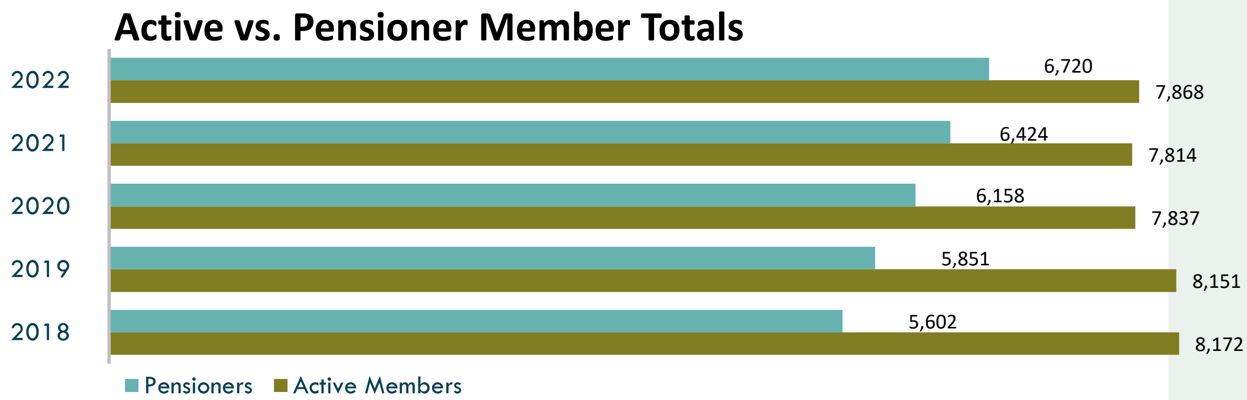
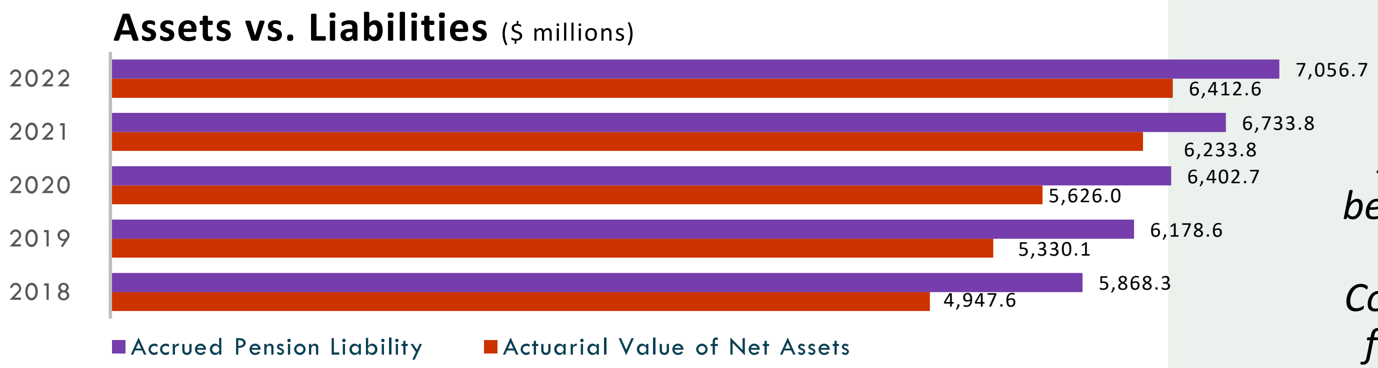
COMMUNIQUÉ - SPRING 2023

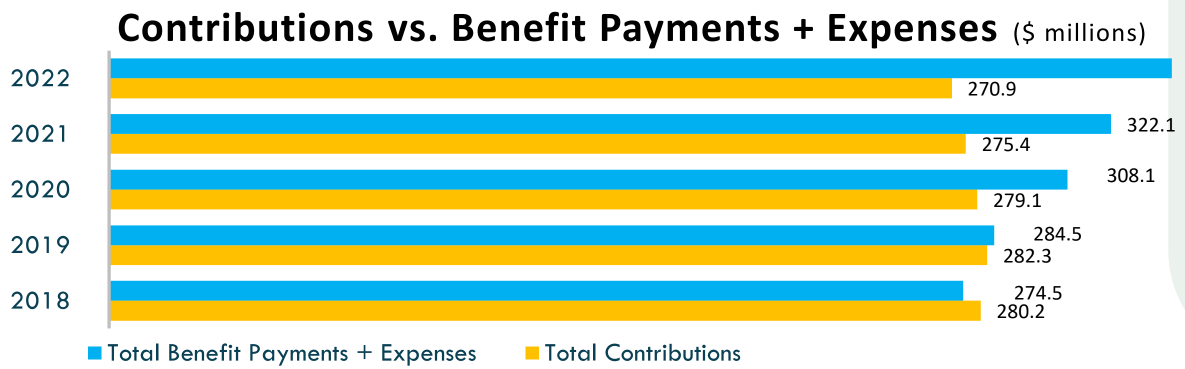
UNIVERSITIES ACADEMIC PENSION PLAN

HIGHLIGHTS OF THE 2022 ANNUAL REPORT

The UAPP's 2022 Annual Report has been released and this issue of the Communiqué provides financial, statistical, and other summary highlights of the Report. The full Annual Report is available at [uapp.ca/publications.](uapp.ca/publications)







