

HALIFAX

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Item No. 12
Halifax Regional Council
October 6, 2015

TO: Mayor Savage and Members of Halifax Regional Council

Original signed by



SUBMITTED BY:

Richard Butts, Chief Administrative Officer

DATE: September 25, 2015

SUBJECT: Executive Compensation Retirement Savings Plan

INFORMATION REPORT

ORIGIN

On September 22, 2015, Halifax Regional Council requested that staff provide an Information Report on the Executive Compensation Retirement Savings Plan for the next meeting of Regional Council.

LEGISLATIVE AUTHORITY

Charter Section 35(2) (d) (vi) which provides:

Responsibilities of Chief Administrative Officer

35(2) The Chief Administrative Officer may,

(d) subject to policies adopted by the Council,

vi) determine the salaries, wages and emoluments to be paid to municipal officers and employees, including payment pursuant to a classification system,

BACKGROUND

On September 22, 2014 the CAO presented a report to the Executive Standing Committee which addressed the non-union compensation structure as it had not been presented to Council since 2008. The CAO wanted to keep Council informed of his actions with respect to all non-union employee compensation including any recommended changes as a result of a bi-annual review.

The following information from that report specifically addresses the Retirement Savings Program.

In 2011, 2012 and 2013, HRM conducted searches to replace several retiring Directors. These executive recruitments were difficult as any qualified applicants had total compensation expectations in excess of HRM's then offerings for executive positions.

In many cases, one of the areas of concern for potential candidates was the lack of any kind of retirement savings on earnings over the Income Tax Act maximum. In some cases, qualified candidates withdrew from the process once they learned of this deficiency. More often, candidates who are prepared to accept employment with HRM and have the skills and experience we are seeking for executive level positions are those who had already begun to access their pensions from a prior employer and to whom retirement savings are less of a concern. While these candidates have been excellent contributors to HRM, this recruitment stream is not sustainable. These challenges highlighted a need to refresh our Executive Compensation Strategy around retirement savings.

Currently, all executive level positions are eligible to participate in the HRM Pension Plan (HRMPP). This is a Defined Benefit pension plan offering 2% of final average salary (up to the Income Tax Act (ITA) maximum) per year of service. For 2014 the ITA maximum was \$138,500, (\$140,944.50 for 2015) meaning that the HRMPP provides no pension on earnings over that amount. All of HRM's current executive level pay bands have a minimum in excess of this amount and therefore employees in these pay bands do not accrue any pension on the salary in excess of the ITA maximum. While the ITA maximum does increase annually, the pace of increase is usually less than the pace of executive salary increases resulting in a year over year reduction in pension coverage for this group.

In order to combat this erosion of pension coverage for executives, most private and many public sector organizations offer Retirement Savings Plans also known as Supplementary Executive Retirement Plans (SERPs). A scan of the Public Sector indicates that the Federal Government, Nova Scotia Government, Ontario Government, Ontario Municipalities, Alberta Government, City of Calgary, City of Edmonton, Government of BC and BC Municipalities offer some type of SERP coverage. As HRM increases executive salaries in an effort to attract and retain talent, the percentage of salary not covered by a pension plan will also increase, which will begin to detract from the competitiveness of the total compensation package.

In addition to the external competitiveness of the salary offering for HRM's executive employees, the decrease in the portion of salary covered by pension benefits also creates an inequity between these employees and the rest of HRM's employees. For example:

- An HRM employee with 35 years of service whose final pensionable salary is at or under the ITA maximum (\$138,500 for 2014) will receive an HRM pension equal to 70% of their final average salary in retirement.
- By Comparison, an HRM executive employee with same years of service whose final pensionable salary is at the current executive average (\$171,000) after 35 years will receive an HRM pension equal to 57% of their final average salary in retirement. The level of income replacement continues to diminish as salary increases.

Both the external attraction and internal equity factors have led Human Resources to recommend that the CAO implement a SERP to cover the gap in pension coverage for executive level employees.

