Financial Statements of

LUTHERAN CHURCH - CANADA PENSION PLAN

And Independent Auditors' Report thereon

Year ended December 31, 2019

KPMG LLP
360 Main Street
Suite 1900
Winnipeg MB
R3C 3Z3

Telephone (204) 957-1770
Fax (204) 957-0808
www.kpmg.ca

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Lutheran Church - Canada

Opinion

We have audited the financial statements of Lutheran Church - Canada Pension Plan (the "Entity"), which comprise the statement of financial position as at December 31, 2019, the statements of changes in net assets available for benefits and changes in pension obligations - defined benefit plan for the year then ended, and notes to the financial statements, including a summary of significant accounting policies (hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2019, and its changes in net assets available for benefits and its changes in pension obligations for the year then ended in accordance with Canadian accounting standards for pension plans.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the ***"Auditors' Responsibilities for the Audit of the Financial Statements"*** section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Canadian accounting standards for pension plans, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity’s financial reporting process.

Auditors’ Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors’ report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors’ report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors’ report. However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG LLP

Chartered Professional Accountants

Winnipeg, Canada

June 25, 2020

LUTHERAN CHURCH - CANADA PENSION PLAN

Statement of Financial Position

December 31, 2019, with comparative information for 2018

	2019	2018
		(Restated, note 4)
Assets		
Cash	$ 1,266,917	$ 1,330,351
Accounts receivable	69,953	85,715
Goods and services taxes receivable	10,824	12,257
Contributions receivable from LCC Worker Benefit Services Inc.	–	29,860
Receivable from broker	496	–
	1,348,190	1,458,183
Investments (note 3)	84,154,065	75,874,051
	85,502,255	77,332,234
Liabilities		
Accounts payable and accrued liabilities	109,657	138,766
Payable to LCC Worker Benefit Services Inc.	9,006	–
	118,663	138,766
Net assets available for benefits - defined benefit plan	85,383,592	77,193,468
Actuarial value of pension obligations - defined benefit plan (note 4)	79,330,233	78,948,166
Excess (deficiency) of net assets available for benefits over pension obligations - defined benefit plan	$ 6,053,359	$ (1,754,698)

See accompanying notes to financial statements.

On behalf of the Board:

G.K. Henderson Director

Arnold Herring Director

LUTHERAN CHURCH - CANADA PENSION PLAN

Statement of Changes in Net Assets Available for Benefits

Year ended December 31, 2019, with comparative information for 2018

	2019			2018		
	Defined benefit plan	Defined contribution plan	Total	Defined benefit plan	Defined contribution plan	Total
Increase in assets:						
Contributions - employer	$ 2,344,520	$ 1,113,065	$ 3,457,585	$ 3,402,503	$ 1,151,576	$ 4,554,079
Contributions - employee	50,525	973,192	1,023,717	62,760	1,012,584	1,075,344
Investment income (note 5)	2,082,161	–	2,082,161	1,924,583	–	1,924,583
Unrealized investment gains (losses) net of unrealized gains (losses)	6,768,645	–	6,768,645	(2,796,991)	–	(2,796,991)
Change in fair value of annuity	1,448,494	–	1,448,494	122,500	–	122,500
Realized investment gains, net of realized losses	664,452	–	664,452	1,367,829	–	1,367,829
	13,358,797	2,086,257	15,445,054	4,083,184	2,164,160	6,247,344
Decrease in assets:						
Pension benefits paid	3,644,114	2,086,257	5,730,371	3,537,114	2,164,160	5,701,274
Lump sum transfers to members	904,410	–	904,410	1,990,405	–	1,990,405
Administration expenses (note 6)	620,149	–	620,149	643,979	–	643,979
	5,168,673	2,086,257	7,254,930	6,171,498	2,164,160	8,335,658
Increase (decrease) in net assets	8,190,124	–	8,190,124	(2,088,314)	–	(2,088,314)
Net assets available for benefits, beginning of year	77,193,468	–	77,193,468	79,281,782	–	79,281,782
Net assets available for benefits, end of year	$85,383,592	$ –	$ 85,383,592	$ 77,193,468	$ –	$ 77,193,468

See accompanying notes to financial statements.

