Management Employees Pension Plan
Funding Policy

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1 Purpose of the Funding Policy

The Management Employees Pension Plan ("MEPP" or "the Plan") Funding Policy has been prepared with reference to Section 3 and 5 of Schedule 5 of the *Public Sector Pension Plans Act* (Alberta) (PSPPA or the "Act"). This section sets out the Plan and the Funding Policy, the Plan's actuarial valuation report, and current service funding requirements. Under these sections:

> The mandate of the Board to establish policy for the MEPP for investment and fund management is as established under PSPPA, Schedule 5, Section 3 (1), Item 2(c)i and (c)ii which read:
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> > (c) *to set general policy guidelines on:*
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> > > (i) the investment and management of the plan fund's assets in accordance with section 6(3) and the regulations; and,
> > > (ii) the administration of the Plan that it considers should be followed.
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> The Plan's actuarial valuation report and current service funding requirements as established under the PSPPA, Schedule 5, Section 5(1) and 5(2) which read:
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> > 5(1) The Minister, in consultation with the Board, shall have an actuarial valuation of the Plan performed, and a report on that valuation prepared by the Plan's Actuary at least once every three years.
> > 5(2) The Minister shall, if necessary, within a reasonable time after receiving the report and after consulting with the Board, make a recommendation to the Lieutenant Governor in Council to make Plan rules, following the recommendations of the Plan's actuary in the report by adjusting either or both the employer and member contribution rates for current service so that those rates will meet or exceed the funding requirements and, if applicable, the solvency funding requirements.

In the implementation of these provisions, the Board leads the actuarial valuation process. The Board selects the Actuary, and selects the proposed assumptions in consultation with the Plan's Actuary and Alberta Treasury Board and Finance (ATBF). The Board then provides the finalized valuation report incorporating its proposed assumptions, and the Board's advice on funding to the Minister.
The purpose and details of the MEPP Funding Policy are:

- To set out the principles and guidelines governing the funding requirements of the Plan in accordance with the PSPPA and the objectives of the Management Employees Pension Board ("MEPB" or "the Board").
- To serve as a guide to the MEPB and the Plan's Actuary relating to decision making involving the funding of the MEPP's benefits prior to advancing a recommendation to the Minister.
- To establish the risk tolerance of the Plan as it relates to funding principles.
- To guide periodic review process for setting assumptions for actuarial valuations and making recommendations for total contributions to the Plan.
- To be taken into consideration in the development and periodic review of the MEPP Investment Policy.
- To be reviewed by the MEPB and the Plan's Actuary on an annual basis prior to recommending any adjustment to the employer and member contribution rates; prior to conducting an actuarial valuation of the MEPP to ensure that the Funding Policy continues to meet the objectives of the Plan and the MEPB.

2 Overview of MEPP

Established in 1972, the Management Employees Pension Plan (MEPP) is a contributory defined benefit pension plan for managers within the Alberta public service, approved agencies, boards and commissions. The Plan is established under the provisions of the PSPPA and the Public Sector Pension Plans (Legislative Provisions) Regulation. The Plan rules are prescribed under the MEPP Regulation. The Plan is financed by active members and employer contributions, and by the investment earnings of the MEPP fund.

The Minister is the Trustee of the MEPP and holds all assets of the Plan in trust to provide benefits pursuant to the Plan and to meet Plan costs. The MEPB monitors the administration and investment activities of the Plan, sets general policy guidelines on the investments for the Plan such as the MEPP Investment Policy, and any policies that the Board believes should be followed regarding administration of the Plan. The Board's full mandate, as established under the Act, is noted in Schedule 5, Section 3, and Schedule 6.

Under the terms of the Act, the MEPP is financed by participating employers and members. Contributions are required to fund the cost of service being earned by participating employees (current service contributions), as well as any shortfall, should assets plus expected future investment income be considered insufficient to cover the liabilities for promised benefits (unfunded liability contributions). Pension legislation requires an actuarial valuation be done at least every three years to determine the Plan's funding requirements. It must be filed with Canada Revenue Agency and contribution rates must be adjusted accordingly.

The actuarial valuation to determine the Plan's funding requirements determines the funded position on a going-concern and solvency basis. The Plan is exempt from funding any solvency deficiencies but is required to report the solvency position. The MEPP also prepares annual financial statements which provides an estimated surplus or deficit for accounting purposes, determined using different methods and assumptions than the going-concern valuation. All references to liabilities, funded positions, surpluses or deficits through the remainder of this policy refer to those determined on a going-concern basis in the actuarial valuation to determine funding requirements unless otherwise specified.
The MEPP includes some features such as early retirement, pension partner protection provisions, and a guaranteed 60 per cent cost-of-living adjustment for pensioners.