UAPP SPRING 2023 COMMUNIQUÉ

Financial Position of the Plan

The Plan's Assets

During 2022, the Plan's assets decreased in market value for only the second time in fourteen years, declining by $641.0 million from $6,655.1 million at the start to $6,014.1 million by the year's conclusion. The -8.6 per cent investment return was the largest drop for the Fund since the global financial crisis of 2008. While most of the decline is due to unrealized losses on investments, a small part is due to the widening negative gap between contribution in-flows and benefit payment out-flows since benefit payments of $339.0 million outpaced contributions of $270.9 million. Fortunately, several years of positive rates of return prior to 2022 left the Fund in a position to withstand the market challenges of this past year. The Funded Ratio declined slightly from 92.6 per cent to 90.9 per cent. The current Funded Ratio is still among the Plan's highest in its history.

	December 31, 2022			December 31, 2021		
	Pre-1992	Post-1991	Total	Pre-1992	Post-1991	Total
Fair Value of Net Assets	464.3	5,549.8	**6,014.1**	597.6	6,057.5	**6,655.1**
Actuarial Adjustment	28.8	369.7	**398.5**	(43.2)	(378.1)	**(421.3)**
Actuarial Value of Net Assets	493.1	5,919.5	**6,412.6**	554.4	5,679.4	**6,233.8**
Accrued Pension Liability	1,359.2	5,697.5	**7,056.7**	1,389.1	5,344.7	**6,733.8**
Actuarial Surplus (Deficiency)	(866.1)	222.0	**(644.1)**	(834.7)	334.7	**(500.0)**
Funded Ratio	**36.3%**	**103.9%**	**90.9%**	**39.9%**	**106.3%**	**92.6%**

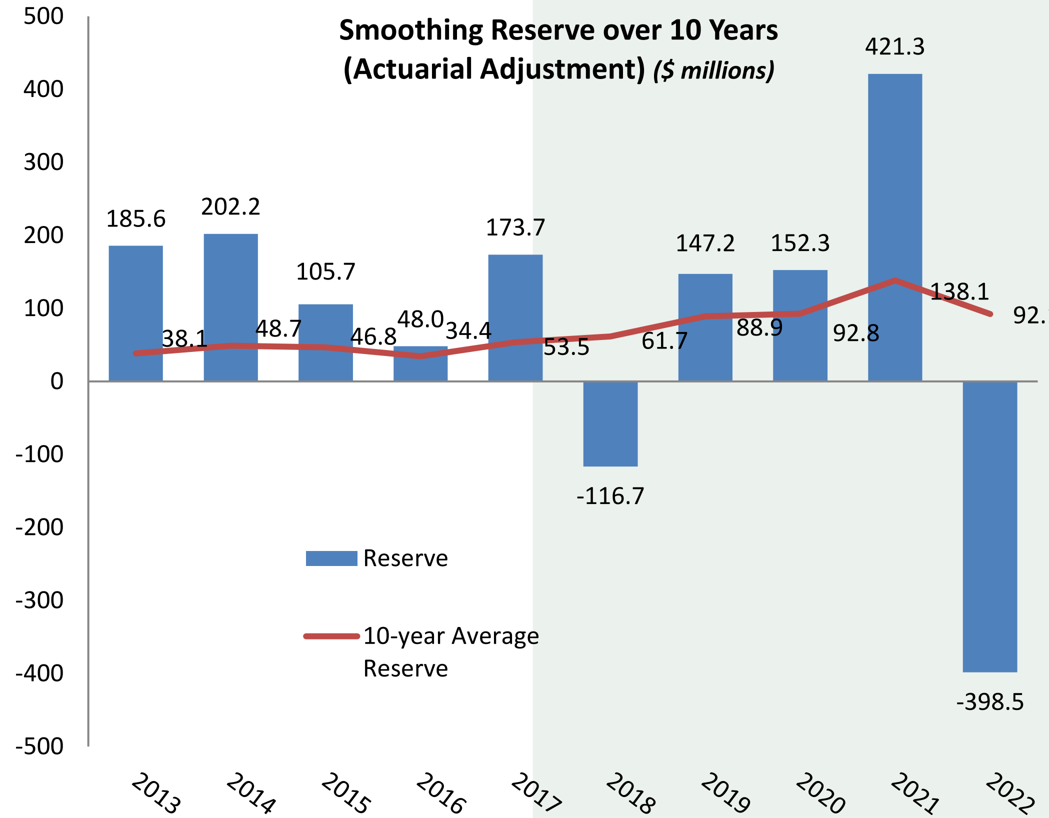
As a long-term investor with a primary focus on meeting pension obligations over the course of decades, UAPP places greater emphasis on the Fund's long-term performance more than the returns of any single year. Over the past twenty years, the Fund has attained an annualized rate of return of 7.4 per cent, somewhat higher than the 6.2 per cent annualized discount rate assumed over the same period.