LUTHERAN CHURCH - CANADA PENSION PLAN

Statement of Changes in Pension Obligations - Defined Benefit Plan

Year ended December 31, 2019, with comparative information for 2018

	2019			2018		
	Pension Obligations			Pension Obligations		
	Going concern	Buy-in annuity	Total	Going concern	Buy-in annuity	Total
						(Restated, note 4)
Actuarial value of obligations, beginning of year	$ 59,697,119	$ 19,251,047	$ 78,948,166	$ 59,287,274	$ 21,516,945	$ 80,804,219
Withdrawal of employers (note 4)	(59,532)	(73,231)	(132,763)	(570,930)	(747,636)	(1,318,566)
Benefits accrued	190,017	–	190,017	282,036	–	282,036
Benefits paid	(2,791,851)	(1,602,313)	(4,394,164)	(2,478,026)	(1,640,762)	(4,118,788)
Interest on accrued benefits	3,213,742	595,931	3,809,673	3,176,765	625,036	3,801,801
Effect of experience losses (gains)	56,741	852,563	909,304	–	(502,536)	(502,536)
Actuarial value of obligations, end of year	$ 60,306,236	$ 19,023,997	$ 79,330,233	$ 59,697,119	$ 19,251,047	$ 78,948,166

See accompanying notes to financial statements.

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements

Year ended December 31, 2019

Lutheran Church - Canada Pension Plan (the “Plan”) is comprised of the Defined Benefit Pension Plan (DBPP) and Defined Contribution Pension Plan (DCPP). Members hired after December 31, 2011 participate in the DCPP only. Effective January 1, 2013, the DBPP members, with the exception of members age 55 or older whose age and years of service equaled 80 points as of December 31, 2012, were transferred into the DCPP. While these transferred DBPP members will not earn any further service benefits under the DBPP after December 31, 2012, their pre-January 1, 2013 benefits will continue to grow within the DBPP. Members age 55 or older whose age and years of service equaled 80 points as of December 31, 2012 continue their membership in the DBPP and earn further service benefits under the DBPP. These members are required to make contributions of 4 percent of earnings to the DBPP.

A description of each component is summarized as follows:

1. Description of Plans:

(i) Defined Benefit Pension Plan:

The following description of the DBPP is a summary only. For more complete information, reference should be made to the DBPP Agreement.

(a) General:

The DBPP is a non-contributory defined benefit pension plan covering employees of the participating employers including Lutheran Church - Canada (LCC), the DBPP’s Sponsor. The DBPP was established on January 1, 1989.

(b) Funding policy:

Employers participating in the DBPP fund the benefits determined under the DBPP. The determination of the value of these benefits is made on the basis of an actuarial valuation (note 4).

(c) Service pension:

A service pension is available based on 1.25 percent of final average monthly earnings (average of the highest 60 consecutive months during the last 240 months of credited service) up to the final average monthly Year's Maximum Pensionable Earnings (YMPE) for the year of retirement and the two previous calendar years, plus 1.6 percent of the final average monthly earnings in excess of the final average monthly YMPE, multiplied by credited years of service.

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

---

1. Description of Plans (continued):

(d) Survivor's pension:

If a member dies before retirement, a benefit is paid to the surviving spouse or to their beneficiary if there is no surviving spouse. If a member's death occurs after retirement, the benefit paid to the surviving spouse is paid according to the form of pension chosen at the time of retirement.

(e) Normal retirement:

Normal retirement accrues on the first of the month coincident with or immediately following the attainment of age 65.

(f) Early retirement:

Unreduced early retirement

Members who are at least age 62 and whose age plus years of credited service is equal to at least 85 points (age of member plus years of service) at the time of retirement, may retire without a reduction to their pension.

Reduced early retirement

A member who retires at or after age 60 will have their normal retirement pension reduced by 0.55 percent for each month that their early retirement date precedes their normal retirement date. A member who retires between age 55 and 60, will have their normal retirement pension reduced by 33 percent plus an additional 0.27 percent for each month that their early retirement date precedes the first day of the month following their 60th birthday.