Eligibility for Membership

An eligible participant is a full-time (with at least 30 hours per week), permanent employee in a designated management position at the date of hire or at the date of being promoted to a designated management position, with the Government of Alberta or another participating employer.

Or, an employee may be eligible to join the MEPP if he or she is in a designated management position and, a) is employed on a full-time basis for a predetermined period and his or her employer has a policy to enroll him or her, or b) is a part-time (at least 14 hours per week), permanent employee and his or her employer has a policy to enroll him or her.

Positions in MEPP are designated through a Ministerial Order by the Minister.

Contributions

Members and employers are required to make contributions to the Plan in order to meet the funding requirements of the PSPPA. Employers and members contribute to the Plan at rates when combined with investment income are expected to provide for the benefits payable. The MEPB conducts actuarial valuations and reviews contribution rates for employers and members at least once every three years. These contribution requirements were outlined in the previous section.

Retirement Benefits

Members are entitled to a pension under the MEPP. A member can retire with unreduced pension when:

- the member is at least 55 years of age and the member's years of service (including any combined pensionable service) plus the member's age equal 80 or more; or
- when the member has attained age 60 with five or more years of service; or
- when the member has attained age 65.

MEPP provides an annual retirement pension based on the formula:

"2.0 per cent (%) x Years of Pensionable Service* x Highest Average Salary**

* Pensionable *service is limited to 35 years. (this includes Combined Pensionable Service (CPS) to reach the maximum 35 years); however, earnings after 35 years will continue to be recognized for benefit calculation purposes.*

** Highest Average Salary equals the average of the highest five consecutive years of salary where, for services after 1991, salary above the salary cap is excluded.

Termination Benefits

With five years of service a MEPP member becomes vested. This means a member is eligible to receive a pension at retirement or, is eligible to receive the value of the pension he or she has earned on their pensionable service. If he or she leaves the MEPP before age 55, this value is called the commuted value. If a member has less than five years of service at time of termination, he or she is not eligible to receive a pension.

In addition to retirement and termination benefits, MEPP also provides disability and death benefits.

Pension Partner Protection

By law, if the member has a pension partner, unless a waiver is signed by the pension partner, the member must choose a pension that, as a minimum, provides a joint-life pension with a 60 per cent pension payable to the surviving pension partner. In MEPP, the normal form of pension for a married member is a pension payable for his or her life. If the member dies first, then the pension partner receives a pension based on 75 per cent of the member's pension on pre-1992 service, and $66^{2/3}$ per cent of the member's pension on post-1991 service.

Combined Pensionable Service

Combined Pensionable Service allows an eligible individual who has pensionable service in both the MEPP and the Public Service Pension Plan (PSPP) with the same employer to combine service in both the MEPP and PSPP for the purposes of qualifying for an unreduced pension used to reach the maximum 35 years total service, and to calculate the highest five years' salary. The actual pension will be calculated and paid by each plan (MEPP and PSPP).

Reciprocal Agreements

When an individual enters or leaves the Plan, a reciprocal agreement may be used to transfer pensionable service and contributions between participating plans.

Cost-of-Living Adjustments (COLA)
Deferred pensions and pensions in pay are increased each year by an amount equal to 60 per cent of the increase in the Alberta Consumer Price Index.

3 Funding Objectives

The MEPB's Vision: That Plan members and employers have a pension plan that is affordable and sustainable.

The MEPB's Mission: To provide prudent governance of the MEPP and the Plan fund.
The funding objectives of the MEPB are to:

- sustain funding of the Plan to maintain the current level of benefits promised to Plan members and beneficiaries;
- ensure the financial sustainability of the Plan, including setting contribution rates that best meets the Plan's needs;
- ensure that, to the extent possible, each generation of active members pays for the benefits that are earned by that generation of active members; and
- manage the Plan's funded position from adverse risks.

In outlining these objectives, the MEPB recognizes the prudence of keeping the Plan fully funded whenever possible. Whenever circumstances arise which reduce the Plan's funded position below a fully funded level, the MEPB shall restore the Plan's funded status over an appropriate period of time that reflects these objectives. The MEPB shall incorporate minimum funded ratio thresholds and permissible maximum contribution thresholds to ensure contribution rates (including deficit financing) align to financial sustainability of the Plan.

