ADMINISTRATIVE REPORT

Title: **Restructuring the City of Winnipeg Employees' Group Life Insurance Plans**

Critical Path: **Executive Policy Committee (EPC), Council**

AUTHORIZATION

Author	Department Head	CFO	CAO
Mike Ruta	Mike Ruta	Mike Ruta	D. Joshi A/CAO

RECOMMENDATIONS

1. That Council request the Province of Manitoba to pass a regulation pursuant to Subsection 212(2) of The City of Winnipeg Charter that authorizes the City to incorporate a new company (Newco) controlled by the City for the purposes of operating the Group Life Insurance Plans (Plans).
2. That subject to passage of the provincial regulation pursuant to Subsection 212(2) of The City of Winnipeg Charter, the City Solicitor / Director of Legal Services be instructed to prepare for submission to Council the governing by-law for Newco and the restructuring of the Plans, in accordance with the terms and conditions of such regulation and the City's restructuring proposal as set forth in this Report.
3. That Council delegate authority to the Chief Administrative Officer to negotiate and approve any and all documents and agreements relating to the incorporation of Newco and the restructuring of the Plans.
4. That Council approve an additional over-expenditure of up to $150,000 beyond the original amount approved by EPC on September 18, 2013 for professional services related to the incorporation of Newco and the restructuring of the Plans.
5. That in accordance with the current by-laws governing the Plans, the Public Service be instructed to obtain written reports with respect to the restructuring of the Plans from the Boards and a Fellow of the Canadian Institute of Actuaries, to be submitted to Council for consideration along with the by-law to be submitted pursuant to Recommendation 2 hereof.
6. That the Proper Officers of the City be authorized to do all things necessary to implement the intent of the foregoing.

REASON FOR THE REPORT

Council approval is required to request legislative amendments from the Province.

IMPLICATIONS OF THE RECOMMENDATIONS

Incorporation of a new company to operate the Group Life Insurance Plans and creation of a new by-law to provide oversight will permit the Plan's reserves to operate on a non-taxable basis. Provincial approval is required for new municipal corporations under S212 of the City of Winnipeg Charter.

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HISTORY

- The Winnipeg Employees Group Life Insurance Plan (the "Plan") was first established in 1975 and is comprised of two plans, the Civic Employees' Group Life Insurance Plan for employees of the City of Winnipeg other than police officers and the Police Employees' Group Life Insurance Plan for police officers of the City.
- The Board of Trustees of The Winnipeg Civic Employees' Benefits Program (Pension Fund) and the Winnipeg Police Pension Board (the Boards) have been delegated oversight responsibility over the Plan by virtue of Bylaws 5644/91 (Civic Employees' Group Life Insurance Plan) and 5643/91 (Police Employees' Group Life Insurance Plan). The staff of the Winnipeg Civic Employees' Benefits Program administers the Plan on behalf of the City and the Boards. However, ultimate responsibility for the Plan lies with the City.
- There are close to 15,000 members (employees and retirees) in the two plans.
- At the end of 2012, there were net assets representing reserves available to finance post-retirement insurance totaling $131 million (the "Reserves"). The Reserves were funded by contributions from both the employees and the City of Winnipeg. All such contributions were tax paid by the employees.
- Historically, the income from these Reserves was always considered to be non-taxable as part of the City's government. As a result of an inquiry from one of the Plan's investment managers asking for confirmation of the Plan's status, the City engaged a tax professional to review the tax status of the Reserves. The review determined that, because the Reserves are not recorded as an asset in the City's financial statements, the Reserves may not be tax-exempt.
- This matter was voluntarily reported to officials of the Canada Revenue Agency (CRA) in Winnipeg, who in turn took this matter to officials in the head office in Ottawa. CRA has advised that it will grandfather the tax-exempt status of the Plan until the end of 2013.
- The City has been working with its tax and actuarial advisors to restructure the Plan going forward. A proposal for restructuring the Plan (the "new proposal") was given to CRA in June, 2013 for their concurrence.
- On September 18, 2013, EPC approved a sole source report engaging Deloitte Inc., Fillmore Riley LLP and Western Compensation & Benefits Consultants Inc. (WCBC) to assist with the evaluation and restructuring of the City of Winnipeg Employees' Group Life Insurance Program (the"Program") for a total estimated cost for all contracts of $150,000 plus GST and MRST.

