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Superintendent of
Financial
Services



Surintendant des
services
financiers

IN THE MATTER OF the *Pension Benefits Act*, R.S.O. 1990, c. P.8, as amended (the "PBA");

AND IN THE MATTER OF a Notice of Intended Decision of the Superintendent of Financial Services to Make an Order under section 87(1)(a) of the PBA relating to The Corporation of the City of York Employee Pension Plan, Registration Number 0320622.

NOTICE OF INTENDED DECISION

TO:

York Employees' Pension and Benefit Committee
City of Toronto
55 John Street, 13th Floor
Toronto ON M5V 3C6

Attention:

Angelo Tassone
Manager, Pensions

Administrator

AND TO:

Toronto Professional Firefighters' Association
Toronto Professional Fire Fighters' Association
14 Cosentino Drive
Toronto ON M1P 3A2

Union

AND TO:

PD

Member

AND TO:

GB

Member

I INTEND TO MAKE AN ORDER in respect of The Corporation of the City of York Employee Pension Plan, Registration Number 0320622 (the “Plan”), under section 87(1)(a) of the PBA requiring the City of Toronto (the “City”), administrator of the Plan, to administer the Plan in accordance with the Superintendent’s interpretation of the Plan text relating to the calculation of the post retirement adjustment (“PRA”) as follows:

- a. the value of the “earnings of the Plan fund” in the definition of “Inactive Lives Excess Yield” or the “ILEY” in section 2.27 of the Plan text refers to earnings of the Fund in the relevant Plan year and not the total assets of the Plan fund at the end of the Plan year;
- b. the definition of “Opening Inactive Lives Fund” or the “OILF” in section 2.33 of the Plan text deems the OILF to be equal to the value calculated for the “Opening Inactive Lives Reserve” or “OILR” as defined in section 2.34 of the Plan text; and
- c. the term “recognized gains and losses” in the definition of the “Closing Inactive Lives Fund” or the “CILF” in section 2.11 of the Plan text means “realized gains and losses” and does not include unrealized gains and losses.

Si vous désirez recevoir cet avis en français, veuillez envoyer votre demande immédiatement à: Adjointe, audiences, Greffe, Commission des services financiers de l’Ontario, 5160 rue Yonge, boîte 85, Toronto ON M2N 6L9.

YOU ARE ENTITLED TO A HEARING before the Financial Services Tribunal (the “Tribunal”) pursuant to section 89(6) of the PBA. **A hearing before the Tribunal about this Notice of Intended Decision may be requested by completing the enclosed Request for Hearing (Form 1) and submitting it to the Tribunal within 30 days after this Notice of Intended Decision is served on you.**¹ **A copy of that form is included with this Notice of Intended Decision.** Additional copies can be obtained by visiting the Tribunal’s website at www.fstontario.ca.

If a Request for Hearing (Form 1) is submitted to the Tribunal within 30 days after this Notice of Intended Decision is served on you, sections 89(8) and 89(9) of the PBA provide that the Tribunal shall appoint a time for and hold a hearing, and by order may direct the Superintendent of Financial Services (the “Superintendent”) to make or refrain from making the intended decision indicated in this notice and to take such action as the Tribunal considers the Superintendent ought to take in accordance with the PBA and its regulations, and for such purposes, the Tribunal may substitute its opinion for that of the Superintendent.

IF NO WRITTEN REQUEST FOR A HEARING IS MADE within 30 days after this Notice is served on you, TAKE NOTICE THAT the Superintendent will carry out the intended decision to make an order requiring the Plan administrator to administer the PRA provisions of the Plan as set out on page 2 of this Notice pursuant to section 87(1)(a) of the PBA.

A completed Request for Hearing form must be received by the Tribunal within 30 days after this Notice is served on you. Forms may be mailed, faxed, or delivered to:

Financial Services Tribunal
5160 Yonge Street, 14th Floor
Toronto ON M2N 6L9

Attention: The Registrar
Fax: 416-226-7750

The hearing before the Tribunal will proceed in accordance with the Rules of Practice and Procedure for Proceedings before the Financial Services Tribunal made under the authority of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22. Those Rules are available at the website of the Tribunal: www.fstontario.ca. Alternatively, a copy can be obtained by telephoning the Registrar of the Tribunal at 416-590-7294, or toll free at 1-800-668-0128 ext. 7294.