SERP Form

Most Public Sector organizations with a SERP provide a Defined Benefit (DB) SERP which provides identical benefits to the base pension plan on the earnings in excess of the ITA maximum. A DB SERP is the most expensive type of SERP as these plans usually are designed to provide coverage on all years of service covered under the base plan. To implement a DB SERP for HRM's executive group on all years of service is estimated to have an initial cost in excess of \$700,000; which under accounting rules would have to be funded in the first year. Implementing a DB SERP on go forward service only would reduce

this initial cost, however, the nature of DB funding means that the HRM would be accepting the risks of future funding shortfalls and therefore pose a risk to HRM's financial stability.

One alternative to a DB SERP is to provide a Defined Contribution (DC) SERP. In a DC SERP, the employer contributes a percentage of the excess earnings (usually similar to the base plan contribution level) into each member's account. The accumulated contributions plus any investment earnings are used to provide a stream of payments at retirement either through direct payment or the purchase of an annuity. As a result there is no future funding shortfall risk associated with a DC - SERP. As well a DC - SERP can be structured to make member contributions tax deductible. It is Human Resources recommendation that the CAO implement a Retirement Savings Plan through a DC SERP to address the gap in executive pension coverage due to the cost certainty and tax effectiveness that a DC SERP would provide.

Funding

A SERP provides pension coverage on earnings over the ITA maximum and as such they cannot be funded like a Registered Pension Plan. Funding directly made into a SERP is considered a Retirement Compensation Arrangement (RCA) by the Canada Revenue Agency and subject to a 50% refundable tax. In an RCA, 50% of contributions are paid into a trust and 50% are paid to Canada Revenue Agency which holds the money in a non-interest bearing refundable tax account. In addition, 50% of any income earned on RCA investments is remitted by the trust custodian to the Canada Revenue Agency. When the employee retires, 50% of the monthly SERP income is returned to the custodian from the Canada Revenue Agency tax account to fund the benefit.

Like any Retirement Plan a SERP requires some administrative governance structures to be set up, including: selecting a trust custodian, selecting an investment strategy and investment manager (if applicable), filing annual trust statements, monthly contribution remittances to the Canada Revenue Agency, etc. Establishing a SERP does create a Fiduciary responsibility for the employer to ensure the SERP funds are appropriately managed on behalf of the employees. An advantage to an RCA funded SERP is that it allows for employees to make contributions to the SERP as well. These contributions are tax deductible to the employee providing additional value. As a result it is recommended that the CAO fund the SERP through an RCA.

DISCUSSION

Subsequent to the presentation of the report to the Executive Committee of Council, Human Resources began working on the implementation plan for the SERP. As part of the implementation planning it was determined that there were insufficient internal resources to administer a program with significant taxation and regulatory complexities. In addition, it was determined that there were no internal resources with the requisite skills and abilities to provide the level of investment management services such a program would require. Specifically, no internal HRM resources deal with equity (stock market) investments.

As a result, Human Resources proceeded to develop a Request for Proposal (RFP) in order to tender the administration and investment services required to implement the SERP program. RFP 15-332 was issued on August 21, 2015 and closed on September 15, 2015.

It is intended that the implementation will commence later in 2015 once many of the participants have reached their maximum contributions under the HRM Pension Plan.

The Audit and Finance Committee asked whether or not Council has the ability to "override" the CAO's decision on the matter. Subject to the Halifax Charter;

35(2) The Chief Administrative Officer may,

(d) subject to policies adopted by the Council.

vi) determine the salaries, wages and emoluments to be paid to municipal officers and employees, including payment pursuant to a classification system,

FINANCIAL IMPLICATIONS

The recommended DC SERP would have contributions equal to the current HRMPP contribution rate of 11.96% of earnings over the ITA maximum. For the current executive group salary levels this is estimated to be a total cost of \$45,000 per year. There will be some initial one time set up costs associated with establishing the RCA, custodian, etc. estimated at approximately \$15,000.

Full costs of administration will be known once a provider has been selected. It is anticipated that HRM and the participants will share the costs of administration 50/50.

ENVIRONMENTAL IMPLICATIONS

N/A

ALTERNATIVES

N/A

ATTACHMENTS

N/A

If the report is released to the public, a copy can be obtained by contacting the Office of the Municipal Clerk at 902.490.4210, or Fax 902.490.4208.

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