The City's proposal

- Attached as Appendix A and B are details of the City's proposal to restructure the Plan prepared in consultation with our advisors. In addition, the Board of the civic pension plan has passed motions to provide the City with notice that the Board will be resigning from all aspects of responsibility for the Plans effective June 30, 2015, unless otherwise agreed by the Board. It is anticipated that the Board of the police pension plan will pass a similar motion. In summary:

- The existing fund would continue to be dealt with as if entirely comprised of tax paid assets such that use of it toward future insurance premiums would not result in a taxable benefit to the Plan members
- The tax-paid assets of the existing fund would be drawn upon to supplement the difference between contributions from retirees and premium requirements
- Retirees currently do not report a taxable benefit for the premiums funded out of the existing fund because it has been treated as being tax-paid assets
- Under the new proposal, existing retirees would be "grandfathered" from receiving taxable benefits because their subsidization would come entirely out of the existing fund
- Future retirees would be assessed a taxable benefit based on the portion of premiums paid out of Newco reflecting the proportion of their service under the new proposal
- Over time the tax-paid assets of the existing fund would be depleted; until that happens the assets would be loaned to Newco on an interest-free basis
- It is projected that a major portion of the premiums for working plan members prior to their retirement would be financed out of their own contributions. The balance, if any, of the premiums required for working plan members would be funded out of the City's contributions.
- Under the new proposal, taxable benefits from the City's contributions will occur primarily during the post-retirement period, whereas under the present structure, taxable benefits from the City's contributions occur during their active employment
- Under the new structure initially there would be less tax paid but ultimately the aggregate tax paid will be larger under the new proposal
- The City will continue to match the contributions of the employees, and any excess contributions for the year will be retained in Newco.
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- Subject to Council approval the City would be seeking the Province's consent to establish a new Municipal Corporation controlled by the City as required by S212 of the City of Winnipeg Charter. Newco would be governed by a Board appointed by Council and controlled by the City that would include City and union representatives. It will also be governed by the new by-law.

Current Status

- The City has been in regular contact with CRA who have indicated they are assembling a working group to address the City's proposal.
- The City has also contacted the Minister of National Revenue seeking acceptance to grandfather tax-exempt status of the Plan until such time as the restructuring can be completed.
- The alternative to having to deal with the new proposal would be to continue with the present structure of the Plan and treat the Reserves as a City asset. It is the City's understanding that apparently other governments including the Federal Government have similar plans with reserve funds which are treated as being tax-exempt even though these reserve funds are not consolidated in these governments' financial statement. The City has asked that it not be prejudiced because apparently it is the one government that has come forward and raised this issue with CRA. The City has asked CRA to adopt the transitional steps under the City's proposed restructuring or that the tax-exempt status quo be permitted until CRA provides new guidelines to treat all such plans of the different governments on a consistent and prospective basis.
- Tax-exempt status has only been granted to December 31, 2013 so the City has conveyed its concern to the Federal government regarding transitional provisions as set out above. However, in the event of no response the City is recommending to proceed with the reorganization on the basis provided in the Appendices on the premise that the Plan will remain non-taxable.

- The City has paid professional fees totaling $100,538 to the end of June 10, 2014. It has been proposed for Council approval that any professional fees incurred exceeding $150,000 be recovered from Newco after reorganization.

Summary of Proposed By-Law Considerations

- To preserve tax-free status afforded by association with municipal government, the majority of the Newco Board would be comprised of members appointed by the City and the remainder of the members would be selected representatives of the participating union groups.
- Newco would request that the Winnipeg Civic Employees' Benefit Program enter into a service sharing agreement to provide administrative services including investment assistance.
- Meetings of the Newco Board would be held semi-annually or more often at the call of the chairperson.
- Current provisions set out in By-laws 5644/91 and 5643/91 relating to the Civic Employees' and Police Employees' Group Life Insurance Plans will be merged into one by-law and amended to reflect changes to provisions required to maintain non-taxable status.
- The Boards of both existing plans have been apprised of the changes.
- A communication plan providing details of the changes will be prepared and distributed to members of the Plan following Council approval.