(g) Postponed retirement:

Retirement benefits cannot be postponed beyond the end of the year in which a member turns 71 years of age.

(h) Vested termination benefit:

Unless otherwise stipulated by the pension regulations, a member will immediately be entitled to total pension benefits earned to the date of termination under four alternative forms of payment.

1. Description of Plans (continued):

(i) Income taxes:

The DBPP is a registered Pension Trust and is not subject to income taxes.

(j) Defined Contribution Pension Plan:

(a) General:

The DCPP was initially established to encourage members to participate and enhance their registered pension plan benefit by providing them with the opportunity to contribute and therefore enhance the future benefit payments from their registered pension plan.

The provisions of the DCPP are set out in the plan text with the service provider.

(b) Funding policy:

Subject to Sections 2.02, 2.03 and 2.04 of the Lutheran Church - Canada Pension Plan document, each calendar year or portion thereof, a member may contribute to the DCPP, by regular payroll deduction, up to a maximum of 4 percent of compensation. Commencing January 1, 2013, employers contribute 6 percent of a members' compensation to the DCPP and members' are also required by the DCPP provisions to make contributions of 4 percent of compensation to the DCPP.

(c) Income taxes:

The DCPP is a registered benefit plan and is not subject to income taxes.

2. Significant accounting policies:

(a) Basis of preparation:

The Plan follows Canadian accounting standards for pension plans for accounting policies related to its investment portfolio and pension obligations. In selecting or changing accounting policies that do not relate to its investment portfolio or pension obligations, the Plan complies on a consistent basis with Canadian accounting standards for private enterprises.

2. Significant accounting policies (continued):

These financial statements are prepared on the going concern basis and present the aggregate financial position of the Plan as a separate financial reporting entity independent of the sponsor and plan members. Only the net assets of the Plan and obligations to the members eligible to participate in the Plan have been included in these financial statements. These financial statements do not portray the funding requirements of the Plan or the benefit security of the individual plan members.

As disclosed in note 4, the financial position at December 31, 2019 for the DBPP is an estimate based on the actuarial valuation as of December 31, 2019. The actuarial valuation indicates that the DBPP has a going concern surplus of $2,523,000 (2018 - $46,000) and a statutory solvency deficiency of $15,810,000 (2018 - $18,454,000). At the forbearance of the Province of Alberta Superintendent of Pensions, the DBPP is currently not required to fully fund the solvency deficiency within the amortization period stipulated in the Act, but rather on a best efforts basis.

(b) Financial instruments:

Financial instruments are recorded at fair value on initial recognition. Freestanding derivative instruments that are not in a qualifying hedging relationship and investments are subsequently measured at fair value. All other financial instruments are subsequently measured at cost or amortized cost, unless management has elected to carry the instruments at fair value. The Plan has elected not to carry any such financial instruments at fair value.

Transaction costs incurred on the acquisition of financial instruments measured subsequently at fair value are expensed as incurred. All other financial instruments are adjusted by transaction costs incurred on acquisition and financing costs. These costs are amortized using the straight-line method.

(c) Fair value measurement:

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

The Plan uses closing market price for fair value measurement. When available, the Plan measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

---

2. Significant accounting policies (continued):

If a market for a financial instrument is not active, then the Plan establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models.

All changes in fair value, other than interest and dividend income, are recognized in the statement of changes in net assets available for benefits within unrealized and realized investment gains and losses.

Fair values of investments are determined as follows:

Bonds, mortgages and equities are valued at year-end closing market prices.

Pooled investment funds are valued at the unit values supplied by the fund administrator, which represents the Plan's proportionate share of underlying net assets at fair values determined using year-end closing market prices.

Investments in derivative financial instruments, being forward foreign exchange contracts, are valued at year end quoted market prices where available. Where quoted prices are not available, values are determined using pricing models, which taken into account current market and contractual prices of the underlying instruments, as well as time value and yield curve or volatility factors underlying the positions.

Alternative investments are recorded at fair value determined by the external manager. A number of valuation methodologies are considered in arriving at the fair value of unquoted investments, including internal or external valuation models, which may include discounted cash flow analyses. The most appropriate methodology to determine fair value is chosen on an investment by investment basis. Any control, size, liquidity or other discounts or premiums on the investment are considered by the external manager in their determination of fair value.