In most years, investors have been able to rely on the benefits of diversification such that fixed income investments perform well in years of down equity markets and, in years where fixed income investments have struggled, those losses can be offset by strong equity performance. The past year presented an anomaly in that both these asset classes provided poor or negative returns. Even the outstanding performance the Fund received from alternative investments in 2021 was followed up with lower returns in 2022.

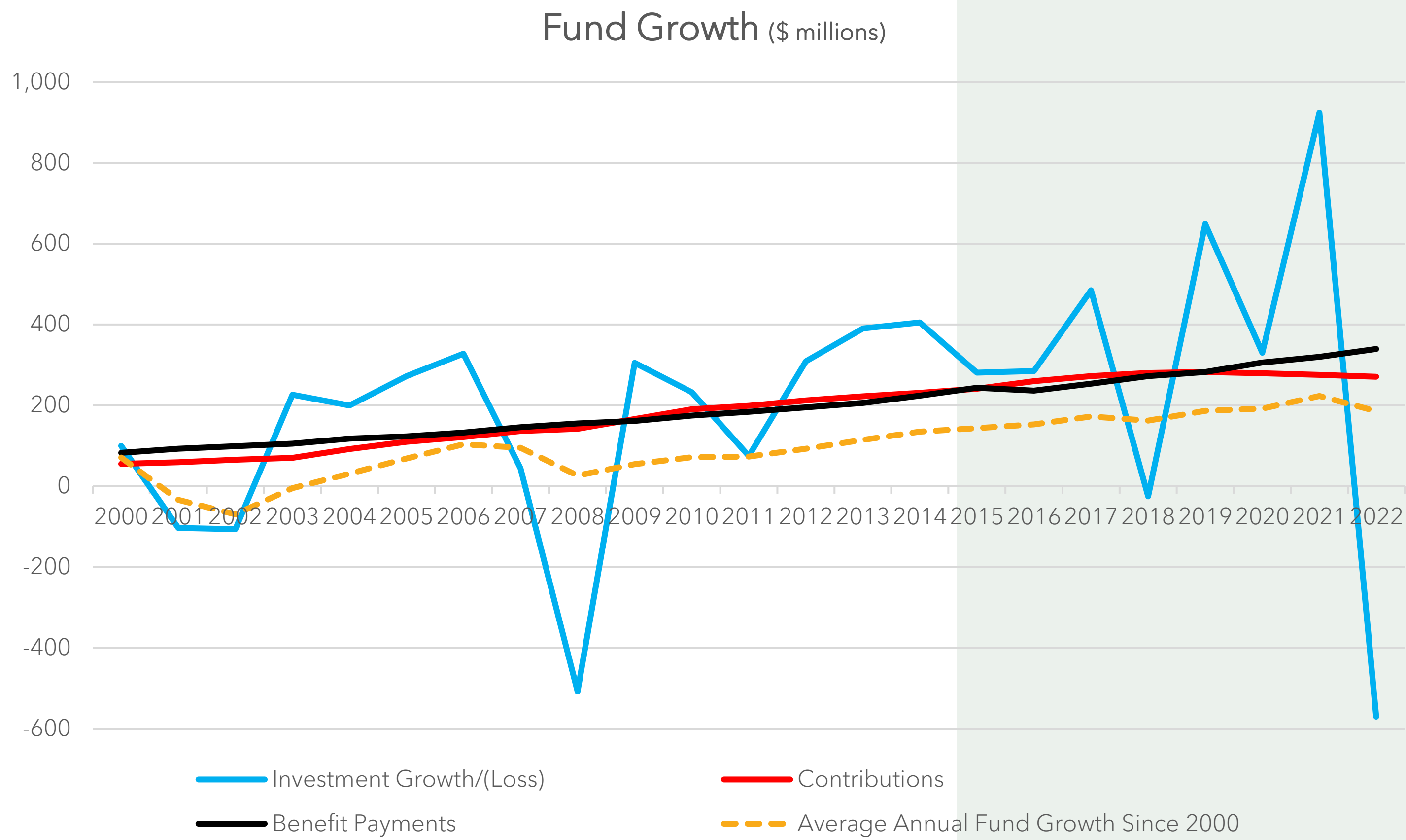
UAPP SPRING 2023 COMMUNIQUÉ

Given their long-term focus, pension plans are able to smooth out the fluctuations in market returns in valuing assets used in actuarial valuations. The past two years have provided an example of the real merit in applying a smoothing method. The outstanding 2021 positive returns were largely given back through exceptionally large unrealized losses in 2022, leaving the Fund a little more than four per cent larger than it was at the end of 2020. By smoothing the assets, pension plans are not penalized (or unfairly rewarded) for unusually weak (or strong) performance that happens to occur in the year leading up to the completion of an actuarial valuation. By the same token, should the Fund experience continued poor (or outstanding) performance, that would certainly be reflected in the smoothing over time.

As at December 31, 2022, the Fund has a negative smoothing reserve of $398.5 million, compared to a positive reserve of $421.3 million for 2021. After attaining an all-time high reserve in 2021, the Fund has attained an all-time high negative reserve in 2022. Never before has the Fund experienced such extreme fluctuations in these values from one year to the next. The actuarial value of assets increased by $178.8 million, to $6,412.6 million at the end of 2022 from $6,233.8 million at the start of the year. After a large increase in 2021, the 10-year average reserve returned to roughly the same level ($92.1 million) it was at as at the end of 2020 ($92.8 million).