Financial Implications of Proposed Restruct



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Financial Impact Statement

Date: September 8, 2014

Project Name:

Group Life Insurance Plans - Restructuring

First Year of Program 2014

	2014	2015	2016	2017	2018
Capital					
Capital Expenditures Required					
Less: Existing Budgeted Costs					
Additional Capital Budget Required	$ -	$ -	$ -	$ -	$ -
Funding Sources:					
Debt - Internal					
Debt - External					
Grants (Enter Description Here)					
Reserves, Equity, Surplus					
Other - Enter Description Here					
Total Funding	$ -	$ -	$ -	$ -	$ -
Total Additional Capital Budget Required	$ -				
Total Additional Debt Required	$ -				
Current Expenditures/Revenues					
Direct Costs	$ 150,000				
Less: Incremental Revenue/Recovery	150,000				
Net Cost/(Benefit)	$ -	$ -	$ -	$ -	$ -
Less: Existing Budget Amounts					
Net Budget Adjustment Required	$ -	$ -	$ -	$ -	$ -

Additional Comments: Any professional fees incurred in excess of $150,000 previously approved by EPC up to an additional amount of $150,000 will be recovered from Newco after reorganization.

(Original Signed by Ramona Hodges)
Ramona Hodges
Manager of Finance (Campus)
Corporate Finance Department

CONSULTATION

In preparing this report there was consultation with:

Legal Services
Fillmore Riley
Smith Pension & Actuarial Consultants

SUBMITTED BY

Department: Corporate Finance
Division: CFO Office
Prepared by: Mike Ruta
Date: September 8, 2014
File No.

Revised
June 12, 2013

City of Winnipeg Group Life Insurance Plans
Financial Implications of Proposed Restructuring

1. Background

The proposed restructuring of the City's group life insurance plans effective January 1, 2014 involves the following:

- Freezing the existing fund (the "Old Fund") and treating it as tax-paid employee contributions.
- Establishing a new fund (the "New Fund") to be held by a newly constituted municipal corporation.
- Loaning the assets of the Old Fund (currently about $130 million) to the New Fund on an interest-free basis, so that all future investment income will be earned in the New Fund. This investment income will be tax-sheltered as the New Fund is held by a municipal entity.
- Using the Old Fund to pay a portion of future insurance premiums. The loan to the New Fund would be repaid as necessary to finance these premium payments. As the source of these premiums is tax-paid employee contributions, this portion of the premiums will not give rise to taxable benefits for the Plan members.
- Directing all future employee, pensioner and employer contributions to the New Fund.
- Using the New Fund to pay the balance of the future insurance premiums.

The proposed structure assumes that premiums for pre-retirement insurance are financed firstly out of employee contributions to minimize or eliminate the taxable benefits allocated to employees. The taxable benefits for retirees will be based on the premiums paid from the New Fund for post-retirement insurance coverage less the amounts of the pensioners' own contributions.

2. Allocation of Insurance Premiums Between the Old and New Funds

We propose that the future payments of insurance premiums be allocated between the Old Fund and New Fund as follows:

	Old Fund	New Fund
Pre-retirement insurance	None.	Total premium for pre-retirement insurance.
Post-retirement insurance:		
Existing pensioners (at 1/1/14)	Excess of total premium over pensioner's own contribution.	Amount equal to pensioner's own contribution.
Future pensioners	(Premium - pensioner's own contribution) x $\frac{OS}{TS}$ where OS ("old service") is service before 1/1/14 and TS ("total service") is total service under Plan prior to retirement.	Total premium - portion paid from Old Fund.

For this purpose, premiums would be calculated using:

- a single blended rate for employees' pre-retirement insurance, and
- a single blended rate for pensioners' post-retirement insurance.

Any experience refunds would be reflected in these calculations as an offset against the following year's premiums.

Example

As an example of the allocation of premiums, if we assume that a pensioner has $30,000 of post-retirement insurance coverage, the pensioner's contribution rate is 0.25% of the insurance coverage per year and the blended premium rate for pensioners is $20 per $1,000 of insurance:

- the annual premium is $600;
- the pensioner's annual contribution is $75, which would be paid to the New Fund;
- if the pensioner retired in 2013 or earlier, the $600 premium would be allocated as follows: Old Fund – $525; New Fund – $75; and

- if the pensioner retired on December 31, 2014 and had 25 years of service at retirement, the $600 premium would be allocated as follows: Old Fund – $504 (= ($600 - $75) x 24/25); New Fund – $96.