Annuity buy-in insurance policies are purchased to cover a portion of DBPP retirees with fair value of the annuity buy-in determined based on the solvency pension obligation associated with covered DBPP retirees.

LUTHERAN CHURCH - CANADA PENSION PLAN

2. Significant accounting policies (continued):

(d) Foreign currency translation:

Transactions in foreign currencies are translated into Canadian dollars at the exchange rate at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into Canadian dollars at the exchange rate at that date.

Foreign currency differences arising on retranslation are recognized in the statement of changes in net assets available for benefits within unrealized investment gains and losses.

(e) Investment transactions and income recognition:

(i) Investment transactions:

Investment transactions are accounted for on a trade date basis.

(ii) Income recognition:

Investment income has been accrued as reported by the issuer of the pooled funds and bonds. Dividend income from publicly traded securities is recorded as of the ex-dividend date. Interest income has been accrued as earned.

(f) Contributions:

Contributions from employers and employees are recorded on an accrual basis.

(g) Benefits:

Benefit payments to members, termination refunds to former members, and transfer payments to other plans are recorded in the period in which they are paid or payable. Any benefit payment accruals not paid are reflected in accounts payable and accrued liabilities.

(h) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of increases and decreases in net assets during the year. Significant items subject to such estimates and assumptions include the determination of the actuarial value of pension obligations. Actual results could differ from those estimates.

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

3. Investments:

The investments as at December 31 are as follows:

	2019	2018
Pooled funds:		
Canadian equities	$ 19,402,764	$ 15,542,711
Foreign equities	28,907,543	24,637,050
Real estate	5,341,494	4,915,932
Mortgages	11,408,354	11,469,392
Buy-in annuity	19,023,997	19,251,047
Alternative investments	69,913	57,919
	$ 84,154,065	$ 75,874,051

During fiscal 2017, DBPP purchased a buy-in annuity for retirees for $22,446,733. Future cash flows from the annuity will match the amount and timing of benefits payable by the Plan, substantially mitigating the exposure to future volatility in the related pension obligation associated with the annuity. At December 31, 2019, reflecting the buy-in annuity, 24 percent (2018 - 24 percent) of the DBPP obligation was fully hedged against future discount rate and longevity risk (potential increases in life expectancy of DBPP retirees).

During fiscal 2018, DBPP converted $738,020 of the buy-in annuity purchased for select retirees in fiscal 2017 into a buy-out annuity. During fiscal 2019, DBPP purchased a buy-out annuity for select retirees for $75,526 (2018 - $661,096). The purchase of a buy-out annuity results in a transfer of all future investments, discount rate, and longevity risk to the insurance company in the amount indicated and as a result, is no longer reflected in the financial statements of the Plan.

4. Pension obligations - DBPP:

The actuarial value of pension obligations of DBPP at December 31, 2019 was determined by Ellement Consulting Group, the actuary, using the projected unit credit actuarial cost method prorated on service and the Board of Directors best estimate assumptions. The next valuation will be filed no later than December 31, 2022.

The actuarial value of pension obligations of DBPP have been retroactively restated as a result of a change in the actuarial valuation methodology regarding the buy-in annuity. The buy-in annuity included in the obligation is now being valued on a solvency basis rather than a going concern basis to match the value of the buy-in annuity investment, which is valued on a solvency basis (note 3).

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

4. Pension obligations - DBPP (continued):

As a result, the actuarial value of pension obligations increased by $4,398,271 at January 1, 2018 to $80,804,219 and increased by $3,281,309 at December 31, 2018 to $78,948,166 from the amounts previously reported.

The assumptions used in the going concern actuarial value of pension obligations are assumptions adopted by the Board of Directors and were developed by reference to expected long-term market conditions. The significant long-term actuarial assumptions used in the valuation were:

(a) the average rate of compensation increase was assumed to be 2.75 percent (2018 - 2.75 percent); and

(b) the discount rate for accrued pension benefits and the asset rate of return were assumed to be 5.5 percent (2018 - 5.5 percent).