REASONS FOR INTENDED DECISION:

Background

1. The Plan is a single employer defined benefit pension plan, originally established in 1945. There are presently no active members of the Plan and no current service contributions being made.
2. The employer and Plan sponsor is the City of Toronto. The Plan Administrator is the York Employees' Pension and Benefit Committee, which is composed of employer and employee appointees (the "City").
3. GB, a retired member of the Plan, wrote to the Financial Services Commission of Ontario ("FSCO") on July 10, 2012, complaining, among other things, that the post retirement adjustment ("PRA") provisions of the Plan had been misinterpreted by the City, such that no PRA had been applied to retired members' benefits from 2002 to present.
4. GB alleged that in or about 2002, a change in the way the PRA provisions in the Plan had been interpreted took place resulting in a denial of the increase in any year where the Plan was underfunded.
5. Prior to 2002, the retired members had received PRAs every year despite the plan being underfunded.
6. On October 8, 2015, counsel representing the Toronto Professional Fire Fighters' Association (the "Fire Fighters") and retired member PD wrote to FSCO also stating their position that the PRA provisions of the Plan had been misinterpreted by the City, such that PRAs were not properly calculated.
7. After seeking submissions from the City, FSCO determined, for the reasons set out below, that the PRA provisions of the Plan had been incorrectly interpreted in three respects.
 - a. the value of the total assets of the Plan fund was used in lieu of the value of the earnings of the Plan fund for the purposes of the excess earnings formula (also known as the Inactive Lives Excess Yield or the "ILEY");
 - b. the market value of the total fund was used in place of the inactive liabilities for the purposes of the Opening Inactive Lives Fund (the "OILF"); and
 - c. unrealized capital gains and losses were included in recognized gains and losses attributed to the Inactive Members for the purposes of calculating the Closing Inactive Lives Fund (the "CILF").
8. By letter dated December 1, 2016, FSCO requested that the City administer the Plan in accordance with FSCO's interpretation of the Plan text on a prospective basis, as set out therein. Based on the calculations provided to FSCO by the Plan's actuary, FSCO's view is that had the PRAs been calculated in accordance with FSCO'S interpretation of the

Plan provisions, additional PRAs would not have been granted.

9. On September 6, 2017, counsel for the Fire Fighters and PD wrote to FSCO advising that they did not agree with FSCO's interpretation of the "recognized gains and losses" in the CILF calculation and requested that the Superintendent of Financial Services (the "Superintendent") issue a Notice of Intended Decision ("NOID") requiring the City to administer the Plan so as interpret "recognized gains and losses" to include both realized and unrealized gains and losses, which the City had done prior to FSCO's December 1, 2016, letter.
10. On November 16, 2017, the City confirmed that it had been administering the Plan in accordance with FSCO's December 1, 2016, letter, including with respect to the preparation of the Plan's 2016 actuarial valuation report, and continued to do so. Further, the City requested that in the event the Superintendent issued a NOID in response to the September 6, 2017, request of the Fire Fighters and PD, all issues related to the PRAs be addressed in the NOID, including the interpretation of the "OILF". While the City has been administering the Plan in accordance with FSCO's December 1, 2016, letter, it does not agree with FSCO's interpretation set out therein.

The Post Retirement Adjustment

11. The PRA provides for an increase to the benefits of the Plan's pensioners, deferred members and survivors (collectively "Inactive Members") as of July 1 by the average percentage by which the earnings of the Plan fund in the previous four Plan years exceed what is needed to match any change in the liabilities attributable to Inactive Members. If there are no excess earnings or there has been a decrease in earnings, no adjustment to benefits is granted at that particular July 1.
12. The PRA provisions have not changed materially since their inception in 1984.² The current version of the Plan text is the 1992 restatement, as amended.
13. Section 10.04 of the Plan text creates the entitlement to PRAs:

Each July 1, the monthly amounts payable under the Plan to the following persons will be increased:

...

The amount of this increase will be determined annually by the Actuary as the annual income multiplied by the sum of the Inactive Lives Excess Yields calculated for each of the previous four calendar years divided by four.

Notwithstanding the foregoing, if the increase calculated pursuant to this section is negative or zero, no change in benefits will be granted at that particular July 1.

Pursuant to this provision of the Plan text, the amount of the PRA is equal to earnings of the Plan fund for the year (referred to as the "annual income" in section 10.04) multiplied by a positive ILEY. Inactive Members will only receive a PRA in a year in which the ILEY, averaged over the previous four years, is positive. There is no entitlement to a PRA where the average ILEY is negative or zero.