3. Calculation of Taxable Benefits

Based on the proposed allocation of premiums, the calculation of taxable benefits each year under the new structure would be as follows:

Category of Member	Formula for Calculating Taxable Benefit
Employee	(Insurance coverage x blended premium rate for pre-retirement insurance) - employee's contribution for year. Note: If the aggregate premiums (net of refunds) for pre-retirement insurance are equal to or less than the aggregate employee contributions for the year, no taxable benefits would be attributed to employees. Also, to the extent that an employee's contributions for a year exceed the premium for pre-retirement insurance, the "excess contributions" will be carried forward to offset against future years' taxable benefits.
Pensioner	Portion of premium paid from New Fund (based on blended rate for post-retirement insurance) - pensioner's contribution for year.

Examples

1. Employee

Salary: $60,000
Insurance coverage: $120,000
Employee contribution rate: 0.5% of salary
Blended premium rate for pre-retirement insurance: $2.00 per $1,000 per year.

Taxable benefit = annual premium – employee contribution
= $240 - $300
= nil
("excess contribution" of $60 carried forward to offset against future years' taxable benefits)

2. Pensioner retired before 1/1/14

Insurance coverage: $30,000
Annual premium (based on blended rate for post-retirement insurance):
$525 paid from Old Fund
$75 paid from New Fund

Taxable benefit = annual premium paid from New Fund – pensioner contribution
= $75 - $75
= nil

3. Pensioner retired on 31/12/14

Insurance coverage: $30,000
Annual premium (based on blended rate for post-retirement insurance):
$504 paid from Old Fund
$96 paid from New Fund
Pensioner contribution: $75

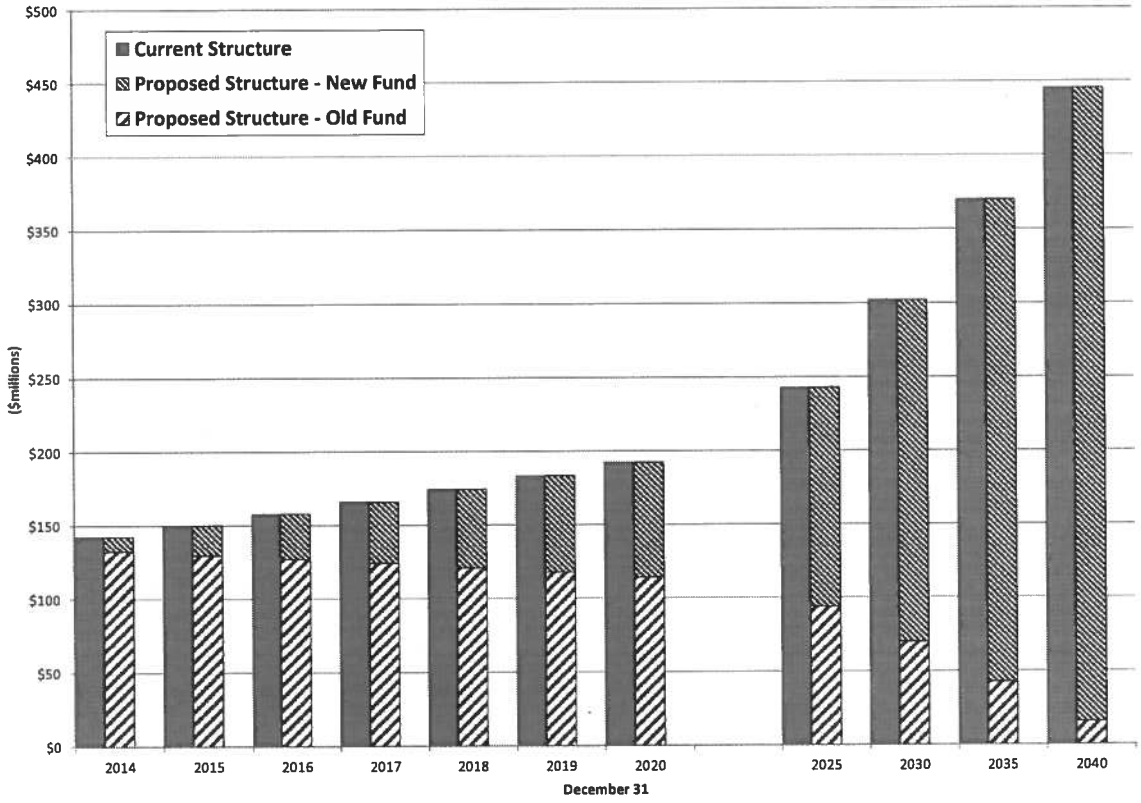
Taxable benefit = $96 - $75
= $21

4. Projections

We have carried out a series of projections to illustrate the financial operation of the proposed structure and the calculation of taxable benefits.

