

2019 **Annual Report**

Supplementary Retirement Plan for Public Service Managers
Year ending December 31, 2019



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1.0 Plan Profile

The Supplementary Retirement Plan for Public Service Managers (“SRP” or “the Plan”) was established on July 1, 1999.

The Plan provides additional pension benefits to public service managers of designated employers who participate in the Management Employees Pension Plan (MEPP) and whose annual salary exceeds the maximum pensionable salary limit under the Income Tax Act.

Alberta government employees who are part of MEPP and whose annual salary exceeds the maximum pensionable salary limit under the Income Tax Act accrue benefits under SRP effective July 1, 1999, or from their date of participation in MEPP, if later. Agencies, boards and commissions associated with the Government of Alberta have the option of participating in SRP, if their employees are contributing members of MEPP, and their application is approved by the President of Treasury Board and Minister of Finance (“the Minister”).

SRP is supplementary to MEPP. Years of service under MEPP are used to determine eligibility for vesting and early retirement. A member's pension commencement date is the same under both plans and the pension payable is in the same form.

SRP and MEPP are two distinct pension plans, each with its own separate funding, investments, accounting, pension benefits and entitlements. SRP is funded as a Retirement Compensation Arrangement, which under the federal tax rules is an acceptable means of providing a supplementary pension on salary above the yearly maximum pensionable salary limit.

Current service costs for SRP are funded by employee and employer contributions which, together with investment earnings, income tax refunds and transfers from the SRP Reserve Fund, are expected to provide for all benefits payable under SRP.

The contribution rate in effect on January 1, 2019, was at 12.80% of pensionable salary in excess of the yearly maximum pensionable earnings limit for participating employees and designated employers. This is the same rate as the 2018 contribution rate (12.80%).

Employers make additional contributions to the SRP Reserve Fund. The Minister implemented an employer contribution rate increase which changed the rate to 9.9%, effective April 1, 2015.

An actuarial valuation is performed at least every three years to determine the contribution rate payable to the Reserve Fund. The last actuarial valuation was performed as at December 31, 2018, by Aon Hewitt and the results were extrapolated to December 31, 2019.

1.1 Plan Administration

The Minister is responsible for the administration of SRP and has delegated this responsibility to Alberta Pensions Services Corporation (APS).

The SRP Advisory Committee (“the Committee”) was established by the Minister pursuant to Treasury Board Directive 01/06 (previously 01/99 as amended by Directive 04/99). The mandate of the committee is to oversee the administration, investment and funding of SRP. The Committee is composed of three members, all of which are Government of Alberta employees.

1.2 Investment Management

The Minister is responsible for the investment of the Plan assets through its provincial corporation, Alberta Investment Management Corporation (AIMCo).

1.3 Financial Highlights

- Contributions made to SRP for 2019 totaled \$5.476 million, down from \$6.623 million in 2018. This included \$2.735 million employers' contributions and \$2.741 million employees' contributions.
- Payments from SRP in 2019 totaled \$8.872 million, up from \$7.269 million in 2018. Payments included \$7.999 million in benefit payments (\$6.473 million in 2018), \$822,000 in administration expenses (\$747,000 in 2018), and \$51,000 in investment expenses (\$49,000 in 2018).
- The contribution rate for eligible employees and designated employers is 12.80% of pensionable salary (in excess of the yearly maximum pensionable earnings limit).
- Effective April 1, 2015, the employer contribution rate to the Reserve Fund is 9.9%.
- Over 10 years, the Plan's actual return of 8.8% (which includes inflation of 1.6%) exceeds the nominal return of 6.0% (4.0% plus expected inflation of 2.0%) resulting in the Plan meeting its investment objective.
- In 2019, the Plan's actual before-tax return was 13.0% compared to its policy benchmark of 13.5%.
- At the end of 2019, net assets available to pay benefits were \$208.1 million (up from \$189.6 million in 2018). This included \$18.6 million (net of receivables and payables) in the RCA Fund, \$35.9 million in the refundable income tax account and \$153.6 million in the Reserve Fund.

1.4 Operational Highlights

- At December 31, 2019, SRP had 950 active members, 248 deferred members and 1,194 pensioners. In 2018, there were 1,009 active members, 223 deferred members and 1,128 pensioners.
- Approximately 18% of active MEPP members participate in SRP.
- The average, annualized pension paid from SRP in 2019 was \$6,187.79 to plan members and \$3,320.29 to plan member beneficiaries (including pension partners).

1.5 Additional Information

- Financial statements for the SRP Reserve Fund are included in the Treasury Board and Alberta Finance annual reports.
- Additional information on SRP is available on the MEPP website at mepp.ca.

2.0 Investment Highlights

The SRP consists of a *Retirement Compensation Arrangement Plan (RCA Fund)* and a refundable income tax account. Half of the contributions from participating employees and participating employers are deposited in the *RCA Fund*. The other half of contributions and 50% of the RCA Fund's realized income are forwarded to Canada Revenue Agency and held in a refundable income tax account. The refundable income tax account does not earn interest. Refundable income tax is returned to the Plan, at the same rate, when pension benefits are paid to Plan members and beneficiaries.