14. ILEY is an excess earnings calculation and is defined in section 2.27 of the Plan text:

2.27 “Inactive Lives Excess Yield” means the earnings of the Fund that are in excess of that needed to match the liabilities established for pensioners, survivors and deferred Members. This percentage is calculated annually by the formula:

$$\frac{CILF - CILR}{CILR} \times 100\%$$

Accessible description of the image containing the formula:

The formula is shown as the difference between CILF minus CILR divided by CILR. The resulting decimal number is multiplied by 100% to get the percentage.

This figure will be calculated annually by the Actuary.

15. CILF is defined in section 2.11 of the Plan text:

2.11 “Closing Inactive Lives Fund” (“CILF”) means the amount, as determined by the Actuary, of the OILF at the end of the calendar year. This figure is calculated by adjusting the OILF for investment income, recognized capital gains and losses, and expenses on a pro rata basis with the entire Fund, and assuming that all benefits paid to recipients valued in that year’s OILR are paid from the OILF.

16. Converting this definition to a formula produces the following:

$$CILF = OILF + I + R - E - P$$

where,

I = investment income attributable to the OILF

R = recognized capital gains and losses attributable to the OILF

E = expenses attributable to the OILF

P = benefits paid to recipients

Therefore, the CILF is the value of the OILF updated after the investment experience, expenses, and benefit payments of one Plan year.

17. OILF is defined in section 2.33 of the Plan text (emphasis added):

2.33 “Opening Inactive Lives Fund” (“OILF”) means the amount of the Fund **set aside to match** the OILR. This amount, as determined by the Actuary, **will always equal** the OILR for the same calendar year. [emphasis added]

18. OILR is defined in section 2.34 of the Plan text (emphasis added):

2.34 “Opening Inactive Lives Reserve” (“OILR”) means the liability of the Fund, as determined by the Actuary, with regard to pensioners, deferred Members eligible for pensions, and survivors in receipt of pension benefits as of each January 1.

19. Reading the two definitions together, if the entire membership of the Plan is comprised of Inactive Members only, and the OILF equals the OILR, then the OILF will equal the total Plan liabilities at the beginning of the Plan year.

20. CILR is defined in section 2.12 of the Plan text:

2.12 “Closing Inactive Lives Reserve” (“CILR”) means the liability of the Fund, as determined by the Actuary, with regard to pensioners, deferred Members eligible for pensions, and survivors in receipt of pension benefits as of each December 31. This reserve shall be calculated using the amounts of pension and recipients utilized in determining the OILR for the same calendar.

(a) Interpretation of ILEY

21. The interpretation of “earnings of the Fund” in the definition of ILEY is the first issue in dispute in this matter.
22. The City advised GB in its letter of January 9, 2013, that it understands the first sentence of the definition of ILEY in section 2.27 of the Plan text to be a minimum requirement for the payment of a PRA (emphasis added):

[ILEY] means the **earnings of the Fund** that are in excess of that needed to match the liabilities established for pensioners, survivors and deferred Members...

23. Therefore, the City is of the view that a PRA cannot be granted where Plan assets are insufficient to meet the liabilities. In its view, it is not clear that the ILEY formula even applies if the minimum requirement in the first sentence has not been met. This approach interprets the defined terms in the formula in light of the threshold requirement that assets must at least equal liabilities for ILEY to exist.
24. The Superintendent is of the view that this approach confuses *assets* of the Plan fund with *earnings* of the Plan fund. The first sentence of the ILEY definition is a plain language statement of what the formula represents mathematically. In other words, the effect of the formula is to calculate the percentage of the earnings of the Plan fund attributable to the Inactive Members that is in excess of that needed to match the change in the liabilities attributable to the Inactive Members.
25. In the Superintendent’s view, the first sentence of the ILEY definition does not require a consideration of the quantum of Plan fund assets before a PRA should be granted. Assets of the Plan fund do not need to equal liabilities of the Plan fund before a positive ILEY will exist. Rather, the PRA formula in section 10.04 must be applied as drafted in order to determine whether a PRA in any year should be granted.

(b) Interpretation of the OILF

26. The interpretation of OILF is the second issue in dispute in this matter.
27. Section 2.33 of the Plan text provides that:

2.33 “Opening Inactive Lives Fund” (“OILF”) means the amount of the Fund set aside to match the OILR. This amount, as determined by the Actuary, will always equal the OILR for the same calendar year. [emphasis added]

28. The City has calculated PRAs based on the view that the amount of the OILF can never be greater than the market value of Plan fund assets, with the result that it appears that no PRAs were applied from 2002 to the present. The Plan actuary explained his calculation of the OILF in a letter to the City dated October 5, 2007, as follows (emphasis original):

If the market value of the assets at January 1 is less than the OILR at that date, we have interpreted the OILF to be equal to the market value of the assets at that date, otherwise, the OILF will equal the OILR.