Since the intention is that the DBPP will continue into the future indefinitely, the obligations of the DBPP, excluding the portion related to the buy-in annuity, are calculated by using the going concern actuarial basis. As underlying conditions change over time, going concern assumptions adopted by the Board of Directors may also change, which could cause a material change in the actuarial value of pension obligations.

The assumptions used in the actual value of pension obligations for the buy-in annuity are based on solvency assumptions with a discount rate of 2.95 percent (2018 - 3.02 percent).

During fiscal 2019, the Plan entered into Participating Employer Withdrawal Agreements with seven employers which specifically quantified the covenants agreed upon for facilitating the withdrawal as a participating employer in the Plan. In accordance with the Participating Employer Withdrawal Agreements, the employers made a contribution for their share of the actuarial value of pension obligations which was reflected as a withdrawal from the Plan in fiscal 2019.

During fiscal 2018, the Plan entered into Participating Employer Withdrawal Agreements with four employers which specifically quantified the covenants agreed upon for facilitating the withdrawal as a participating employer in the Plan. In accordance with the Participating Employer Withdrawal Agreements, the employers made a contribution for their share of the actuarial value of pension obligations which was reflected as a withdrawal from the Plan in fiscal 2018.

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

4. Pension obligations - DBPP (continued):

For funding purposes, the actuarial value of net assets available for benefits has been determined at amounts that reflect long-term market trends (consistent with assumptions underlying the actuarial value of pension obligations). This valuation is based on a five year moving average market method. Under this method, all experience gains and losses are averaged over a five year period.

The financial position at December 31, 2019 is an estimate based on the most recent filed actuarial valuation report as at December 31, 2019. The financial position at December 31, 2018 was an estimate based on an extrapolation of the previously filed actuarial valuation report as at December 31, 2017. The actuarial valuation report at December 31, 2019 indicates that there is a going concern surplus of $2,523,000 (2018 - $46,000). The going concern surplus is calculated utilizing the average fair value of assets for the last five fiscal years which resulted in an reduction of $3,530,000 (2018 - addition of $1,791,000) from the net assets available for benefits as disclosed in the statement of financial position. The actuarial valuation report at December 31, 2019 also indicated that there was a statutory solvency deficiency of $15,810,000 (2018 - $18,454,000). At the forbearance of the Province of Alberta Superintendent of Pensions, the Plan is currently not required to fund the solvency deficiency within the amortization period stipulated in the Act, but rather on a best efforts basis.

5. Investment income:

	2019	2018
Pooled funds	$ 2,081,841	$ 1,920,871
Alternative investments	320	3,712
	$ 2,082,161	$ 1,924,583

6. Administration expenses - DBPP:

	2019	2018
Investment management fees	$ 231,490	$ 221,574
Custodial fees	38,431	39,581
Consulting fees	94,928	135,929
Salaries and benefits	117,056	114,806
Legal	27,858	38,413
Other	110,386	93,676
	$ 620,149	$ 643,979

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

6. Administration expenses - DBPP (continued):

Administration expenses, except for investment management fees, custodial fees, consulting fees, and legal fees, represent management's estimate of the Plan's share of office and administrative expenses incurred by LCC Worker Benefit Services Inc. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

7. Capital management:

The main objective of the Plan is to sustain a certain level of net assets in order to meet the pension obligations of the DBPP. The DBPP fulfils its primary objective by adhering to specific investment policies outlined in its Statement of Investment Policies and Procedures (SIPP), which is reviewed annually by the Board of Directors of LCC Worker Benefit Services Inc. The Board of Directors of LCC Worker Benefit Services Inc. manages net assets by engaging knowledgeable investment managers who are charged with the responsibility of investing existing funds and new funds (current year's employer and employee contributions) in accordance with the approved SIPP. Increases in net assets are a direct result of investment income generated by investments held by the DBPP and contributions into the DBPP by the employers and employees. The main use of net assets is for benefit payments to eligible DBPP members.