Due to the tax treatment of the RCA, contributions to and investment income from the *RCA Fund* are not large enough to provide for all expected future benefit payments. As a result, the Government of Alberta established a regulated Reserve Fund which is administered by the Minister. Contributions are collected from participating employers; the funds are invested in the Reserve Fund to meet future obligations of the SRP.

2.1 Investment Performance

AIMCo manages and invests the assets of the Plan on behalf of the Minister. The primary investment objective for the Plan is to earn a before-tax long-term rate of return of 4.0% above inflation. The Plan uses an expectation of inflation of 2.0% when valuing the Plan's liabilities. Over ten years, the Plan's actual return of 8.8% (which includes inflation of 1.6%) exceeds the nominal return of 6.0% (4.0% plus expected inflation of 2.0%). The Plan continued to meet this investment objective in 2019.

The real rate of return is the return earned above inflation; it measures the return after taking into account the decrease in the purchasing power of the Canadian dollar. Additionally, AIMCo is expected to achieve a value-added target of 0.5% measured by comparing actual returns against the return of the policy benchmark (measured on a before tax basis) over a rolling four-year time horizon.

In 2019, the Plan's actual before-tax return was 13.0% (2018: 0.9%) compared to its policy benchmark of 13.5% (2018: 0.7%). Returns in 2019 rebounded from a poor 2018 as a result of strong performance by equity markets overall.

Investment Performance

Investment Returns December 31, 2019 (in %)

		One Year Return				Compound Annualized Return	
		2019	2018	2017	2016	4 Years	10 Years
Actual Gain		13.0	0.9	9.7	6.7	7.5	8.8
Benchmark Gain*		13.5	0.7	8.9	6.2	7.0	8.2
Value Added by Investment Manager		(0.5)	0.2	0.8	0.5	0.5	0.6

* The policy benchmark return is the product of the weighted average policy sector weights and sector returns.

2.2 Asset Allocation

The table below shows the Plan's long-term target asset mix in comparison to the Plan's actual asset mix at December 31, 2019 and 2018.

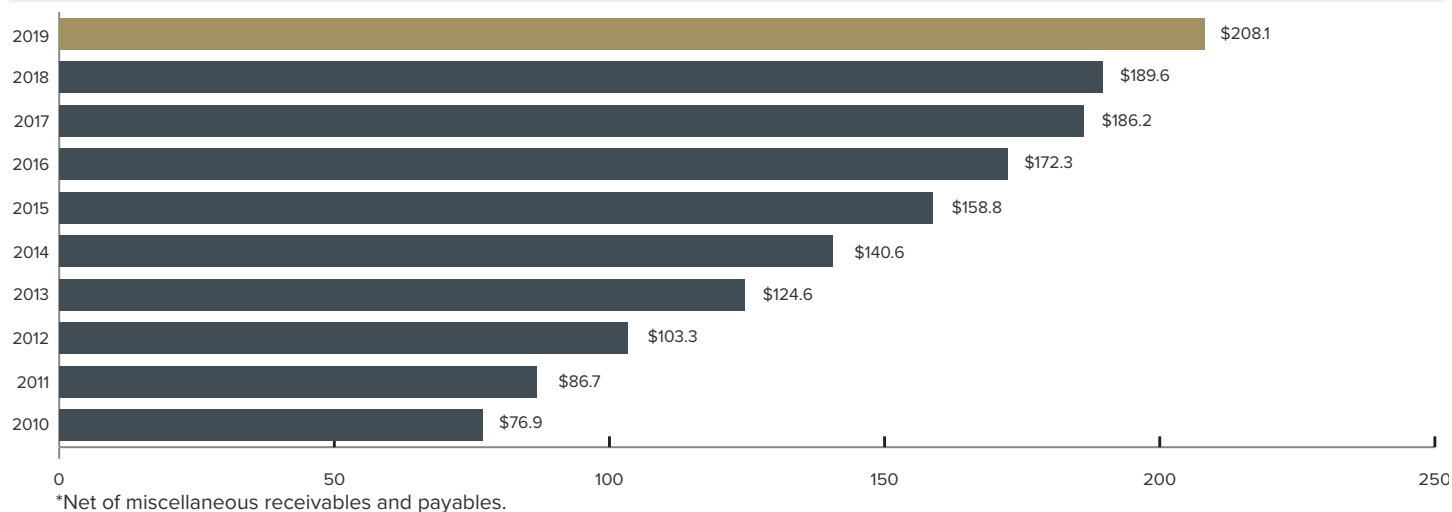
Asset Mix %

	Long-Term Policy		Actual	
	2019	2018	2019	2018
Fixed Income				
Cash & Short Term	0.5	0.5	0.7	0.7
Bonds & Mortgages	31.5	31.5	31.0	32.9
	32.0	32.0	31.7	33.6
Equities				
Canadian	14.0	14.0	14.3	13.3
Foreign	34.0	34.0	33.9	31.4
Private	0.0	0.0	1.1	1.5
	48.0	48.0	49.3	46.2
Inflation Sensitive and Alternative Investments				
Real Estate	10.5	10.5	10.0	11.1
Infrastructure	7.5	7.5	6.3	6.1
Timberland	2.0	2.0	1.6	1.6
	20.0	20.0	17.9	18.8
Strategic/Tactical Opportunities	-	-	1.1	1.4
Total	100.0	100.0	100.0	100.0

2.3 Change in Assets

Net assets available to pay benefits at the end of 2019 for the SRP were \$208.1 million including \$18.6 million (net of receivables and payables) in the *RCA Fund*, \$35.9 million in the refundable income tax account and \$153.6 million in the Reserve Fund.