UAPP SPRING 2023 COMMUNIQUÉ



Investment returns, both positive and negative, have overwhelmingly dictated the ultimate direction of the Fund. For most years, benefit payments have been roughly offset by contributions. However, during the past three years, these amounts have diverged, leaving the plan to rely in a small way on the Fund's returns to cover the shortfall in contributions. Since 2000, the Fund has grown at an average annual rate of $185.3 million when all cash flows are considered.

UAPP SPRING 2023 COMMUNIQUÉ

The Plan's Liabilities

As of December 31, 2022, the Plan's accrued liabilities have grown to $7,056.7 million, an increase of 4.8 per cent from the December 31, 2021 estimated liability of $6,733.8 million. Both amounts have been extrapolated from the last actuarial valuation as of December 31, 2020. Due to the funding nature of the Plan, financial reporting includes a split of assets and liabilities between the pre-1992 and post-1991 service periods. A total of $1,359.2 million of the $7,056.7 million overall Plan liability relates to the pre-1992 service period and $5,697.5 million relates to the post-1991 service period.

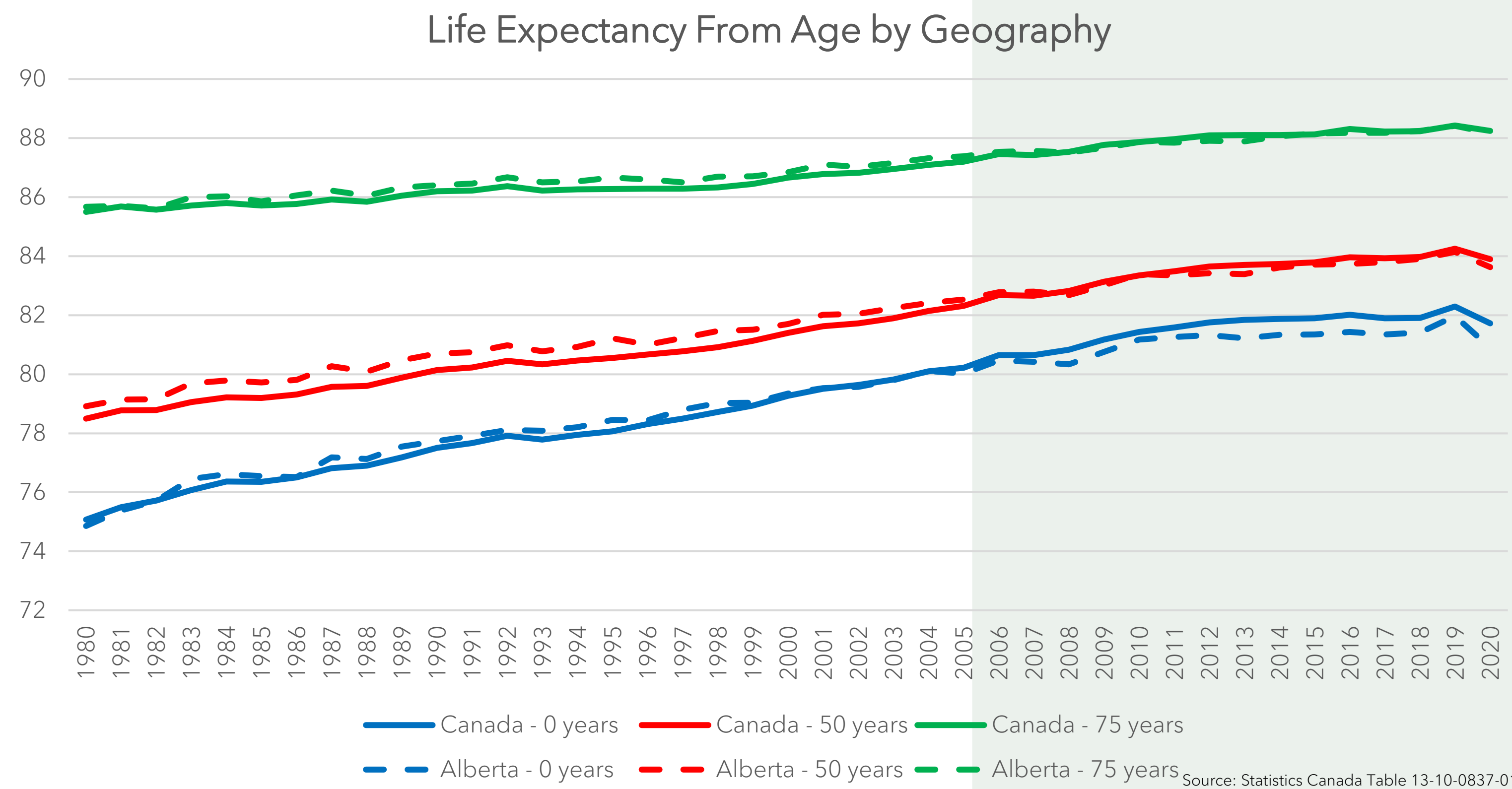
The Plan will be working with its actuary during 2023 to complete an updated actuarial valuation to ensure the Plan remains appropriately funded. As part of this process, the actuary will also complete a mortality experience study to evaluate the suitability of one of the valuation's most influential assumptions, namely the longevity of Plan members. As the Fund pays pensions for the lifetimes of Plan members and, in many cases, their surviving spouses, the actuary must make projections of mortality.

