Staff of the Non-Public Funds
CANADIAN FORCES

Personnel des fonds non publics
FORCES CANADIENNES

Canadian Forces Non-Public Fund Employees Pension Plan

Members Report

2013

Plan Highlights for 2013

Membership:

As at 31 December 2013, the Pension Plan had a total of 3511 members, including 2060 active members, 66 disabled members, 864 pensioners and beneficiaries, and 521 members with deferred benefits.

Net assets available for benefits:

As at 31 December 2013, the market value of net assets available for benefits was $234.1 million.

Contributions to the Fund:

During 2013, active members and the Employer contributed a total of $24.3 million to the Fund including $11.8 million in special payments made by the Employer.

Going concern actuarial valuation:

The most recent actuarial valuation of the Pension Plan filed with regulators, as at 31 December 2013, reported a surplus on a going concern basis of $29.9 million and a funded ratio of 115.4%. This is a valuation that assumes the Pension Plan will continue indefinitely.

Pension benefits paid:

In 2013, a total of $6 million was paid out to retirees and other beneficiaries. A further $6.2 million was paid out in lump sum refunds on behalf of terminated and deceased members.

Solvency actuarial valuation:

The most recent actuarial valuation of the Pension Plan filed with regulators, as at 31 December 2013, reported a deficit on a solvency basis of $13.1 million and a funded ratio of 94.7%. This is a valuation that assumes the Pension Plan will terminate on the date of valuation.

Return on investments:

For 2013, the Fund’s total rate of return was 13.5%. The four-year targeted annualized real rate of return (i.e. the rate of return after adjusting for inflation) was 5.7% and the Fund achieved a four-year return of 7.5%.

Special payments:

As at 31 December 2013, the three-year average solvency ratio was 83.9% resulting in special payments of $7.9 million in 2014.

INTRODUCTION

THE CANADIAN FORCES NON-PUBLIC FUND EMPLOYEES PENSION PLAN FUND (THE "FUND") DELIVERED STRONG RESULTS IN 2013, with an investment return of 13.5% compared to 6.3% in 2012. Total investment value increased to $231.6 million from $196.9 million the year before.

As encouraging as these results are, the pension plan remains in a solvency deficit position and special payments are being made by the Employer to return it to a fully funded status. In this inaugural edition of the Members Report, the Associate Director General and Pension Chair, Doug Langton, and the Chief Financial Officer, Shirley Tang-Jassemi, explain the impact of the investment environment on plan funding and why the Employer will continue to invest prudently and stay focused on the best funding options to ensure the long-term sustainability of the pension plan.

2013 Highlights

2013		2012
$19.7 million	Total employer contributions	$18.9 million
$4.7 million	Total employee contributions	$4.9 million
$231.7 million	Total Plan assets	$197.2 million
$34.5 million	Increase in Plan assets	$4.5 million
13.5%	Investment Return	6.3%

Investment approach:

The Staff of the Non-Public Funds' (the Employer) primary investment objective is to invest the pension plan's assets in a way that investment returns, along with the anticipated contributions from the Employer and active members, will be sufficient to make benefit payments as they fall due. To accomplish this objective, investments are made at an appropriate level of risk, with consideration to the need to secure benefits and the Employer's ability to absorb increases in future cash contributions.

2013 IN REVIEW

The Fund performed well last year, with an investment return of 13.5%. Contributing to these results was an increase in interest rates late in 2013 and better than average investment returns. While appreciative of these results, we remain very cautious about interest rates, which could again slip to the low levels experienced in the past couple of years, and about economic uncertainty in some major international economies which can result in unpredictable investment markets.

In this Members Report, Associate Director General and Pension Chair, Doug Langton, and the Chief Financial Officer, Shirley Tang-Jassemi, explain the relationship between interest rates, fund performance and contributions, and the Employer's plans for fund management.

"We continue to take a balanced and long-term approach to managing the assets of the Fund.

We do this primarily by diversifying our investments which is a way to manage risk under various market conditions."

How did the Fund perform in 2013?

CFO: The Fund assets increased by $34.5 million (after pensioner and lump-sum payments of $12.2 million) representing a 13.5% investment return compared to returns of 6.3% in 2012 and 0% in 2011. Although 2013 was a good investment year, our pension plan, like most defined benefit plans in Canada, has been pressured by prolonged low interest rates and unpredictable investment markets over the past few years.

How do interest rates affect the performance of our Fund and contributions?

CFO: Although interest rates increased late in 2013, the low interest rates experienced in 2011 and 2012 have had a significant impact on the plan liabilities, bond yields and the Plan's funded status. For example, for every 1% decrease in interest rates, pension plan liabilities increase by 16% to 18% or approximately $35 million to $40 million. When pension liabilities increase, it costs more to fund the pension benefits due to plan members.

Isn't it a good thing to have low interest rates? Why do pension liabilities increase when interest rates decrease?