Net Assets*(in millions \$)



SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

Financial Statements

Year Ended December 31, 2019

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Independent Auditor's Report

To the President of Treasury Board, Minister of Finance

Report on the Financial Statements

Opinion

I have audited the financial statements of the Supplementary Retirement Plan for Public Service Managers, which comprise the statement of financial position as at December 31, 2019, and the statements of changes in net assets available for benefits and changes in pension obligation for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In my opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Supplementary Retirement Plan for Public Service Managers as at December 31, 2019, and the changes in net assets available for benefits and changes in its pension obligations for the year then ended in accordance with Canadian accounting standards for pension plans.

Basis for opinion

I conducted my audit in accordance with Canadian generally accepted auditing standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of the Supplementary Retirement Plan for Public Service Managers, in accordance with the ethical requirements that are relevant to my audit of the financial statements in Canada, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Other information

Management is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the financial statements and my auditor's report thereon. The Annual Report is expected to be made available to me after the date of this auditor's report.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

When I read the Annual Report, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Canadian accounting standards for pension plans, and for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Supplementary Retirement Plan for Public Service Managers' ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless an intention exists to liquidate or to cease operations, or there is no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Supplementary Retirement Plan for Public Service Managers financial reporting process.

Auditor's responsibilities for the audit of the financial statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Supplementary Retirement Plan for Public Service Managers' internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Supplementary Retirement Plan for Public Service Managers' ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Supplementary Retirement Plan for Public Service Managers to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

[Original signed by W. Doug Wylie FCPA, FCMA, ICD.D]
Auditor General

June 1, 2020
Edmonton, Alberta

Statement of Financial Position

As at December 31, 2019

	(\$ thousands)	
	2019	2018
Net assets available for benefits		
Assets		
Investments (Note 3)	\$ 18,250	\$ 19,447
Refundable income tax (Note 1f and Note 5)	35,872	36,541
Contributions receivable		
Employers	110	128
Employees	109	126
Other receivables	4	-
Due from Alberta Pensions Services Corporation	378	444
Due from SRP Reserve Fund (Note 6)	153,607	133,157
Total Assets	208,330	189,843
Liabilities		
Income tax payable	216	265
Other payables	17	1
Total Liabilities	233	266
Net assets available for benefits	208,097	189,577
Pension obligation and deficit		
Pension obligation (Note 7)	252,795	259,887
Deficit (Note 8)	(44,698)	(70,310)
Pension obligation and deficit	\$ 208,097	\$ 189,577

The accompanying notes are part of these financial statements.

Statement of Changes in Net Assets Available for Benefits

Year ended December 31, 2019

	(\$ thousands)	
	2019	2018
Increase in assets		
Contributions (Note 9)	\$ 5,476	\$ 6,623
Increase in SRP Reserve Fund (Note 6)	20,450	3,586
Investment income (Note 10)	1,466	399
	27,392	10,608
Decrease in assets		
Benefit payments (Note 11)	7,999	6,473
Investment expenses (Note 12)	51	49
Administrative expenses (Note 13)	822	747
	8,872	7,269
Increase in net assets	18,520	3,339
Net assets available for benefits at beginning of year	189,577	186,238
Net assets available for benefits at end of year	<u>\$ 208,097</u>	<u>\$ 189,577</u>

The accompanying notes are part of these financial statements.

Statement of Changes in Pension Obligation

Year ended December 31, 2019

	(\$ thousands)	
	2019	2018
Increase in pension obligation		
Interest accrued on opening pension obligation	\$ 10,445	\$ 10,695
Benefits earned	9,074	10,188
	19,519	20,883
Decrease in pension obligation		
Benefits paid	7,999	6,473
Net decrease (increase) due to actuarial assumption changes (Note 7a)	1,096	(4,255)
Net experience gains (Note 7b)	17,516	-
	26,611	2,218
Net (decrease) increase in pension obligation	(7,092)	18,665
Pension obligation at beginning of year	259,887	241,222
Pension obligation at end of year (Note 7)	<u>\$ 252,795</u>	<u>\$ 259,887</u>

The accompanying notes are part of these financial statements.