The last valuation revealed that the entire post-1991 unfunded liability would be eliminated effective June 30, 2022. With the decline in the value of the Fund during 2022, one of the storylines to watch in the actuarial valuation will be whether a new unfunded liability emerges. However, given the effectiveness of the smoothing method applied to Plan assets in the funded position calculation, the post-1991 period may continue to hold a small surplus of assets.

The long-term impact of the COVID-19 pandemic on mortality will take considerable time to be fully realized, but clearly life expectancy has been affected starting in 2020. According to data from Statistics Canada, the future life expectancy of both Canadians and Albertans declined in 2020 from at least three ages: newborns, age 50 (approximately the average age of an active UAPP Plan member), and age 75 (approximately the average age of a retired UAPP Plan member).

Just prior to the actuarial valuation, the Plan's actuary will perform a longevity study to evaluate how the mortality experience of UAPP plan members compares with the overall Canadian population. This data will be used to make adjustments to the standardized mortality tables to enhance the projected mortality experience that the Plan will assume going into the future. Of course, this valuation will occur too soon to fully factor in the pandemic. However, COVID-19 will obviously impact the Plan's membership going forward. Only time will reveal the degree of this impact.

UAPP SPRING 2023 COMMUNIQUÉ

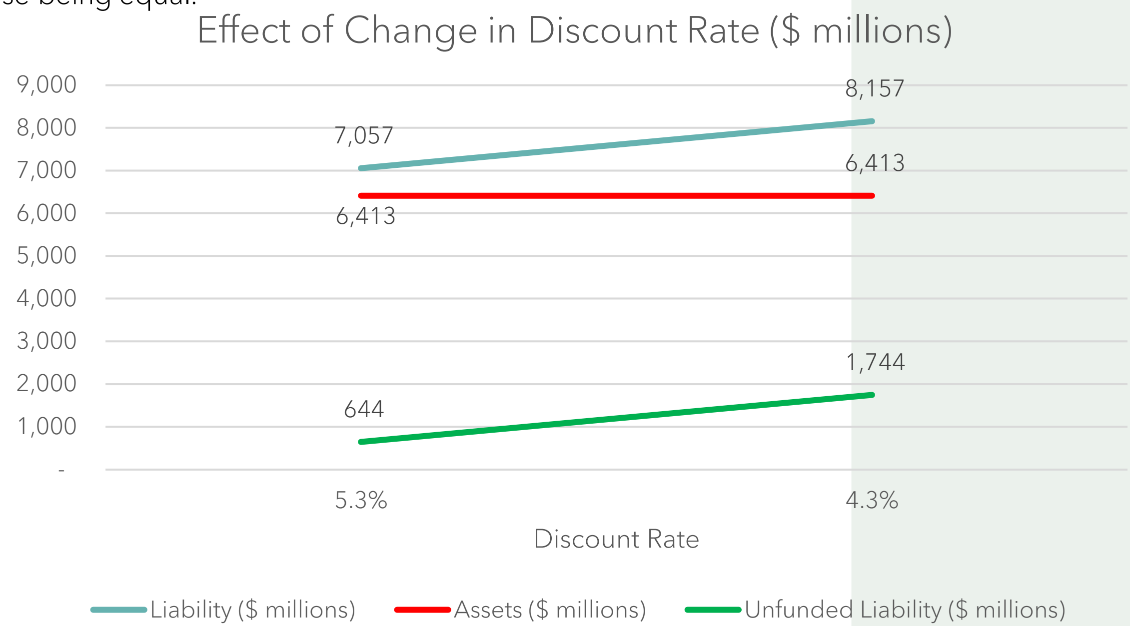


Source: Statistics Canada Table 13-10-0837-01

Another key valuation assumption that will be reviewed for this valuation is inflation. As a pension plan with cost-of-living adjustments (COLA) pegged to the Consumer Price Index, the rate of inflation directly affects the value of UAPP pensions. One tool that has been used by central banks to combat inflation has been to increase interest rates. An offshoot of current interest rate increases is the potential for long-term increases in the expected rates of return on fixed income investments. This trend benefits pension plans, like UAPP, that have a large target allocation to universe and long bonds. When those expected rates of return increase, valuation discount rates typically rise, which in turn causes a decrease in the present value of future pensions, known as actuarial liabilities, thus leading to improved financial positions of the plans.

UAPP SPRING 2023 COMMUNIQUÉ

Included in the actuarial extrapolation report used to determine the pension obligation of the Plan is a calculation identifying just how sensitive the liabilities are to changes in assumptions like the inflation rate and the discount rate (see Note 6 of the Financial Statements for more details). The extrapolation report as at December 31, 2022 shows that a one per cent decrease in the discount rate has the impact of increasing the actuarial liability of the Plan by $1,100.2 million. From this, we can conclude that an increase in the discount rate, justified in future valuations by the potential for greater expected fixed income returns, would have a proportional decreasing effect on the actuarial liability, all else being equal.



The liability calculations for December 31, 2022 are derived from the Plan actuary's extrapolation report to that date from the December 31, 2020 actuarial valuation. The 2021 liabilities are determined from an extrapolation of the same actuarial valuation.