29. The reason the Plan actuary has taken this approach to the OILF is that there are no active members of the Plan. As such, all of the assets of the Plan and all of the liabilities of the Plan are attributable to Inactive Members. This means that if the OILF (i.e., Inactive assets) is equal to the OILR (i.e., Inactive liabilities), the ILEY formula can produce earnings sufficient to produce a PRA even where the plan is underfunded. This is because the ILEY formula does not include the actual market value of the total Plan fund. Therefore, where the market value of the total Plan fund is less than the value of the liabilities related to the Inactive Members (because the Plan is underfunded), the ILEY formula can produce a positive ILEY, which when averaged over four years, can result in a PRA despite underfunding. It is the City's view that the formula for PRAs was meant to give these adjustments only when adequate funds exists.
30. In the June 13, 2013, letter from the City to GB, the City stated as follows regarding its interpretation of the OILF definition:
- [Section 2.33] contains two sentences, and when the plan has a deficit, reading the sentences together as a logical whole produces a result that differs from what is obtained when the second sentence is given prominence.
31. In the Superintendent's view, the definition of the OILF is clear and there is no inconsistency between the first sentence, which provides that the OILF "means the amount of the Fund **set aside to match** the OILR" and the second sentence which provides that "This amount, as determined by the Actuary, **will always equal** the OILR for the same calendar year" (emphasis added). In the Superintendent's view, the second sentence clarifies that the OILF is deemed to equal the OILR, even where that amount is greater than the value of the total Plan fund.
32. The Plan may have been drafted on the assumption that there would always be active members contributing to the Plan and as a result that the value of the total Fund would always exceed the value of the Inactive liabilities. The fact that this was not the case does not change the clear language of the Plan text.

(c) Interpretation of CILF

33. The third issue in dispute in this matter is the interpretation of the phrase "recognized gains and losses" in the definition of CILF in section 2.11 of the Plan text.
34. Section 2.11 of the Plan text requires the OILF to be updated for "investment income, **recognized capital gains and losses**, and expenses..." in order to determine the CILF, which can be converted into the following formula:

$$\text{CILF} = \text{OILF} + \text{I} + \text{R} - \text{E} - \text{P}$$

where,

I = investment income attributable to the OILF

R = recognized capital gains and losses attributable to the OILF

E = expenses attributable to the OILF

P = benefits paid to recipients

35. In an October 5, 2007, letter from the Plan actuary to the City, the Plan actuary indicated that section 2.11 of the Plan text has been interpreted to include “all interest and dividend income and both realized and unrealized capital gains and losses.”
36. "Recognized gains and losses" is not a defined term in the Plan text. The plain and ordinary meaning of this phrase is the portion of an investment gain or loss resulting from the disposition of an asset for income tax purposes.
37. While a registered pension fund would not be subject to income tax, in the Superintendent's view, “recognized gain or loss” can only be interpreted as one in which an asset has actually been disposed of and a loss or a gain realized for income tax purposes (or would have been realized had the fund not been tax exempt).
38. Therefore, in the Superintendent's view, only realized gains and losses fall within the definition of “recognized gains and losses” for the purposes of calculating CILF.

Grounds to Make an Order

39. Section 87(1)(a) of the PBA provides that the Superintendent may make an order requiring an administrator or any other person to take or refrain from taking any action in respect of a pension plan or a pension fund if the Superintendent is of the opinion, upon reasonable and probable grounds, that the pension plan or pension fund is not being administered in accordance with the PBA, the regulations made under the PBA or the pension plan.
40. For the reasons above, the Superintendent is of the view that the Plan had not been administered in accordance with its terms prior to December 1, 2016, and that there are grounds to order the Plan administrator, the City, to continue to administer the Plan in accordance with the Superintendent's interpretation of the PRA provisions as set out on page 2 of this Notice.
41. Such further and other reasons as may come to my attention.

DATED at Toronto, Ontario, this 18th day of June, 2018.

Original Signed By

Lester J. Wong
Deputy Superintendent, Pensions
By delegated authority from the
Superintendent of Financial Services

1 NOTE - Pursuant to section 112 of the PBA any Notice, Order or other document is sufficiently given, served or delivered if delivered personally or sent by regular mail and any document sent by regular mail shall be deemed to be given, served or delivered on the fifth day after the date of mailing.

2 Section 10.04 was amended once in 2004 by City of Toronto By-Law No. 243-2004. Previously, the first sentence of section 10.04 was: “Each July 1, the monthly incomes of the following Members will be increased...”.