Notes to the Financial Statements

December 31, 2019

(All dollar amounts in thousands, except per member data)

NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Supplementary Retirement Plan for Public Service Managers (the Plan) is a summary only. For a complete description of the Plan, reference should be made to sections 5, 7 and 98 of the *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000 and the *Supplementary Retirement Plan - Retirement Compensation Arrangement Directive* (Treasury Board Directive 01/06). The President of Treasury Board, Minister of Finance has overall responsibility for the operations of the Plan and is responsible for investments. Alberta Treasury Board and Finance is management for the purpose of these financial statements. Unless otherwise stated, all terms that are not defined below have the meaning prescribed to them in the Plan. Should anything in Note 1 or the financial statements conflict with the legislation, the legislation shall apply.

a) GENERAL

The Plan was established on July 1, 1999 to provide additional pension benefits to certain public service managers of designated employers who participate in the Management Employees Pension Plan (MEPP) and whose annual salary exceeds the MEPP salary cap. The Plan is supplementary to MEPP. Service under MEPP is used to determine eligibility for vesting and early retirement. A member's pension commencement date is the same under both plans and the pension is payable in the same form. Members of MEPP who have attained 35 years of combined pensionable service cannot subsequently start participating in the Plan.

b) PLAN FUNDING

Current service costs are funded by employee and employer contributions, which together with investment earnings and transfers from the Supplementary Retirement Plan Reserve Fund (see Note 6) are expected to provide for all benefits payable under the Plan. The contribution rate for designated employers equals or exceeds the rate for eligible employees. The contribution rates in effect at December 31, 2019 were 12.80% (2018: 12.80%) of pensionable earnings over the MEPP salary cap limit for eligible employees and designated employers.

An actuarial valuation of the Plan is required to be performed at least once every three years. The rates are to be reviewed periodically by the President of Treasury Board, Minister of Finance.

c) BENEFITS

The Plan provides a pension of 2.0% of pensionable earnings that are in excess of the MEPP salary cap for each year of pensionable service after July 1, 1999 in which the employer was a participating employer, based on the average salary of the highest five consecutive years.

Vested members are entitled to an unreduced pension on service if they have either attained age 60, or age 55 and the sum of their age and combined pensionable service equals 80. Pensions are reduced if the member is under age 60 and the 80 factor is not attained.

NOTE 1 SUMMARY DESCRIPTION OF THE PLAN**CONTINUED**

Disability, death, termination benefits and cost-of-living adjustments under this Plan usually follow those of the MEPP.

d) GUARANTEE

Designated employers guarantee payment of all benefits arising under the Plan. If assets held in the Plan are insufficient to pay for benefits as they become due, the amount due is payable by designated employers.

e) SURPLUS PLAN ASSETS

The Province of Alberta has the right to amend or discontinue the Plan in whole or in part at any time. Any assets remaining in the Plan after provision for benefits payable to or in respect of members on the complete wind-up of the Plan accrue to the Province of Alberta.

f) INCOME TAXES

The Plan is a *Retirement Compensation Arrangement* (RCA) as defined in the *Income Tax Act*. Refundable income tax is remitted on any cash contributions from eligible employees and designated employers and net investment income received at the rate of 50%. Refundable income tax is returned to the Plan at the same rate when pension benefit payments are made to Plan members and beneficiaries.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES**a) BASIS OF PRESENTATION**

These financial statements are prepared on the going concern basis in accordance with Canadian accounting standards for pension plans. The Plan has elected to apply International Financial Reporting Standards (IFRS) for accounting policies that do not relate to its investment portfolio or pension obligation. The statements provide information about the net assets available in the Plan to meet future benefit payments and are prepared to assist Plan members and others in reviewing the activities of the Plan for the year.

b) VALUATION OF INVESTMENTS

Investments are recorded at fair value. As disclosed in Note 3, the Plan's investments consist primarily of direct ownership in units of pooled investment funds ("the pools"). The pools are established by Ministerial Order 16/2014, being the Establishment and Maintenance of Pooled Funds, pursuant to the *Financial Administration Act* of Alberta, Chapter F-12, Section 45, and the *Alberta Investment Management Corporation Act* of Alberta, Chapter A-26.5, Section 15 and 20. Participants in pools include government and non-government funds and plans.

Contracts to buy and sell financial instruments in the pools are between the Province of Alberta and the third party to the contracts. Participants in the pools are not party to the contracts and have no control over the management of the pool and the selection of securities in the pool. Alberta Investment Management Corporation (AIMCo), a Crown

corporation within the Ministry of Treasury Board and Finance, controls the creation of the pools and the management and administration of the pools including security selection. Accordingly, the Plan does not report the financial instruments of the pools on its statement of financial position.

The Plan becomes exposed to the financial risks and rewards associated with the underlying financial instruments in a pool when it purchases units issued by the pools and loses its exposure to those financial risks and rewards when it sells its units. The Plan reports its share of the financial risks in Note 4.

The fair value of pool units held directly by the Plan is derived from the fair value of the underlying financial instruments held by the pools as determined by AIMCo (see Note 3b). Investments in pool units are recorded in the Plan's accounts. The underlying financial instruments are recorded in the accounts of the pools. The pools have a market-based unit value that is used to distribute income to the pool participants and to value purchases and sales of the pool units. The pools include various financial instruments such as bonds, equities, real estate, derivatives, investment receivables and payables and cash.

The Plan's cut-off policy for valuation of investments, investment income and investment performance is based on valuations confirmed by AIMCo on the fourth business day following the period end. Differences in valuation estimates provided to Treasury Board and Finance after the period cut-off date are reviewed by management. Differences considered immaterial by management are included in investment income in the following period.

Investments in units of the pools are managed and evaluated on a fair value basis. As such, all investments are designated and recorded in the financial statements at fair value.

Investments in pool units are recorded in the Plan's accounts on a trade date basis.