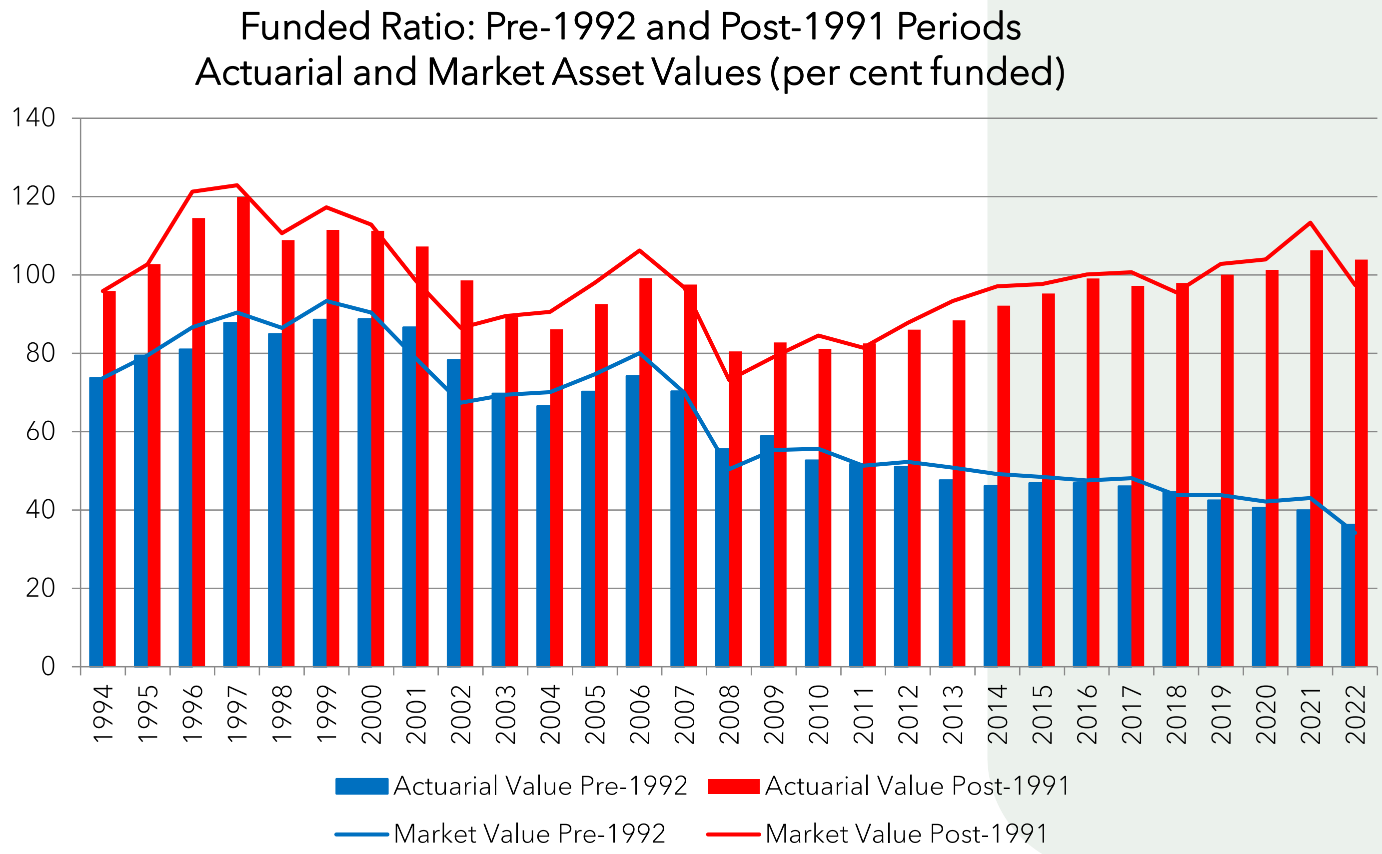
The Plan's Funded Ratio

An important metric that is monitored in the regular actuarial valuations is the financial position of the Plan, not only on a total Plan basis, but also split between the pre-1992 service period and the post-1991 service period. With the Government of Alberta partially funding the ongoing unfunded liability for the pre-1992 period, the valuation will identify the appropriate level of contributions to fund that deficit. Contributions toward this service period from employers and members will continue until pensions for the pre-1992 period are fully funded. Government contributions will continue until the earlier of that date or December 31, 2043.

UAPP SPRING 2023 COMMUNIQUÉ

