Email - November 30 2016 - FW_ Expert Panel Word Doc.pdf

From:	Patricia O"Malley
To:	Uros Karadzic; Martin, Paul (FIN) (Paul.Martin@gnb.ca); Murray Gold (mgold@kmlaw.ca)
Cc:	Tam, Nelson (TBS)
Subject:	Re: Expert Panel Word Doc
Date:	November-30-16 10:24:56 AM

Hi Uros

Thanks for taking time to organize this on your vacation. Hope you are having a good time.

I think you will see many of the same points in my draft analysis. Look forward to talking about them on Monday.

Tricia

From: Uros Karadzic <uros.karadzic@ca.ey.com>
Sent: November 29, 2016 19:32
To: Patricia O'Malley; Martin, Paul (FIN) (Paul.Martin@gnb.ca); Murray Gold (mgold@kmlaw.ca)
Cc: Tam, Nelson (TBS)
Subject: FW: Expert Panel Word Doc

Let's try this one with the usual password.

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From: Sarah Anderton
Sent: Tuesday, November 29, 2016 3:32:30 PM
To: Uros Karadzic
Subject: Expert Panel Word Doc

Good morning Uros,

Hope your trip has been wonderful so far.

I have attached the word document which is password protected – I will confirm the password in a separate e-mail.

Please let me know if there is anything else I can help with.

Thank you,

Sarah

Sarah Anderton | Executive Assistant | People Advisory Services

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Uros - Expert Panel Nov 25.docx

To Panel Members,

This note summarizes my thinking on the key question of asset recognition in the financial statements of the Province, as well as a few other elements we discussed. My thoughts are based on the review of the all the materials provided to us to date (except for the full text of the Deloitte report, which is pending the resolution of the indemnity letter).

<u>Asset Recognition</u>

In my view, the Province is right to recognize its portion of the Plan asset on accounting basis. The reason for my view is somewhat different from the views put forward by the Province, but I believe we come to the same conclusion.

The Plan is a joint defined benefit Plan (JDBP) under PS 3250. This appears to be agreed to both by the Province and by the AG. It also appears to be universally accepted that the Province's portion of the Plan is 50%. I agree with both of these conclusions.

PS 3250.81 directs us to apply DB accounting to a JDBP, and for each of the sponsors to account for its portion of the Plan.

Therefore, the test of whether there is an economic benefit to the Plan related to any surplus assets should be applied to the Plan (JDBP) as a whole, and the resulting accounting should then be apportioned to each of the sponsors in proportion.

It is clear that any surplus assets in the Plan can be used for the benefit of the sponsors jointly. In other words, if there are surplus assets in the Plan, the benefits of that surplus will flow to the sponsors - there are no third parties, other restrictions, or required approvals or agreements that would interfere with the sponsors enjoying the benefits of surplus jointly. The benefits would not necessarily take the same form for each of the sponsors (eg. benefit increases/reductions, or contribution increases/decreases), but they would be shared equally. This is the premise supporting the 50/50% JDBP accounting, and is also been the actual past practice of the Plan.

Deloitte analysis of expected future benefit (EFB), although restricted only to the Province's portion of the Plan, would arrive at the same conclusion if applied to the Plan as a whole. Therefore, there is sufficient ability to reduce future contributions for the Plan sponsors in order to use up the surplus in question. Furthermore, viewing the Plan as a whole would also lead to the conclusion that any withdrawable surplus would flow to the Plan sponsors jointly. Therefore, it is clear that the Plan surplus has economic value to the Plan sponsors, and the asset can be recognized. The Province's portion of that asset should be determined in proportion to the Province's share of the Plan (ie. 50% in this case).

The question of unilateral control is also addressed with this view. The Plan sponsors have full control over the decisions on how to use the surplus jointly. There are no rules or conditions that would make sponsors' joint right to surplus conditional. Therefore, the Plan surplus has economic value to the Plan sponsors, and the asset can be recognized. The Province's portion of that asset should be determined in proportion to the Province's share of the Plan (ie. 50% in this case).

The results of applying this view also align with the logic behind the common understanding of how the Plan works: namely, that each of the sponsors generally contributes 50/50%, shares the risks and benefits 50/50% and has joint control and governance over the decisions affecting the Plan benefits and contributions. There is no serious concern that the surplus in the Plan would not be consumed through a combination of benefit increases and/or contribution reductions, and there is no reasonable basis on which to assume that that sharing of surplus would not be equitable between the sponsors. If any of these tenets were false, then the current JDBP Plan accounting would also not be correct.

Similarly, requiring unilateral control over a JDBP by any one of the sponsors would invalidate JDBP classification. It would also not allow for any asset recognition for any JDBP – clearly an outcome not contemplated by PS 3250 and not in line with economic reality of jointly sponsored Plans.

I found that the government's analogy to recognizing assets in government partnerships made sense and that the same logic should be extended to JDBPs.

Actuarial Valuations and techniques

The actuarial work done to date appears to provide the right level of analysis and appears to be in line with PS 3250. One exception is noted above – the EFB calculations should be done at the JDBP level, not at sponsor level, but I do not expect that the conclusion that there is economic benefit to the surplus would change.

There are references in the materials provided as to uncertainty of measuring the Plan asset. For example, Deloitte had prepared a number of estimates, of various views as to the length of contribution requirements. I believe that approaching the asset impairment question from the JDBP perspective, and apportioning the resulting accounting to each of the Plan sponsors in line with their proportion of the Plan, removes some of this uncertainty. As noted above, it is hard to conceive of a realistic surplus scenario that would lead to assets in the Plan that could not benefit the sponsors jointly, through either contribution holidays/benefit improvements or surplus refunds. I therefore think there is no real measurement uncertainty in the case of OTPP and OP Trust, although obviously the actuarial analysis, similar to what Deloitte performed but applied at the JDBP level, should be performed each year.

The question linking funding and accounting measures of surplus, initially raised by the AG but then pulled back, is irrelevant under PSAS. The standard acknowledges the different purposes of funding and accounting measures of the Plan. It is important to keep in mind that any valuation merely allocates costs to periods – in fullness of time the real costs of the providing pension benefits will be the same under all frameworks. Therefore our focus is correctly placed on assessing whether any surplus in JDBP can be justified using the methods prescribed in paragraphs 3250.50-59.