The results of the projections are summarized in the following graphs:

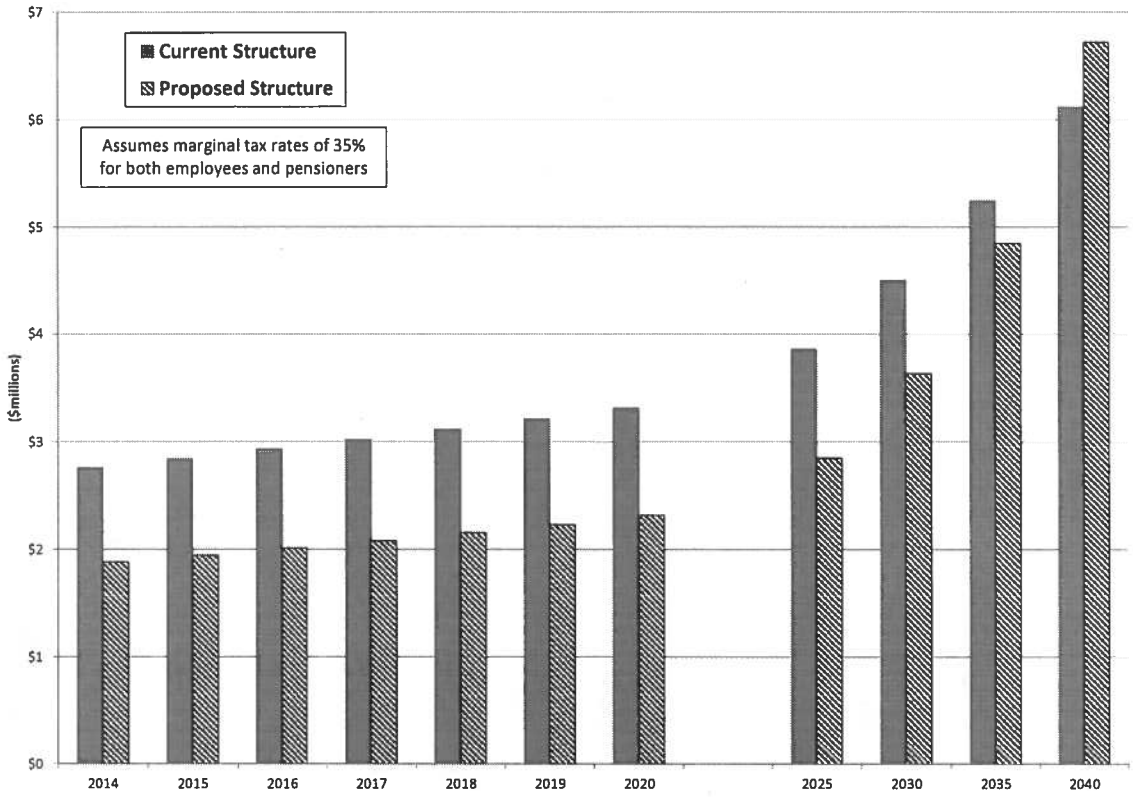
Figure 1 – Fund Projections



This illustrates the projected evolution of the Old Fund and New Fund under the proposed structure, based on a reasonable set of assumptions (including 5% per year investment returns and 3% per year growth in employee payroll).

Note that, if the Old Fund and New Fund are exempt from tax, the aggregate of the two will be the same as the projected fund under the current Plan structure if the status quo is maintained.

