November 2014

UPEI Pension Update

from the Board Pension Advisory Committee

Results of the April 30, 2014 pension valuation were presented to the Board Pension Advisory Committee by the plan's actuary on September 29, 2014. These results show that the UPEI pension plan has an excellent investment performance track record and—spurred by a stronger-than-expected stock market recovery—investment returns during the period since the last triennial actuarial valuation have been well above projected levels.

However, despite the market rally and an additional $2.8 million a year in required special shortfall payments, pension fund growth hasn't kept pace with rising pension costs. The valuation shows a significant gap between the assets held in the pension fund and the cost of providing the pensions earned by our plan members.

Current financial position

The overall funding of the plan has improved slightly—from 80% to 84.2%—when measured on a percentage basis. However, the dollar amount of the shortfall has grown from $35.2 million to $36.6 million.

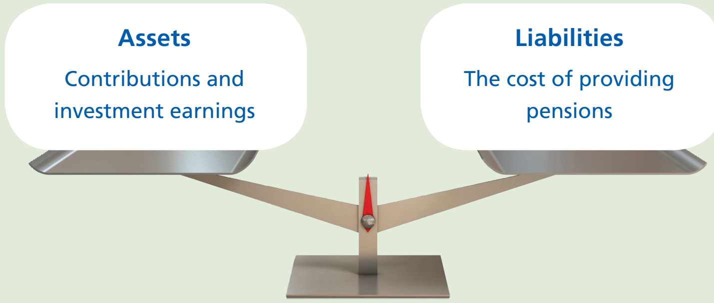
Type of valuation	What the valuation is for	Position on April 30, 2011	Position on April 30, 2014
Going concern	Measures funding over the long term. Assumes the pension fund will continue to earn an average investment return of 5.75%, contributions will continue to be made as expected, and members will retire as planned.	$35.2 million shortfall (80% funded)	$36.6 million shortfall (84.2% funded)
		Shortfalls are normally paid down over 15 years.	

Why pension costs have increased

Two key factors have pushed pension costs higher: low interest rates and longer life expectancies.

- Low interest rates translate into reduced expectations for long-term returns. For the purposes of the going concern valuation, long-term investment return expectations have been lowered from an average annual return of 6% in 2011 to 5.75% in 2014. This change alone has increased the funding gap by an estimated $7 million.
- In 2014, the Canadian Institute of Actuaries introduced new mortality tables that reflect a significant improvement in Canadian life expectancy. These additional years of pension payments have added approximately $12 million to our pension costs.

Two sides of the pension plan's balance sheet



While our investments have been performing well, the cost of pensions has been rising due to factors such as improvements in life expectancy. Valuation reports—like the April 30, 2014 report recently completed by our actuaries—give us a clear picture of how the plan is doing by looking at both sides of the balance sheet.

Given the growth in plan costs and the potential risk this poses for the university, the Board Pension Advisory Committee has asked the actuaries to conduct additional analysis to assess the financial security of the plan.

Contributions

- Total required pension contributions, including special payments, will increase from $10.3 million in 2013/2014 to $11.6 million in 2014/2015.
- Of this, members will continue to contribute about 9% of payroll (approximately $4.4 million). The university will contribute about 15% of payroll (approximately $7.2 million)—up from 13% of payroll last year. This translates into an additional $940,000 to be paid from the university's annual operating budget.

A maturing plan

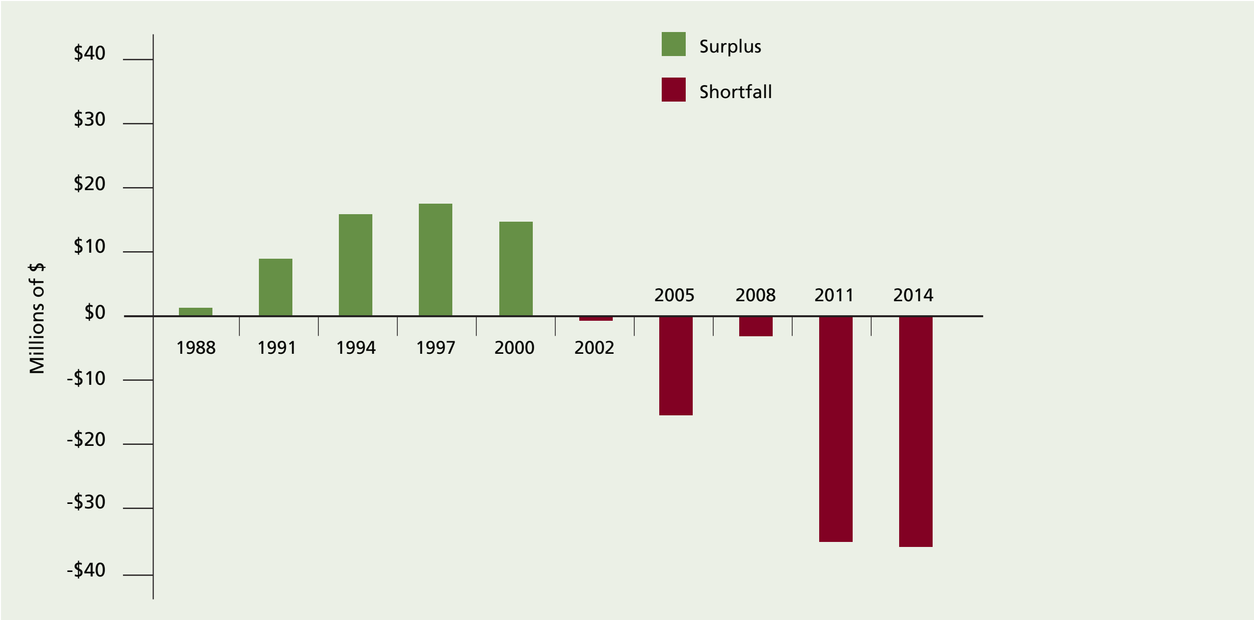
In addition to the pressures created by continued improvements in life expectancy and lower long-term investment returns, the plan is maturing. The number of actively contributing members declined in the three years since the last valuation—from 658 in 2011 to 604 in 2014. At the same time, the pensioner population grew from 251 to 313.