CFO: Let's say you don't have a pension plan at work and you need to save for your retirement. You're earning $50,000 per year and decide you want to retire in 30 years at the age of 65. To do that you need to save approximately $710,000 to retire. To reach this goal, you need to put aside about $750 every month, at an annual interest rate of 5%. However, if interest rates are lower, say at 4% annually, you would then need to save over $880 per month (or an additional $1,550 per year) in order to achieve your retirement goal. A decrease of 1% in interest rates results in about a 17% increase in the amount you need to save. In other words, you'd need to save more each month in order to make up the difference between your expected savings and your actual savings.

In the world of pension funds, the gap between what the Employer is committed to paying out for future pension benefits and what accumulates in the Fund through contributions and investments is called an unfunded liability or deficit. Low interest rates have had a direct impact on the pension plan's pension liabilities over the past few years. Furthermore, the Employer has no control over the interest rates used to value pension liabilities in a solvency valuation.

How are we responding to current market conditions?

CFO: We continue to take a balanced and long-term approach to managing the assets of the Fund. We do this primarily by diversifying our investments, which is a way to manage risk within various market conditions. The asset allocation chart (page 7) in this Report shows how the Fund is currently diversified.

Is our Fund sustainable?

Assoc DG: Fortunately, the pension plan is fully funded on a going concern basis; however, on a solvency basis we still have a substantial unfunded liability (deficit) resulting from previous low interest rates, which requires ongoing special funding. As mentioned, it takes more money to fund the pension plan when interest rates are low. Until rates increase significantly, this will continue to be the case and the Employer will continue to make any special payments required to fulfill its commitment to the pension plan. As a result, Employer contributions accounted for roughly 81% of total contributions to the Fund in 2013.

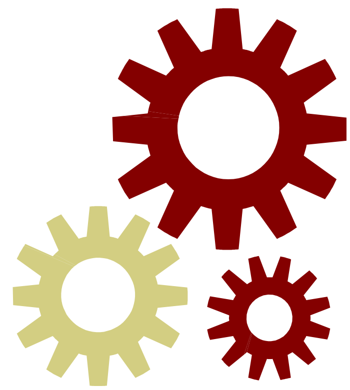
What are the Employer's plans for managing the Fund going forward?

Assoc DG: The Employer believes that Fund assets should be measured, balanced, and managed in accordance with market conditions, the pension liabilities, and the Fund's risk tolerance. To this end, we have commissioned a funding options study to determine a fair and consistent approach to pension funding, while ensuring that sufficient assets will be accumulated to deliver the promised benefits to plan members. We will continue to be responsible sponsors of the pension plan and its Fund assets.

OUR PENSION FUND: HOW IT ALL WORKS

WE HAVE A DEFINED BENEFIT PLAN THAT PROVIDES PENSION BENEFITS FOR MEMBERS WHEN THEY RETIRE. THE AVERAGE RETIREMENT AGE IN 2013 WAS 60.5 YEARS OF AGE. THESE NEW PENSIONERS WILL RECEIVE, ON AVERAGE, 28 YEARS' WORTH OF PENSION BENEFITS, INCLUDING SPOUSAL BENEFITS.

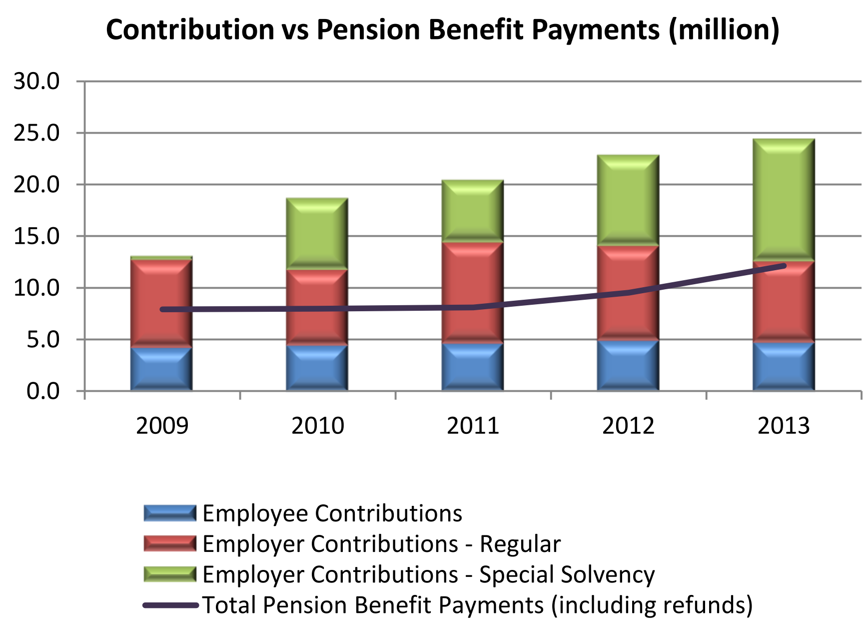
Step 1:



It starts with contributions

Plan members make set contributions to the Fund during their working years. The Employer also makes contributions in order to fully fund the pension plan. Currently, member contributions account for approximately 19% of total plan contributions and the Employer contributes the remaining 81% of total plan contributions.