The total Plan funded ratio is 90.9 per cent (2021: 92.6 per cent) on an actuarial value basis where the assets are smoothed to even out year-to-year market fluctuations. For the pre-1992 service period, the funded ratio is 36.3 per cent (2021: 39.9 per cent) and for the post-1991 service period, the funded ratio is 103.9 per cent (2021: 106.3 per cent). The smoothing of the assets reduces the impact of the drop in Fund market value to December 31, 2022 from the all-time high value at December 31, 2021.

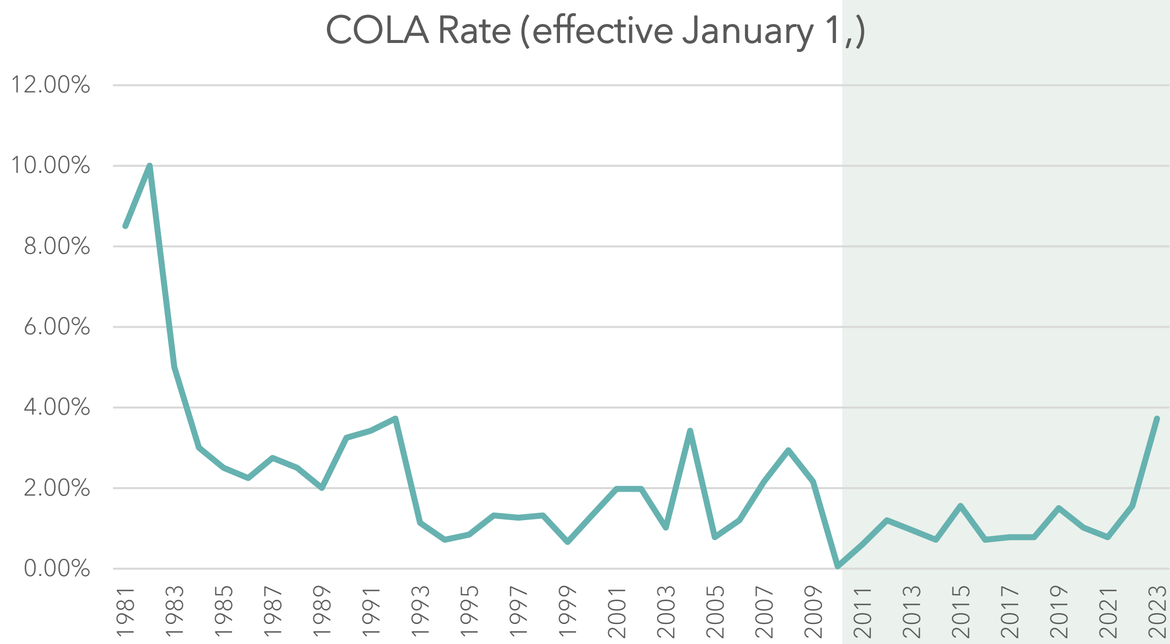
In valuing the assets on a market value basis only, the total Plan funded ratio is 85.2 per cent (2021: 98.8 per cent), the pre-1992 period funded ratio is 34.2 per cent (2021: 43.0 per cent), and the post-1991 period funded ratio is 97.4 per cent (2021: 113.3 per cent). These ratios have all fallen significantly over the same period due to the large decrease in the market value during 2022.



