan rules.
- b) Intergenerational equity is an important consideration and hence the sustainability of indexing going forward is a high priority.
- c) The sustainable indexing rate will be assessed every three years as part of the triennial valuation. The Actuary will report on the sustainability of indexing in a report that is separate from the actuarial report filed with the Superintendent of Pensions.
- d) If, after taking into account the overall resources of the Plan, the target-indexing rate is not sustainable in the long term at 100% of CPI, efforts will be made to encourage the plan partners to increase the contributions to the IAA. If contributions remain insufficient to provide for full indexing, then the indexing will be reduced to the "maximum sustainable indexing rate" as defined in section 4.3 of this policy.
- e) If, the actuary concludes that full indexing is sustainable, it is expected that the Board will annually approve cost of living increases at 100% of the increase in CPI.
- f) At all times the Board retains the right to grant indexing at less than the maximum allowed by this policy if the circumstances at the time require it.

4.3 Actuarial Assessment

As a reference point, the "maximum sustainable indexing rate", the highest rate of indexing, to a maximum of 100% of CPI, that can be sustained indefinitely into the future taking into account the resources and obligations of the Plan, will be calculated at each valuation as follows:

- a) The rate will be based on a valuation of the total Plan, i.e. the Basic Account (less any RSA) and IAA combined. Assumptions will be as for the Basic valuation, but using best estimate

investment return and inflation assumptions, i.e. with the margins for adverse deviations in the investment return and inflation assumptions removed.

- b) As for the Basic Account assessment, asset values and investment returns should be smoothed over a five-year period. To prevent the IAA from being run down faster than appropriate in periods of extremely weak investment returns, the smoothed value of all the assets should be limited to no more than 105% of the market value of the assets. Correspondingly, the smoothed value of the assets will not be less than 95% of the market value of the assets. The actuary should monitor the difference between the smoothed and market value of assets and discuss the implications of the gap with the Board during the valuation process.
- c) The actuary will calculate the level rate of increase that can be sustained over the lifetime of the current members of the Plan, taking into account:
 - i) The smoothed value of the assets in the Basic Account and IAA,
 - ii) The value of the contributions to the Basic Account at the rate required by the corresponding Basic Account valuation,
 - iii) The current contributions to the IAA; and
 - iv) Any future contribution increases already approved by the Plan Partners.

Subsections (ii), (iii) and (iv) together are referred to as the "available contributions".
- d) Once the actuary has calculated the level rate as described in subsection (c) above then:
 - i) If the level rate is less than the actuary's best estimate of inflation, the actuary shall calculate:
 - the increase in the balance of the IAA that would be necessary to cause the level rate to be equal to the actuary's best estimate of inflation; and
 - the amount of increase in IAA contributions that would be required to allow the level rate to be equal to the actuary's best estimate of inflation;
 - ii) If the level rate is greater than or equal to the actuary's best estimate of inflation, the actuary will calculate the amount by which the total assets could be reduced and still allow the level rate to be equal to the actuary's best estimate of inflation.
- e) In assessing the sustainable indexing rate, the contribution rate required to fully fund the Plan at the maximum sustainable indexing rate must be set equal to the long-term level equivalent of the available contributions. The required contribution at the maximum sustainable indexing rate will consist of the entry age normal cost of the Plan when benefits are indexed at the sustainable rate, plus the amount required to amortize any resulting surplus or unfunded liability over an infinite period, on an open group basis, i.e. based on the current payroll of the Plan membership allowing for increases at the assumed salary increase rate. The effect of this

approach is that at the maximum sustainable indexing rate, the required contribution rate will be a level rate that is expected to be sustainable indefinitely into the future.

4.4 Excess Investment Return Transfer

Annually, pursuant to section 75(3)(d) of the plan rules, if there is income that the Board could choose to transfer, the Board shall consider the following items before making the decision to transfer money from the basic account to the IAA:

- a) whether the basic account has a surplus or an unfunded liability
- b) whether the plan can pay full indexing on a sustainable basis;
- c) how much the total assets could fall before the plan loses the ability to pay full indexing;
- d) whether the latest year's investment returns are below the actuary's assumed rate of return;
and
- e) whether the smoothed value of the assets exceed their market value.

NON-PENSION BENEFITS

- 5.1 Subject to some qualification requirements, the plan provides extended health and life insurance benefits for retired members (post retirement group benefits, or PRGB). These will continue to be funded on a pay-as-you-go basis, with no funds accumulated.
- 5.2 As and when needed, the benefits will be adjusted so that the total cost of PRGB will not exceed 1% of payroll.

REVIEW

This policy will be reviewed every three years, or whenever there is a significant change to the plan structure or benefits, or whenever there is a change in legislation or professional guidance relating to funding.

Effective: June 15, 2023

Last Revised: June 15, 2023

APPENDIX 1

A review of this Policy will be conducted at least every three years following the receipt of the actuarial valuation report.

Summary of Basic Account Contribution Rate Calculation:

If there is an unfunded liability

- Amortize over 15 years; Contribution rate = normal cost increased for amortization

If there is an unfunded liability, but the current contribution rate is in excess of the JTA-B minimum required contributions

- If the current contribution rate is more than 1% above the EANC, reduce contributions to greater of JTA-B required rate or 1% above the normal cost
- If the current contribution rate is less than, or equal to 1% above the EANC, leave the rate unchanged.

If there is a surplus relative to the normal cost