At about $232 million, the plan is now almost five times the size of the university's entire annual payroll of $48.3 million. This mismatch makes it very difficult for the university to underwrite potential risks facing the plan. If, for instance, markets fall and the return on the pension fund drops to -4.25% (10% less than the expected return of 5.75%), the shortfall would increase by about $23.1 million. An increase in contributions amounting to $1.8 million a year for 15 consecutive years would be required to offset this one $23.1 million shock.

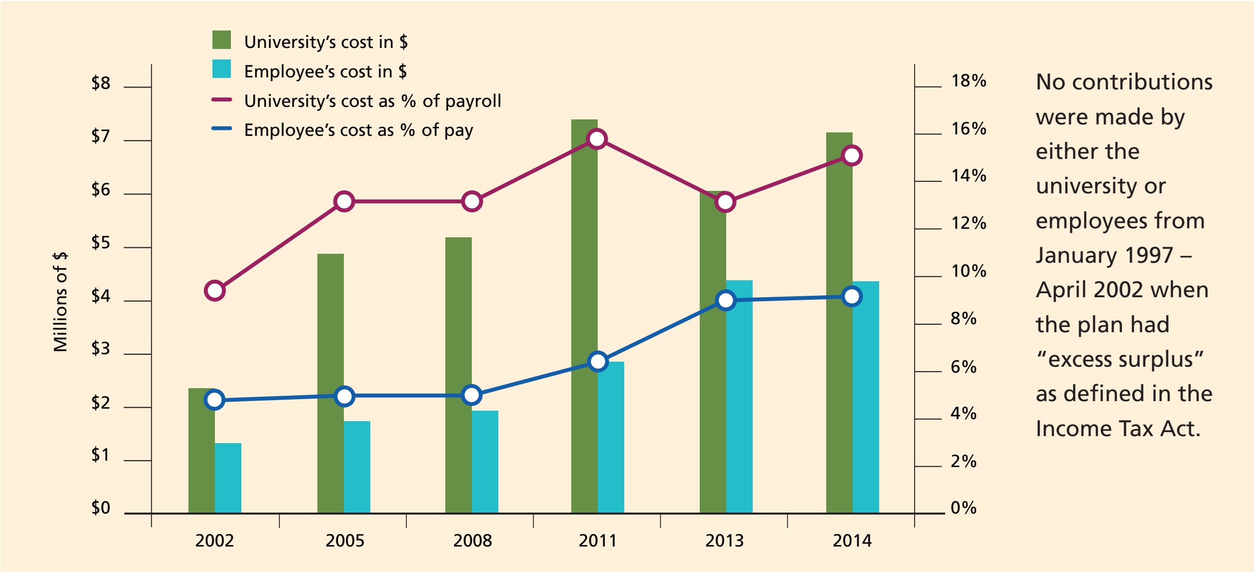
Next steps

- Given the growth in plan costs and the increased sensitivity of the maturing plan to financial shocks—and the potential risks these pose for the university—the Board Pension Advisory Committee will conduct additional analysis to assess the financial security of the plan if the future does not unfold in line with the assumptions used in the valuation.
- Specifically, we will undertake scenario testing and risk analysis to provide a deeper understanding of the drivers of plan cost, and to project how changes in economic markets, investment structure, demographic experience and benefit provisions would affect future plan funding.
- A scenario testing tool is currently under construction and will soon be ready for use. This tool will run thousands of simulations for each scenario in real time. We'll share our findings with all members and stakeholders.

Valuation history



Contribution history



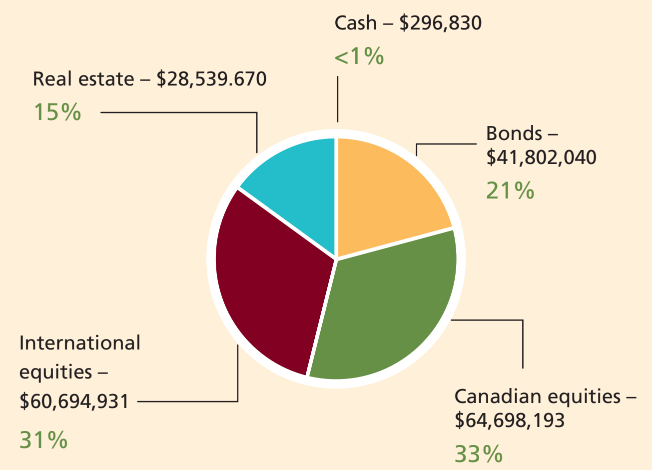
No contributions were made by either the university or employees from January 1997 – April 2002 when the plan had "excess surplus" as defined in the Income Tax Act.

Plan membership history

Annual rate of return (after investment fees)

Asset mix

(December 31, 2013)



Money managers

Foyston, Gordon & Payne

Integrated Asset Management Corp.

Phillips, Hager & North

TD Asset Management

Walter Scott & Partners

If you would like to see a full copy of the actuarial valuation, please contact any member of the Board Pension Advisory Committee.

The final word

This report provides information about the Pension Plan for the Employees of the University of Prince Edward Island (Registration No. 0520635) in simple terms. The plan is administered by Human Resources and Eckler Ltd. Every effort has been made to provide accurate information, but if there is any discrepancy between the information contained here and the official plan reports and legal documents, the official documents will apply.