All purchases and sales of the pool units are in Canadian dollars.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

c) INVESTMENT INCOME

- a) Investment income is recorded on an accrual basis.
- b) Investment income is reported in the statement of changes in net assets available for benefits and in Note 10 and includes the following items recorded in the Plan's accounts:
 - i. Income distributions from the pools, based on the Plan's pro-rata share of total units issued by the pools; and
 - ii. Changes in fair value of units including realized gains and losses on disposal of units and unrealized gains and losses on units determined on an average cost basis.

d) INVESTMENT EXPENSES

Investment expenses include all amounts incurred by the Plan to earn investment income (see Note 12). Investment expenses are recorded on an accrual basis. Transaction costs are expensed as they are incurred.

e) VALUATION OF PENSION OBLIGATION

The value of the pension obligation and changes therein during the year are based on an actuarial valuation prepared by an independent firm of actuaries. The valuation is made

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES...

CONTINUED

at least every three years and results from the most recent valuation are extrapolated, on an annual basis, to year-end. The valuation uses the projected benefit method pro-rated on service and management's best estimate, as at the measurement date, of various economic and non-economic assumptions.

f) MEASUREMENT UNCERTAINTY

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the magnitude of the calculation of the Plan's pension obligation. Uncertainty arises because the Plan's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

While best estimates have been used in the calculation, management considers that it is possible, based on existing knowledge, that changes in future conditions in the short term could require a material change in the recognized amounts. Differences between actual results and expectations are disclosed as actuarial assumption changes and net experience gains or losses in the note describing changes in the benefit obligation in the year when actual results are known.

NOTE 3 INVESTMENTS

The Plan's investments are managed at the asset class level for purposes of evaluating the Plan's risk exposure and investment performance against approved benchmarks based on fair value. AIMCo invests the Plan's assets in accordance with the Statement of Investment Policies and Goals (SIP&G) approved by the Plan's Advisory Committee. The fair value of the pool units is based on the Plan's share of the net asset value of the pooled fund. The pools have a market based unit value that is used to allocate income to participants of the pool and to value purchases and sales of pool units. AIMCo is delegated authority to independently purchase and sell securities in the pools and Plan, and units of the pools, within the ranges approved for each asset class (see Note 4).

Asset class	(\$ thousands)			
	Fair Value Hierarchy ^(a)		2019	2018
	Level 2	Level 3	Fair Value	Fair Value
Interest-bearing securities				
Cash and short-term securities	\$ 192	\$ -	\$ 192	\$ 432
Bonds	18,058	-	18,058	19,015
Total Investment	\$ 18,250	\$ -	\$ 18,250	\$ 19,447

a) Fair Value Hierarchy: The quality and reliability of information used to estimate the fair value of investments is classified according to the following fair value hierarchy with level 1 being the highest quality and reliability.

- **Level 1** - fair value is based on quoted prices in an active market. Although the pools may ultimately hold publicly traded listed equity investments, the pool units themselves are not listed in an active market and therefore cannot be classified as Level 1 for fair value hierarchy purposes. Pool units classified by the Plan as Level 2 may contain investments that might otherwise be classified as Level 1.
- **Level 2** - fair value is estimated using valuation techniques that make use of market-observable inputs other than quoted market prices. This level includes pool units that hold public equities, debt securities and derivative contracts totalling \$18,250 (2018: \$19,447).
- **Level 3** - fair value is estimated using inputs based on non-observable market data. This level includes pool units that hold private mortgages, hedge funds, private equities and inflation sensitive investments totalling \$nil (2018: \$nil).

b) Valuation of Financial Instruments recorded by AIMCo in the Pools

The methods used to determine the fair value of investments recorded in the pools are explained in the following paragraphs:

- **Interest bearing securities:** Public interest-bearing securities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company. Cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.
- **Foreign currency:** Foreign currency transactions in pools are translated into Canadian dollars using average rates of exchange. At year end, the fair value of investments in other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rates.
- **Derivative contracts:** The carrying value of derivative contracts in a favourable and unfavourable position is recorded at fair value and is included in the fair value of the pools (see Note 4d). The estimated fair value of equity and bond index swaps is based on changes in the appropriate market-based index net of accrued floating rate interest. Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates. Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities. Forward foreign exchange contracts and futures contracts are valued based on quoted market prices. Options to enter into interest rate swap contracts are valued based on discounted cash flows using current market yields and volatility parameters which measure changes in the underlying swap. Warrants and rights are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

NOTE 4 INVESTMENT RISK MANAGEMENT

The Plan is exposed to financial risks associated with the underlying securities held in the pools created and managed by AIMCo. These financial risks include credit risk, market risk and liquidity risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Market risk is comprised of currency risk, interest rate risk and price risk. Liquidity risk is the risk the Plan will not be able to meet its obligations as they fall due.

The investment policies and procedures of the Plan are clearly outlined in the SIP&G approved by the Advisory Committee. The purpose of the SIP&G is to ensure the Plan is invested and managed in a prudent manner in accordance with current, accepted governance practices incorporating an appropriate level of risk. The Advisory Committee manages the Plan's return-risk trade-off through asset class diversification, target ranges on each asset class, diversification within each asset class, quality constraints on fixed income instruments and restrictions on amounts exposed to countries designated as emerging markets. Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency.