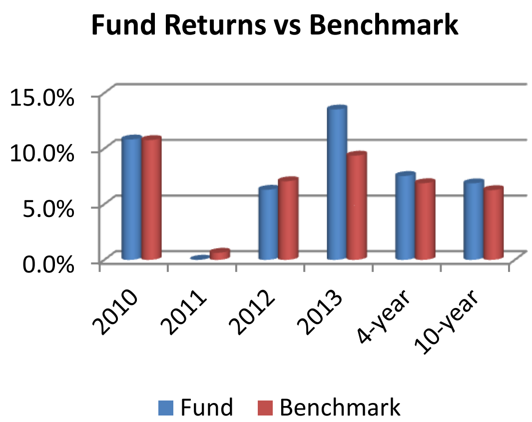
As of 31 December 2013, there were 2060 active members and 1451 pensioners and disabled and deferred members enrolled in the plan. Active members contributed $4.7 million to the Fund. The Employer contributed a total of $19.7 million.

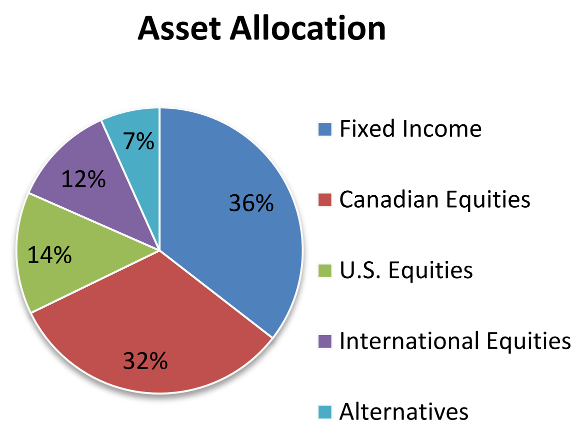


Step 2:

Investing contributions to build assets

Total annual contributions are invested according to the Pension Investment Policy which targets 52.5% of total assets to be invested in equities, 40% in fixed income and 7.5% in alternative types of investments.





Step 3:

Accountable to Members

The Pension Board and Pension Investment Committee's primary responsibility is to protect the Fund's assets and to be transparent in terms of reporting to the Employer and plan members.

This Members Report is part of that accountability. The Pension Board also works with the Human Resources Division and Coughlin and Associates, our third party pension administration provider, to respond to questions about the Plan as they arise and to ensure that members understand their pension benefits.

If you would like more information about your defined benefit pension plan, there are several options available to you:

- Contact Coughlin and Associates by email at npfpension@coughlin.ca or call toll-free at **1-888-613-1234**.
- Visit the HR Website at https://www.cfmws.com/en/EmployeeZone/Pages/default.aspx
- Contact your local Human Resources professional.

Glossary

Asset – An item with monetary value such as cash, stocks, bonds, and real estate.

Actuarial valuation - A type of appraisal which requires making economic and demographic assumptions, typically based on a mix of statistical studies and experience, in order to estimate future liabilities. In pension plans, both going concern and solvency actuarial valuations are required to determine funding requirements.

Benchmark – A point of reference used as a basis for evaluation or comparison. A market index can be used as a benchmark against which the investment performance of a group of similar assets can be measured or compared.

Going concern actuarial valuation – A valuation method that assumes a pension plan will continue indefinitely and uses the expected long-term investment return associated with the pension fund's asset mix at the valuation date to value the plan.

Pension fund - A fund established by an Employer to facilitate and organize the investment of pension contributions from the Employer and plan members. The pension fund is a common asset pool meant to generate stable growth over the long term, and from which pensions can be paid for members who reach the end of their working years and commence retirement.

Pension liability - The amount of money required to be held in a pension fund to satisfy all pension entitlements that have been earned by the plan members up to the valuation date. Pension liabilities are calculated by an actuary, who determines the benefits needed through a present value calculation.

Present value – The value as of the date of calculation of a future pension benefit expressed as a lump sum in today's dollars.

Solvency actuarial valuation – A valuation method that assumes a hypothetical immediate termination of the pension plan. This valuation method assumes that no further contributions will be made to the plan and uses the interest rates prevailing at the valuation date to value the plan.

Unfunded liability - The amount, at any given time, by which value of the future pension benefits exceed the funds available to pay them. For example, a pension plan's payment obligations, including all retirement, death and termination benefits owed, are compared to the plan's assets and, if the total plan obligations exceed the total plan assets at any point in time, the plan has an unfunded liability.