The primary risk the DBPP faces is that the DBPP's asset growth and contribution rates will be insufficient to cover the DBPP's liabilities (funding risk) resulting in an unfunded liability (funding deficiency). If a funding deficiency reaches a certain level, or persists, it may need to be eliminated through contribution rate increases, pension benefit reductions or a combination of the two.

The DBPP's net funded position can change relatively quickly if there are changes in the value of the investments or liabilities. Either can result in a mismatch between the DBPP's assets and its liabilities. The most significant contributors to funding risk are:

- increase or decline in interest rates;
- decline in long-term investment rates of return;
- changes in stock market indices affecting market values of investments, and
- unexpected increases in inflation and salary escalation.

The DBPP's liabilities are affected by non-economic factors like changes in member demographics. The DBPP's assets are subject to financial instrument risks which are explained in more detail in note 8 to these financial statements.

8. Risk management:

The DBPP is exposed to a variety of financial risks as a result of its investment activities and has policies and procedures that govern the management of market, credit and liquidity risk. The Board of Directors establish a target asset mix among interest bearing instruments and Canadian and foreign equities to ensure diversification across asset classes.

This strategy is provided to the investment managers who implement and monitor it to ensure the policies are met.

(a) Market risk:

(i) Interest rate risk:

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair values of financial instruments. Interest rate risk arises when the Plan invests in interest-bearing financial assets. The DBPP is exposed to the risk that the value of such financial assets will fluctuate due to changes in the prevailing levels of market interest rates. The DBPP's exposure to interest rate risk is concentrated in its investments in pooled bond and fixed income funds. To manage the DBPP's interest rate risk, appropriate guidelines on the weighting and duration for fixed income investments are set by the Board of Directors and monitored by the investment managers on a quarterly basis. As at December 31, 2019 and December 31, 2018, DBPP did not hold any investments that would result in interest rate risk to the Plan.

As annuity payments into DBPP are based upon specific pension payments, there is no impact of changes in the interest rates to cash flows. The fair value of the annuity will change as a result of changes in the valuation on a solvency basis. The fair value will increase by $1,910,000 at December 31, 2019 for 1 percent decrease in the discount rate.

(ii) Foreign currency risk:

Foreign currency exposure arises from the DBPP holding investments denominated in currencies other than the Canadian dollar. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of investments. The DBPP and its investment managers have the ability to utilize derivative instruments to mitigate foreign currency risk, subject to the approval of the Board of Directors. At December 31, 2019, the DBPP is exposed to fluctuations in the U.S. dollar, British Pound, Euros, Japanese Yen, Swiss Franc and other currencies.

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

8. Risk management (continued):

The DBPP’s exposure to foreign currencies to Canadian dollars is shown below:

As at December 31, 2019	Actual currency exposure	%
Canadian	$ 57,242,054	67.01
U.S. dollar	14,646,792	17.15
British Pound	3,175,486	3.72
Euros	4,352,733	5.10
Japanese Yen	1,410,419	1.65
Swiss Franc	1,489,002	1.74
Other currencies	3,104,496	3.63
	$ 85,420,982	100.00

As at December 31, 2018	Actual currency exposure	%
Canadian	$ 53,266,574	69.00
U.S. dollar	12,208,005	15.81
British Pound	3,151,218	4.08
Euros	3,684,987	4.77
Japanese Yen	1,227,011	1.59
Swiss Franc	821,083	1.06
Other currencies	2,845,524	3.69
	$ 77,204,402	100.00

A 10 percent increase or decrease in exchange rates at December 31, 2019, with all other variables held constant, would have resulted in a change in unrealized gains (losses) of approximately $ 2,818,000 (2018 - $2,394,000).

(iii) Other price risk:

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk).

To manage the DBPP's other price risk, appropriate guidelines on asset diversification to address specific security, geographic, sector and investment manager risks are set by the Board of Directors and monitored by the investment managers on a quarterly basis.

8. Risk management (continued):

As at December 31, 2019, a decline of 10 percent in equity values, with all other variables held constant, would have impacted the DBPP's equity investments by an approximate unrealized loss of $ 4,831,000 (2018 - $4,018,000).