Figure 2 – Projected Tax Revenues to CRA



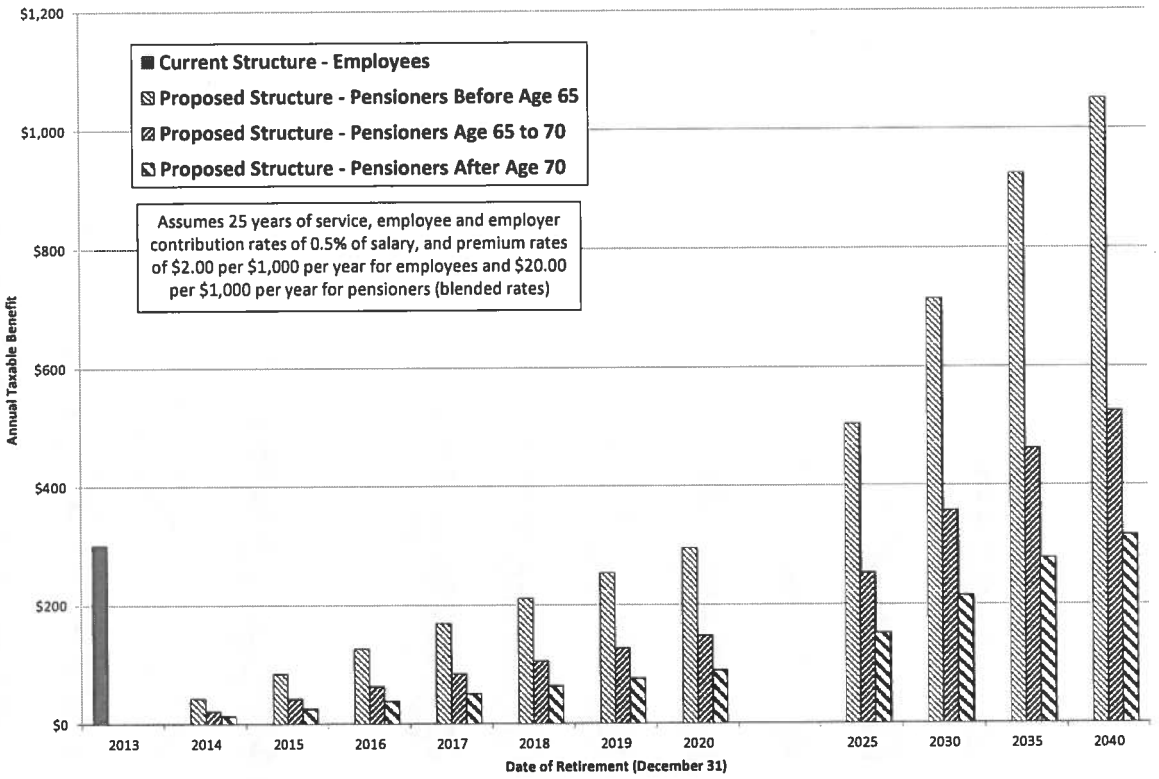
Tax revenues to CRA include:

- tax on employees' and pensioners' earnings used to pay (after tax) employee and pensioner contributions to the Plan,
- tax on taxable benefits allocated to employees and pensioners, and
- tax on fund investment income (assumed to be nil under both current and proposed structures).

Note that tax revenues to CRA would immediately drop by approximately $1 million per year under the proposed structure as a result of eliminating the taxable benefits allocated to employees (provided that premiums for pre-retirement insurance coverage do not exceed the employees contributions).

Ultimately (although potentially 30+ years in the future), tax revenues to CRA under the proposed structure will exceed those projected under the current structure, once taxable benefits allocated to pensioners (in respect of premiums paid from the New Fund, i.e. in respect of service after January 1, 2014) exceed those that would have been allocated to employees in respect of employer contributions under the current structure.

Figure 3 – Projection of Taxable Benefits (in 2013 Dollars)