UAPP SPRING 2023 COMMUNIQUÉ

The post-1991 portion of the Plan recently returned to full funding and remains fully funded on an actuarial value basis. On the other hand, the funded position for the pre-1992 portion of the Plan has been lagging that for the post-1991 period due to the long amortization period (50 years from the date the unfunded liability was first determined) and the fact both discount rates and mortality rates have decreased over the past few decades, increasing the value of the associated liability.

Pensions, and thus liabilities and funded ratios, for both periods are directly impacted by one of the more influential valuation assumptions for pension plans: inflation. For UAPP, monthly pension payments are increased on January 1 of each year by a COLA equal to 60 per cent of the average increase in Alberta's Consumer Price Index for the 12-month period ending October 31 of the previous year. With 2022 inflation the highest in decades, the impact of the annual COLA is significant starting with the rate applied January 1, 2023. On that date, both deferred pensions and pensions in pay received an increase of 3.72 per cent, representing the highest annual increase since the 5.00 per cent increase granted effective January 1, 1983.



UAPP SPRING 2023 COMMUNIQUÉ

With the long-term funding focus of the Plan, the coming actuarial valuation will include an inflation assumption that will be based on expectations over the coming decades, keeping the current high inflation environment in perspective. Nevertheless, inflation data in early 2023 indicates that the steep rise in inflation may only be temporary as central banks continue to work to return it to within their policy targets.

Looking to the Future

During 2022, the Board and its Investment Committee engaged in several discussions about formalizing the importance of responsible investing in the Plan's governing documents. The Board seriously considers its fiduciary duty to act in good faith and in the best interest of the Plan's members and beneficiaries. Given the long-term nature of defined benefit pensions, the Fund benefits from enhanced investment returns and risk mitigation when responsible investing principles are adopted.

Effective January 1, 2023, UAPP adopted a new Statement of Investment Policies and Goals (SIP&G) which incorporated a significant number of responsible investing provisions. Because the Fund utilizes pooled funds managed by third party investment managers, the UAPP has limited ability to influence the selection of specific investments. However, the Board maintains the responsibility to select investment managers that factor responsible investing into their fund management approach.

The coming year will see the UAPP busy with investment manager searches intended to return the Fund's public equity portfolio to active management after two years of passive management following the termination of the asset class's previous manager. The target allocation for public equities is 45 per cent of the Fund, meaning the decisions being made in selecting new managers will require a great deal of careful and thorough consideration. Over the next year or so, the Plan anticipates having in place new managers for Canadian, global, and emerging market public equities.

Results of the last actuarial valuation led to a reduction in pension contributions that took effect during 2022. Improvements in the financial position of the Plan allowed for that rate change. Completing an updated actuarial valuation this coming year will enable the Board to ensure the Plan's assumptions and contribution rates are at the proper levels for the purposes of safeguarding the long-term stability of the Fund.

UAPP SPRING 2023 COMMUNIQUÉ

Retirement Planner

Active members of UAPP have automatic access to the Retirement Planner. The link to the Retirement Planner is on UAPP's home page under Key Information.

Within the Retirement Planner, you can perform retirement calculations by running an unlimited number of pension estimates, adjusting for important details like retirement dates and future salary adjustments. You can also access your Annual Member Statement. If you have questions about your pension or the Retirement Planner, please call the UAPP Administration Centre toll-free at 1.866.709.2092.

Publications

The UAPP website includes a host of publications intended to assist members in understanding their pension plan. In addition to this Communique, these publications include the Member Handbook, Annual Report, and several Information Sheets, covering a range of topics such as New Member Basics, Pension Options, Death or Leaving the Plan Before Retirement, Preparing For Retirement, and the Retired Member Guide.

Contact Us

If you terminate employment and leave your funds in UAPP, ensure we have your current address and beneficiary information. Email us to update your address. Beneficiaries can be updated by using the UAPP Designation of Spouse and Non-Spouse Beneficiary form. Make sure your family and executor know you are entitled to a benefit from the UAPP.

Administration Service Provider

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CIBC Mellon

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