Actuarial liabilities of the Plan are primarily affected by the long-term real rate of return expected to be earned on investments, including assets held in the Supplementary Retirement Plan Reserve Fund (SRP Reserve Fund). In order to earn the best possible return at an acceptable level of risk, the Advisory Committee has established policy asset mix ranges of 25-45% fixed income instruments, 35-60% equities, and 12.5-30% alternative investments.

a) Credit Risk**i) Debt securities**

The Plan is indirectly exposed to credit risk associated with the underlying debt securities held in the pools managed by AIMCo. Counterparty credit risk is the risk of loss arising from the failure of a counterparty to fully honour its financial obligations. The credit quality of financial assets is generally assessed by reference to external credit ratings. The credit rating of a debt security may be impacted by the overall credit rating of the counterparty, the seniority of the debt issue, bond covenants, maturity distribution and other factors. Credit risk can also lead to losses when issuers and debtors are downgraded by credit rating agencies usually leading to a fall in the fair value of the counterparty's obligations. Credit risk exposure for financial instruments is measured by the positive fair value of the contractual obligations with counterparties. The fair value of all investments reported in Note 3 is directly or indirectly impacted by credit risk to some degree. The majority of investments in debt securities have credit ratings considered to be investment grade. Unrated debt securities consist primarily of mortgages and private debt placements.

The table below summarizes debt securities by credit rating at December 31, 2019:

Credit rating	2019	2018
Investment Grade (AAA to BBB-)	96.2%	97.6%
Speculative Grade (BB+ or lower)	0.7%	0.5%
Unrated	3.1%	1.9%
	100.0%	100.0%

ii) Counterparty default risk - derivative contracts

The Plan is exposed to counterparty credit risk associated with the derivative contracts held in the pools. The maximum credit risk in respect of derivative financial instruments is the fair value of all contracts with counterparties in a favourable position (see Note 4f). AIMCo is responsible for selecting and monitoring derivative counterparties on behalf of the Plan. AIMCo monitors counterparty risk exposures and actively seeks to mitigate counterparty risk by requiring that counterparties collateralize mark-to-market gains for the Plan. Provisions are in place to allow for termination of the contract should there be a material downgrade in a counterparty's credit rating. The exposure to credit risk on derivatives is reduced by entering into master netting agreements and collateral agreements with counterparties. To the extent that any unfavourable contracts with the counterparty are not settled, they reduce the Plan's net exposure in respect of favourable contracts with the same counterparty.

iii) Security lending risk

To generate additional income, the pools participate in a securities-lending program. Under this program, the custodian may lend investments held in the pools to eligible third parties for short periods. At December 31, 2019, the Plan's share of securities loaned under this program is \$1,678 (2018: \$1,577) and collateral held totals \$1,796 (2018: \$1,670). Securities borrowers are required to provide the collateral to assure the performance of redelivery obligations. Collateral may take the form of cash, other investments or a bank-issued letter of credit. All collateralization, by the borrower, must be in excess of 100% of investments loaned.

b) Interest Rate Risk

The Plan is exposed to interest rate risk associated with the underlying interest-bearing securities held in the pools managed by AIMCo. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. In general, investment returns from bonds and mortgages are sensitive to changes in the level of interest rates, with longer term interest bearing securities being more sensitive to interest rate changes than shorter-term bonds. If interest rates increased by 1%, and all other variables are held constant, the potential loss in fair value to the Plan would be approximately 7.9% (2018: 7.6%).

c) Liquidity Risk

Liquidity risk is the risk that the Plan will encounter difficulty in meeting obligations associated with its financial liabilities. Liquidity requirements of the Plan are met through income generated from investments, employee and employer contributions, and by investing in units of pools that hold publicly traded liquid assets traded in an active market that are easily sold and converted to cash. These sources of cash are used to pay pension benefits and operating expenses, purchase new investments, settle derivative transactions with counterparties and margin calls on futures contracts. The Plan's future liabilities include the accrued pension benefits obligation and exposure to net payables to counterparties (Note 4d).

NOTE 4 INVESTMENT RISK MANAGEMENT**CONTINUED****d) Use of Derivative Financial Instruments in Pooled Investment Funds**

The Plan has indirect exposure to derivative financial instruments through its investment in units of the pools. AIMCo uses derivative financial instruments to cost effectively gain access to equity markets in the pools, manage asset exposure within the pools, enhance pool returns and manage interest rate risk, foreign currency risk and credit risk in the pools.

By counterparty	Number of counterparties	Plan's Indirect Share (\$ thousands)	
		2019	2018
Contracts in net favourable position (current credit exposure)	11	\$ 22	\$ 118
Contracts in net unfavourable position	10	(89)	(113)
Net fair value of derivative contracts	21	\$ (67)	\$ 5

- (i) Current credit exposure: The current credit exposure is limited to the amount of loss that would occur if all counterparties to contracts in a net favourable position totaling \$22 (2018: \$118) were to default at once.
- (ii) Cash settlements: Receivables or payables with counterparties are usually settled in cash every three months.
- (iii) Contract notional amounts: The fair value of receivables (receive leg) and payables (pay leg) and the exchange of cash flows with counterparties in pooled funds are based on a rate or price applied to a notional amount specified in the derivative contract. The notional amount itself is not invested, received or exchanged with the counterparty and is not indicative of the credit risk associated with the contract. Notional amounts are not assets or liabilities and do not change the asset mix reported in Note 3. Accordingly, there is no accounting policy for their recognition in the statement of financial position.