Whenever the Plan achieves a surplus with a 20% margin, such surplus being defined as the assets exceeding the liabilities calculated with a **20%** margin, the MEPB will attempt to best set the contribution rates to address the maturing nature of the Plan and mitigate the longevity risks.

4 Key Risks Faced by MEPP

Funding Risks
In establishing this policy, the MEPB recognizes that the primary risks that the Funding Policy must take into account are:

- lower and volatile investment returns in the future;
- investments have to be liquidated at depressed values to pay for plan benefits, affecting the Plan's long term investment horizon and contribution rates;
- contribution rates will fluctuate with investment performance and other plan experience;
- plan experience will differ from that expected, resulting in contribution rates that are unaffordable for active members and/or participating employers;
- increased plan maturity resulting in net contribution outflows and a corresponding risk of higher contribution volatility; and
- risk that generations of plan members will have to contribute more (or less) than the actuarial cost of their benefits because of investment performance and other plan experience.

Contribution Risk Sharing

Contribution rates are adjusted periodically, based on the recommendations of the Plan Actuary, to help ensure that there are sufficient assets available to meet the pension benefits promised. Contribution rates are comprised of:

- Current service contributions, plus
- Unfunded liability contributions, less
- Surplus contribution reductions.

The risk of funding the Plan is shared by the employers and the members (active members). The Minister determines the appropriate cost sharing between the employers and members. The Board's role is to make recommendations to the Minister on the total contribution rate for the Plan.

The Board has recommended to the Minister that the future current service contribution rates (effective in the next filed actuarial funding valuations after December 31, 2020) are split equally between employers and active members – 50% for each.
The current contribution rates are as follows:

	MEPP Contribution Rates (Effective January 1, 2020)
Active Members	12.80%
Employers	13.20%
Total Contributions	26.00%

If the total contribution rate remains at 26.00% in the next filed funding valuation, the allocation between members and employers would move to 50%, resulting in member contribution rates of 13.00% of covered pay and employer contribution rates of 13.00% of covered pay.

Unfunded Liability Contributions

A portion of the total contribution is required to pay for any unfunded liability.

As noted previously, as the Plan maturity level increases or there is a significant decrease in the active membership group, a spike in unfunded liability contribution rates can significantly impact contribution volatility and result in significant intergenerational member contribution rate inequity.

In addition, Canada Revenue Agency imposes restrictions on member contribution rates above 9% of pay to ensure that active members do not fund more than 50% of their benefits over their working lifetime. Canada Revenue Agency looks at the total contribution rate being made by active members (without splitting out current service and unfunded liability contributions).

While the goal is now to split total contribution rates equally between active members and participating employers, active member contribution rate limitations do have to be put in place.

These limitations need to ensure that:

- active member contribution rates comply with Canada Revenue Agency limitations (where currently member contribution rates cannot exceed 15% of pensionable pay), and
- active members do not unreasonably take on Plan maturity risk from a significant change in the demographic profile of the Plan or from a significant investment shock.

As a result of these limitations, any unfunded liability contribution would be split equally between active members and participating employers if:

- the Board's recommendation is approved by the Minister;
- the active member contribution rate does not exceed Canada Revenue Agency limits; and
- the rising Plan maturity does not create a significant contribution rate increase for active members.

Solvency Deficiency Contributions

Under the PSPPA, the Plan is exempt from funding solvency deficiencies, although the Plan Actuary must report on the solvency position of the Plan in funding valuation reports.

Funding Volatility factors and Management of Risk

The Plan's liabilities are based on actuarial assumptions. All actuarial assumptions contain risk that actual Plan experience will prove adverse for the Plan. Adverse experience results in funding risk to the Plan. Assumptions having the largest bearing on liabilities and the greatest degree of uncertainty (i.e. funding risk) are the real rate of return and longevity.

The Plan's expected real rate of return is determined from the long-term expected return of the Plan's assets considering the long-term target asset mix of the Investment Policy.

In the short term, a significant degree of uncertainty (funding risk) accompanies the real rate of return given short-term economic volatility, particularly with equity based investments. In the long-term, while there is expected to be greater certainty in the average real rate of return, slight differences between actual and expected returns can have a significant impact on assets and Plan funding given the long-term nature of the liabilities.