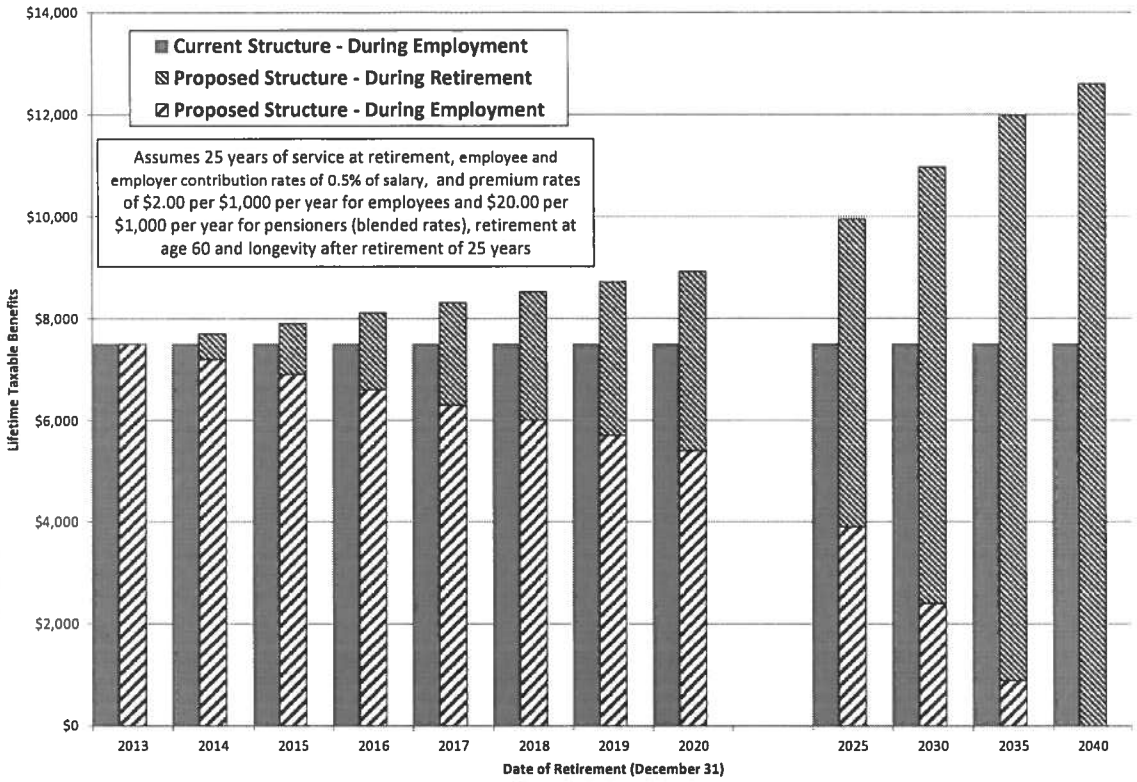


This illustrates how the taxable benefit allocated to a Plan member under the proposed structure is expected to compare with the taxable benefit allocated under the current structure.

Note that under the current structure only employees are allocated taxable benefits (in respect of the employer's contributions). Under the proposed structure, it is likely that:

- the taxable benefits allocated to employees will be eliminated,
- pensioners who retired before January 1, 2014 will have no taxable benefit, and
- pensioners who retire after January 1, 2014 will have a taxable benefit pro-rated on the basis of the proportion of their service after January 1, 2014.

Figure 4 – Comparison of Total Lifetime Taxable Benefits (in 2013 Dollars)



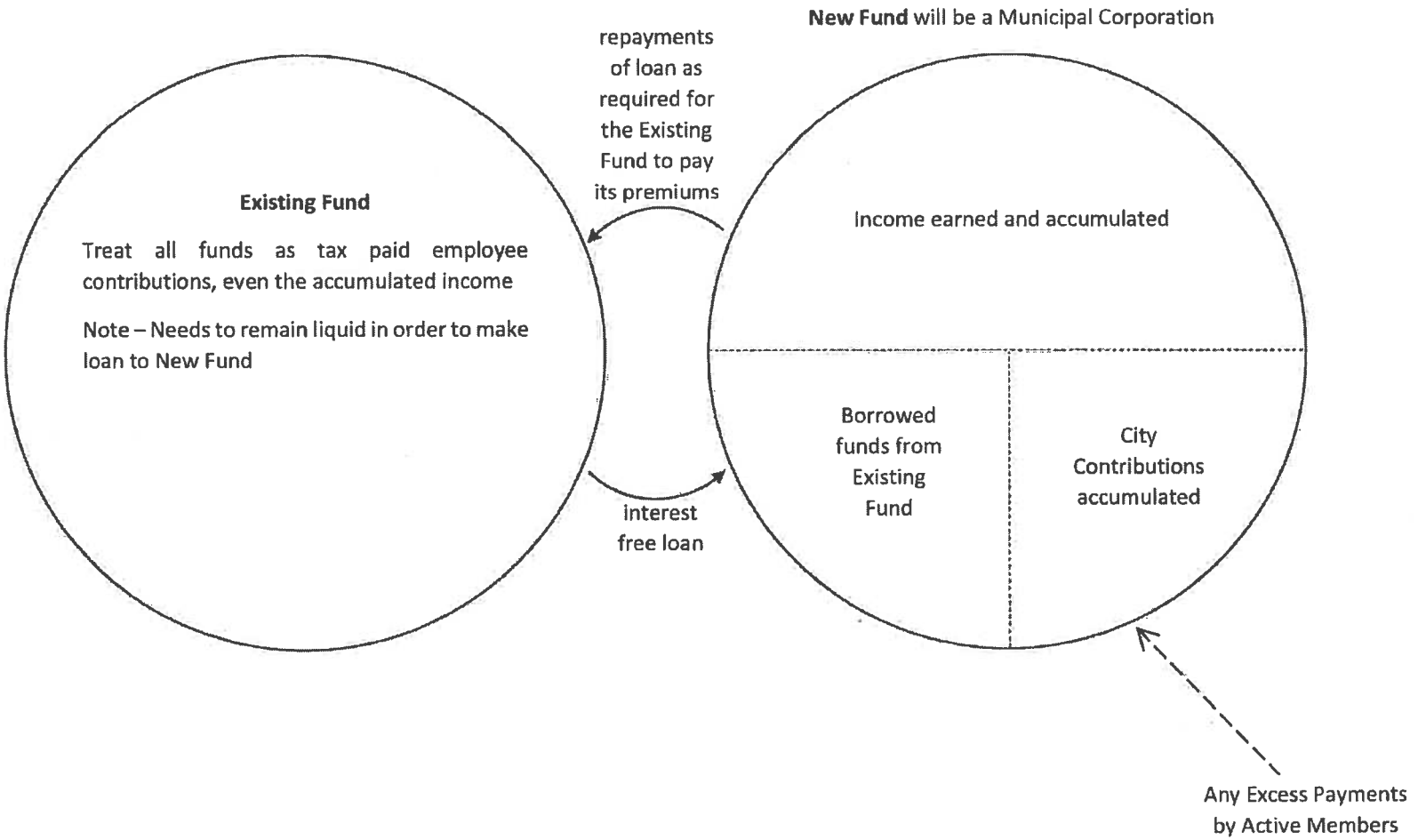
This illustrates the total amount of the taxable benefits an employee (and ultimately as a pensioner) can expect to have allocated over his or her entire lifetime.