Types of derivatives used in pools	Plan's Indirect Share (\$ thousands)	
	2019	2018
Structured equity replication derivatives	\$ (1)	\$ 3
Interest rate derivatives	(70)	20
Foreign currency derivatives	11	(20)
Credit risk derivatives	(7)	2
Net fair value of derivative contracts	\$ (67)	\$ 5

- (i) Interest rate derivatives exchange interest rate cash flows (fixed to floating or floating to fixed) based on a notional amount. Interest rate derivatives primarily include interest rate swaps and cross currency interest rate swaps, futures contracts and options.
- (ii) Foreign currency derivatives include contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.
- (iii) Credit risk derivatives include credit default swaps allowing the pools to buy and sell protection on credit risk inherent in a bond. A premium is paid or received, based on a notional amount in exchange for a contingent payment should a defined credit event occur with respect to the underlying security.
- (iv) At December 31, 2019, deposits in futures contracts margin accounts totaled \$118 (2018: \$49). Cash and non-cash collateral for derivative contracts pledged and received, respectively, totaled \$155 (2018: \$108) and \$nil (2018: \$nil).

NOTE 5 REFUNDABLE INCOME TAX

	(\$ thousands)	
	2019	2018
Refundable income tax at beginning of year	\$ 36,541	\$ 36,597
Tax on employees and employers contributions received	2,839	3,316
Tax on net investment income received plus adjustments of prior year taxes less tax refunds on benefits and refunds payments, net	(3,508)	(3,372)
Refundable income tax at end of year	\$ 35,872	\$ 36,541

NOTE 6 SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND (SRP RESERVE FUND)

Designated employers guarantee payment of all benefits arising under the Plan (see Note 1d). To provide for their future obligations to the Plan, designated employers contribute to the SRP Reserve Fund at rates established by the President of Treasury Board, Minister of Finance. The employer contribution rate is 9.9% of pensionable salary of eligible employees in excess of the *maximum pensionable salary limit* under the *Income Tax Act*.

The SRP Reserve Fund is a regulated fund established and administered by the President of Treasury Board, Minister of Finance to collect contributions from designated employers and to invest the funds, which are reserved to meet future benefit payments of the Plan.

As at December 31, 2019, the SRP Reserve Fund had net assets with fair value totalling \$153,607 (2018: \$133,157), comprising of \$153,607 (2018: \$133,157) in investments and \$nil (2018: \$nil) in receivables. The increase during the year of \$20,450 (2018: \$3,586) is attributed to contributions from employers of \$2,078 (2018: \$2,636), investment gains of \$18,372 (2018: \$950).

NOTE 7 PENSION OBLIGATION**a) ACTUARIAL VALUATION AND EXTRAPOLATION ASSUMPTIONS**

An actuarial valuation of the Plan was carried out as at December 31, 2018 by Aon and results were then extrapolated to December 31, 2019.

The actuarial assumptions used in determining the value of the pension obligation of \$252,795 (2018: \$259,887) reflect management's best estimate, as at the measurement date, of future economic events and involve both economic and non-economic assumptions. The non-economic assumptions include considerations such as mortality as well as withdrawal and retirement rates. The primary economic assumptions include the discount rate, inflation rate, and the salary escalation rate. The discount rate is determined by taking the plan specific asset allocation and applying the expected long term asset returns determined by an independently developed investment model; less expected plan investment expenses; and an additive for diversification and rebalancing. It does not assume a return for active management beyond the passive benchmark.

NOTE 7 PENSION OBLIGATION**CONTINUED**

The major assumptions used for accounting purposes were:

	2019	2018
	%	
Discount rate on an after-tax basis	4.40	4.30
Inflation rate	2.00	2.00
Discount rate	5.60	5.70
Salary escalation rate *	3.00	3.00
Pension cost-of-living increase as a percentage of Alberta Consumer Price Index	60.0	60.0
Mortality rate	2014 Canadian Pension Mortality Table (Public Sector)	

* In addition to age specific merit and promotion increase assumptions.

The next actuarial valuation of the Plan is expected to be completed as at December 31, 2021. Any differences between the actuarial valuation results and extrapolation results as reported in these financial statements will affect the financial position of the Plan and will be accounted for as gains or losses in 2022.

b) NET EXPERIENCE GAINS

Net experience gains of \$17,516 (2018: \$nil) reflect the results of the valuation as at December 31, 2018 extrapolated to December 31, 2019.

c) SENSITIVITY OF CHANGES IN MAJOR ASSUMPTIONS

The Plan's future experience will differ, perhaps significantly, from the assumptions used in the actuarial valuation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Plan.