Over the short to near-term, the impact of members living longer than expected (i.e. the mortality risk) is not expected to be significant. Extending an already long average remaining lifetime by a modest amount has little proportional impact. Longer-term, however, as the Plan's demographics age, the mortality risk is expected to increase in significance. As the Plan matures, the mortality risk becomes more relevant. Short-term variations in early retirement experiences and short-term losses to the Plan are not as significant to the Plan as the long-term experience and early retirement benefits and trends.

Actuarial valuations would include an analysis of potential adverse experience on the funded status of the Plan. Such analysis will provide information on the sensitivities that could materially affect the funded-status, benefit security and contribution rates of the Plan. The nature of the risk analysis would be determined by the Board prior to the valuation.

5 Funding Target Ranges

The funding assumption basis should be set such that the liabilities are calculated with a margin in the range of 0% to 30% with a target of 20%. That is, the liabilities fall within a range of 100% to 130% of the liabilities based on a best estimate assumption basis with a target of 120% of best estimate liabilities. The Funding objective of the Board is that MEPP achieves **120 per cent (%) funded ratio** on a going-concern basis where the liabilities are calculated with a 20% margin. The going-concern measurement means the actuarial basis specific to the Plan that measures its assets, liabilities and surplus/deficit as if it were continuing indefinitely into the future. Key characteristics of the basis for determining going-concern liabilities include:

- real rate of return assumption that reflects the current investment policy and the premise that this policy continues indefinitely into the future; and
- demographic assumptions.

Assumptions are based on best estimate assumptions with appropriate margins to reflect the significance of the underlying risks and the financial measurement parameters. The Board and Plan actuary shall work with the Minister to establish a contribution rate maximum based on the overall affordability of the employers and active members in order to control and minimize the contribution rate fluctuations.

The Board believes that the development of surplus is a normal outcome of funding a pension plan with a bias towards conservatism. A certain amount of surplus should be maintained in the Plan as a cushion against adverse experience that might otherwise require a sudden increase in contribution rates. Surplus that exceeds a reasonable margin should be shared among members and employers, recognizing past contributions towards the development of surplus, and the sharing of future financial risks of the Plan.

In the event that MEPP achieves a 120% funded ratio (with targeted levels of margin) and in a Surplus position, the Board will assess any unfunded liabilities or shortfalls in advance of consulting with the Minister on any required changes and recommend the process for use of any Surplus. Based on the MEPP's funded ratio, the MEPB will consult with the Minister on any Surplus that might occur prior to recommending any changes to contribution rates.

6 Cost Sharing Mechanisms

The Minister shall determine the appropriate cost sharing between the employers and members. The Board's role is to make recommendations to the Minister on the total contribution rate for the Plan. As noted previously, the Board has recommended to the Minister that the future contribution rates (effective in the next filed actuarial funding valuations after December 31, 2020) are split equally between employers and active members – 50% for each.

7 Management of Surplus

The Board will consult with the Minister to determine when and how to use the Surplus, if any. If Surplus can be used for contribution holidays or benefit improvements, the Board and the Minister should establish the factors to be considered before the utilization of Surplus. Factors would include the terms of applicable plan documents and legislative requirements, normal or desired margins of the Plan and funding reserves for future shortfalls, and/or in the event of plan termination.

The Board believes that any MEPP Surplus should be utilized to ensure the Plan's sustainability and to reduce the Plan's investment risks before being used for contribution reductions or benefit improvements.

8 Actuarial Methods, Assumptions and Reporting

Actuarial Cost Method

The actuarial cost method used to determine the Plan's contribution level and funded status is the Projected Accrued Benefit actuarial cost method. Under this method, the actuarial present value of benefits in respect of service prior to the valuation date, but based on pensionable earnings projected to retirement, is compared with the actuarial asset value.

Smoothing

In order to meet the objective of stable contribution rates, the actuarial value of assets will be determined by applying a smoothing methodology to the Plan's market value of assets at the valuation date. This adjustment is determined by amortizing over a five-year period the difference between the actual investment incomes, less investment expenses over the actuarially required net investment income for that year. Further, the actuarial value of assets is restricted to be no less than 85 per cent or no more than 105 per cent of the market value of assets.

Amortization of Unfunded Liabilities

Unfunded liabilities will be amortized commencing one year after the valuation date and continuing for a period not greater than 15 years. In the event contributions exceed the minimum funding requirement, such excess amount will be applied to the earliest unfunded liability.