This shows that pensioners who retired before January 1, 2014 would be unaffected by the change in structure; pensioners who retire after January 1, 2014 can ultimately expect to have greater taxable benefits (and, hence, pay more tax), with the taxable benefits allocated during their retirement years being only partially offset by the reduction in taxable benefits during their pre-retirement service after January 1, 2014.

In this regard, it is important to note that the taxes payable on taxable benefits allocated after retirement will be paid much later than the taxes that would otherwise have been payable on taxable benefits allocated during employment.

Conceptually, provided that the investment income on the funds under the new structure is exempt from tax and the Plan members' marginal tax rate is the same after retirement as it was during employment, the present value of the taxes payable under the new structure will be exactly equal to the present value of the taxes payable under the current structure.

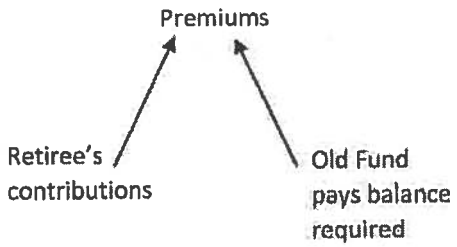
Proposal for Group Term Life Insurance



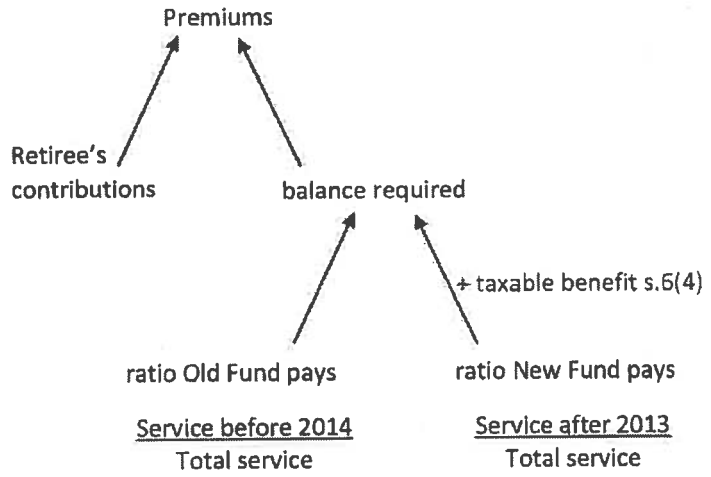
SEE NEXT 2 PAGES AS TO FUNDING OF PREMIUMS BETWEEN EXISTING FUND AND NEW FUND

Retired Members

If retirement date before 2014



If retirement date after 2013



Note – How will experience rated refunds be dealt with?