The following is a summary of the sensitivities of the Plan's net assets and current service cost to changes in assumptions used in the actuarial extrapolation at December 31, 2019:

	(\$ thousands)		
	Changes in Assumptions	Decrease in Net Assets	Increase in Benefits Earned
	%	\$	\$
Inflation rate increase holding discount rate and salary escalation assumptions constant	1.0	21,200	767
Salary escalation rate increase holding inflation rate and discount rate assumptions constant	1.0	44,600	4,464
Discount rate decrease holding inflation rate and salary escalation assumptions constant*	(1.0)	45,400	2,211

* Sensitivities includes investment return of assets held by the SRP Reserve Fund (Note 6).

NOTE 8 DEFICIT

	(\$ thousands)	
	2019	2018
Deficit at beginning of year	\$ (70,310)	\$ (54,984)
Increase in net assets available for benefits	18,520	3,339
Net decrease (increase) in pension obligation	7,092	(18,665)
Deficit at end of year	\$ (44,698)	\$ (70,310)

NOTE 9 CONTRIBUTIONS

	(\$ thousands)	
	2019	2018
Employers	\$ 2,735	\$ 3,312
Employees	2,741	3,311
	\$ 5,476	\$ 6,623

NOTE 10 INVESTMENT INCOME

The following is a summary of the Plan's investment income by asset class:

	(\$ thousands)		
	Income	Change in Fair Value	2018 Total
Interest-bearing securities	\$ 680	\$ 786	\$ 1,466
			\$ 399

The change in fair value includes realized gains and losses from disposal of pool units totaling \$38 (2018: (\$84)) and unrealized gains and losses on units totaling \$747 (2018: (\$73)).

Income earned in pools is distributed to the Plan daily based on the Plan's pro rata share of units issued by the pool. Income earned by the pools is determined on an accrual basis and includes interest, dividends, security lending income, realized gains and losses on sale of securities determined on an average cost basis, and income and expense on derivative contracts.

NOTE 11 BENEFIT PAYMENTS

	(\$ thousands)	
	2019	2018
Retirement benefits	\$ 6,981	\$ 6,095
Termination benefits	969	327
Death benefits	49	51
	<u>\$ 7,999</u>	<u>\$ 6,473</u>

NOTE 12 INVESTMENT EXPENSES

	(\$ thousands)	
	2019	2018
Amount charged by AIMCo for:		
Investment costs ^(a)	\$ 25	\$ 23
GST	1	1
	<u>26</u>	<u>24</u>
Amounts charged by Treasury Board and Finance for:		
Investment accounting and Plan reporting	25	25
Total investment expenses	<u>\$ 51</u>	<u>\$ 49</u>
Increase (decrease) in expenses	4.1%	(9.3%)
Decrease in average investments under management	<u>(5.8%)</u>	<u>(5.8%)</u>
Investment expense as a percent of dollar invested	<u>0.3%</u>	<u>0.2%</u>
Investment expenses per member	<u>\$ 21</u>	<u>\$ 21</u>

(a) Investment expenses are charged by AIMCo on a cost recovery basis. Please refer to AIMCo's financial statements for a more detailed breakdown of the types of expenses incurred by AIMCo. Amounts recovered by AIMCo for investment costs include those costs that are primarily non-performance related including external management fees, external administration costs, employee salaries and incentive benefits and overhead costs. Amounts recovered by AIMCo for performance based fees relate to external managers hired by AIMCo.

The per cent decrease in investment costs and performance based fees is 8.7% (2018: (14.8%)).

NOTE 13 ADMINISTRATION EXPENSES

Administration expenses of \$822 (2018: \$747) were charged to the Plan on a cost recovery basis.

	(\$ thousands)	
	2019	2018
General administration costs	\$ 779	\$ 729
Actuarial fees	42	12
Other professional fees	1	6
	<u>\$ 822</u>	<u>\$ 747</u>
Member service expenses per member	<u>\$ 344</u>	<u>\$ 316</u>

The Plan's share of the Alberta Pensions Services Corporation's (APS) operating and plan specific costs was based on cost allocation formula approved by the President of Treasury Board, Minister of Finance.

NOTE 14 TOTAL PLAN EXPENSES

Total Plan expenses of investment expenses per Note 12 and administration expenses per Note 13 are \$873 (2018: \$796) or \$365 (2018: \$337) per member and 0.42% (2018: 0.42%) of net assets under administration.

NOTE 15 CAPITAL

The Plan defines its capital as the funded status as described in Notes 1b, 1e, Note 6 and Note 8.

NOTE 16 SUBSEQUENT EVENT - DECLINE IN FAIR VALUE OF INVESTMENTS

The fair value of the Plan and SRP Reserve Fund's combined investments is subject to significant market volatility due to the current economic crisis stemming from the global pandemic COVID-19 virus. In the three months subsequent to December 31, 2019, the Plan and SRP Reserve Fund's combined investments declined by an estimated 13.2% or \$22,697. To the extent that investments of the Plan and SRP Reserve Fund may not recover these market-related losses during the remaining nine months of 2020, the funded status of the Plan would experience a correlated decline. The impact to investments between March 31, 2020 and the date of financial statement approval is indeterminable.

NOTE 17 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to be consistent with 2019 presentation.

NOTE 18 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Treasury Board and Finance based on information provided by APS, AIMCo and the Plan's actuary, and after consultation with the Advisory Committee for the Supplementary Retirement Plan for Public Service Managers.