(b) Credit risk:

The DBPP is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. All transactions in listed securities are settled upon delivery using approved investment managers. The risk of default is considered minimal, as delivery of securities sold is only made once the investment manager has received payment. Payment is made on a purchase once the securities have been received by the investment manager. The trade will fail if either party fails to meet its obligation. The DBPP utilizes multiple counterparties and those that have a high credit rating in order to minimize credit risk.

The annuity has limited credit risk as it was purchased from a Canadian insurance company with a S&P rating of AA and the insurance company is a member of Assuris. Assuris is a not-for-profit organization that protects Canadian policyholders should their life insurance company fail to meet its obligations to participants. Every life insurance company authorized to sell insurance policies in Canada is require by the federal, provincial and territories regulators, to become a member of Assuris. Credit risk associated with contributions receivable is minimized due to their nature. No provision for doubtful contributions has been recorded in either 2019 or 2018.

(c) Liquidity risk:

Liquidity risk is the possibility that investments in the DBPP cannot be readily converted into cash when required. The DBPP may be subject to liquidity constraints because of insufficient volume in the markets for the securities of the DBPP or the securities may be subject to legal or contractual restrictions on their resale. Liquidity risk is managed by investing the majority of the DBPP's assets, other than the annuity, in investments that are traded in an active market and can be readily disposed. The annuity has limited liquidity risk as annuity receipts are intended to match outgoing retiree payments for a portion of the DBPP membership.

LUTHERAN CHURCH - CANADA PENSION PLAN

9. Fair value of financial instruments:

The determination of the fair value of investments is as described in note 2(c) with fair values of investments disclosed in note 3.

The DBPP's assets which are recorded at fair value have been categorized into three levels, depending on the inputs used for valuation. The hierarchy of inputs is summarized below:

Level 1 quoted prices in active markets for identical assets or liabilities;

Level 2 inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and

Level 3 inputs for the asset or liability that are not based on observable market data.

Changes in valuation methods may result in transfers into or out of an investment's assigned level. The following is a summary of the inputs used as of December 31 in valuing the DBPP's cash and investments:

December 31, 2019	Level 1	Level 2	Level 3	Total
Cash	$ 1,266,917	$ –	$ –	$ 1,266,917
Pooled funds:				
Canadian equities	–	19,402,764	–	19,402,764
Foreign equities	–	28,907,543	–	28,907,543
Mortgages	–	11,408,354	–	11,408,354
Real estate	–	–	5,341,494	5,341,494
Buy-in annuity	–	–	19,023,997	19,023,997
Alternative investments	–	–	69,913	69,913
	$ 1,266,917	$ 59,718,661	$ 24,435,404	$ 85,420,982

December 31, 2018	Level 1	Level 2	Level 3	Total
Cash	$ 1,330,351	$ –	$ –	$ 1,330,351
Pooled funds:				
Canadian equities	–	15,542,711	–	15,542,711
Foreign equities	–	24,637,050	–	24,637,050
Mortgages	–	11,469,392	–	11,469,392
Real estate	–	–	4,915,932	4,915,932
Buy-in annuity	–	–	19,251,047	19,251,047
Alternative investments	–	–	57,919	57,919
	$ 1,330,351	$ 51,649,153	$ 24,224,898	$ 77,204,402

LUTHERAN CHURCH - CANADA PENSION PLAN

Notes to Financial Statements (continued)

Year ended December 31, 2019

9. Fair value of financial instruments (continued):

At December 31, 2019 and 2018, there were no transfers between Level 1 and Level 2.

The reconciliation of investments measured at fair value using unobservable inputs (Level 3) is presented as follows:

Balance, December 31, 2017	$	26,107,512
Payments made by insurer of annuity		(1,650,378)
Withdrawal for purchase of buy-out annuity		(738,020)
Current period change in fair value of investments		505,784
Balance, December 31, 2018		24,224,898
Payments made by insurer of annuity		(177,542)
Withdrawal for purchase of buy-out annuity		(76,509)
Current period change in fair value of investments		464,557
Balance, December 31, 2019	$	24,435,404

10. Subsequent event:

Subsequent to December 31, 2019, the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Plan is not known at this time. These impacts could include decline in fair value of investments, decreases in investment income, or change in the actuarial value of pension obligations.