Valuation Assumptions

The Board works closely with the Plan Actuary to develop "best estimate" assumptions regarding future economic and demographic variables that affect Plan costs. The Board's approach to setting assumptions reflects the Plan's relatively low tolerance of funding risk, consistent with the long-term nature of the Plan and its participating employers.

Demographic assumptions will be based on best estimate assumptions. These assumptions will be supported by regular experience studies of the Plan where practicable or general Canadian pension plan experience when actual Plan experience is not sufficiently credible.

Economic assumptions will be based on best estimate assumptions with a provision for adverse deviation (margin) either applied to the discount rate (implicit margin approach) or as a percentage increase in liabilities (explicit margin approach). The margin applied will be selected to balance the need for financial security for existing Plan members against overly conservative contribution requirements that potentially results in both intergenerational inequities among members and unnecessary financial strain on the Plan.

The best estimate discount rate assumption is based on the long-term expected return on Plan assets considering the long-term asset target mix described in the Investment Policy.

Best estimate earnings increase assumptions would be based on known adjustments in the short term and on general financial and economic expectations over the long-term.

The margin on the discount rate should be set such that the funding liabilities are within a range of 100 to 125 per cent of best estimate liabilities with a target range of 110 to 115 per cent of best estimate liabilities.

Risk Analysis

Each actuarial valuation shall include a sensitivity analysis around the material assumptions, illustrating the potential impact of adverse experience on the financial position of the Plan, including contribution rates reflecting expected changes in plan maturity over time. Such analysis is to be determined by the Board in consultation with the Actuary prior to the valuation. This analysis will provide the Board with important information regarding Plan risks, particularly Plan demographic changes, investment returns, inflation rates, and levels of risk mitigation margin that could materially affect the funded status of the Plan and, as a result, the security of benefits.

Solvency Valuations

In conjunction with the actuarial valuation, the Actuary will determine the financial position of the Plan on a solvency basis, in accordance with the requirements of the *Public Sector Pension Plans Act* and the *Employment Pension Plans Act.*

9 Frequency of Valuations

An actuarial valuation of the Plan will be performed, and a report on that valuation will be prepared at least once every three years. Filing of the report with the Canada Revenue Agency for funding purposes is required every three years or at the discretion of the Minister of Finance.

On behalf of the Minister, the Board selects the Plan Actuary and arranges for an actuarial valuation of the Plan to be completed, at a minimum of every three years. Within the MEPB's policy, the Board completes a valuation every two years or as the Board deems necessary.

10 Monitoring

The MEPP Funding Policy will be reviewed annually along with the Investment Policy.

11 Communication Policy

The MEPP Funding Policy shall be posted to the MEPP website, www.mepp.ca and a summary of the Plan's Funding Policy should be included in the Annual Spring or Fall Newsletter for distribution to the Plan members and beneficiaries.

The Board believes that transparent communications between itself and the Plan beneficiaries can help build understanding and a trusting relationship. Communicating information on the MEPP Funding Policy can educate the plan beneficiaries on factors that affect the security of beneficiaries' benefits and the variability of the funding costs, as well as the risks that are faced by MEPP and other public sector pension plans. In addition, it can help Plan beneficiaries appreciate the funding decisions that are made by the Minister and the Board.

GLOSSARY

Actuarial valuation

An actuarial valuation is a review of the financial position of the Plan, determining the liabilities, actuarial value of assets and contribution requirements.

Actuarial value of assets

The actuarial value of assets is the asset value used for valuation purposes. Smoothing methods are used to smooth investment gains and losses over a certain period, with the ultimate goal of reducing contribution volatility.

Current service contributions

Contributions, expressed as a level percentage of member earnings, equal to the actuarial present value of benefits expected to be earned by members in respect of a given year, including a provision for the administrative expenses.

Funded ratio

The ratio of the actuarial value of assets to the liabilities.

Liabilities

The liabilities are the actuarial present value of benefits earned in respect of service prior to the valuation date (future service is included in determining future vesting and early retirement reductions), calculated using the going concern assumptions and methods selected by the MEP Board, and determined as at the valuation date.

MEPP Investment Policy

The policy established by the MEP Board in order to clearly outline the policies, procedures and goals in order to ensure the fund is invested and managed in a prudent manner.

Surplus/(unfunded liability)

The difference between the actuarial value of assets and the going concern liabilities.

Unfunded liability contributions

Contributions, expressed as a level percentage of member earnings, that in combination with previously established unfunded liability contribution schedules are required to amortize an unfunded liability revealed in an actuarial valuation prior to 15 years from the date of the actuarial valuation.