TEACHERS' PENSION PLAN ONTARIO

Funding • Pension service • News briefs

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Funding valuation filed

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PENSIONS

OTF and government to develop pension action plan

Retired teacher Jessie knows her pension is secure. But she's worried about the future pension security of young Ontario teachers, like her 29-year-old niece Marta. And when Richard, a teacher for 15 years, hears that many pension plans face financial pressures, he wonders what level of benefits will be there for him in retirement.

Pension security is an important issue. The Ontario Teachers' Federation (OTF) and the Ontario Government are charged with the task of deciding how to keep the Teachers' pension plan viable and affordable in the future.

You may have read that the OTF and government, the plan co-sponsors, filed a funding valuation with the provincial pension regulator in September 2009. This funding valuation—basically a financial check-up—showed the pension plan had enough assets to cover the costs of future pension benefits as of Jan. 1, 2009.

But funding shortfalls have been problematic in the past, and they are projected to return in the future. That's because plan liabilities (the cost of future pensions) continue to grow faster than plan assets.

NEW GROUP GEARING UP

To address this, the OTF and government, in co-operation with the Teachers' pension plan, have set up a working group. The group will develop a plan by mid-2010 to deal with the pension plan's recurring funding challenges. No changes to plan benefits or contributions will occur before the next valuation is filed, which must be done by Sept. 30, 2012.

Along the way, members will be kept informed of the working group's progress.

FACTORS CONTRIBUTING TO SHORTFALL

Why do pension funding challenges still exist? Shortfalls are projected to recur because of several factors, not just one. Collectively these factors are pushing costs higher and assets just aren't keeping up. Some of these factors include:

- Plan demographics. Retired teachers are living longer and collecting pensions for several more years than they did in the past.

FUNDING HIGHLIGHTS

- > Pension benefits and contribution rates will remain the same in 2010.
- > No change is required because the latest funding valuation showed plan assets and the cost of future benefits are in balance as of Jan. 1, 2009.
- > Contribution rates and benefit levels will remain stable at least until the next valuation is filed with the regulator, which must occur by Sept. 30, 2012.
- > Pension benefits already earned by working and retired members cannot be reduced under Ontario's Pension Benefits Act.
- > Only the OTF and the Ontario Government, joint pension plan sponsors, can change benefits and contribution rates.
- > With funding shortfalls projected to recur, a newly-created working group will determine how to keep the pension plan viable and affordable.

- Investment returns are projected to be modest in the future, compared with the high long-term returns achieved in the past.
- Real (after inflation) interest rates also continue to be low. This raises the cost of future pensions. It's the same if you're saving for a house or car by a specific date: if your savings earn less each year because interest rates are low, you'll have to put aside more money to reach your goal on time.
- Despite strong long-term returns, the pension fund, like most investors, lost money in 2008. The 2008 investment loss will be recognized over the next four years due to "smoothing"—a common pension practice that allows investment gains and losses to be recognized over five years, instead of all at once. The Teachers' plan still must absorb $19.5 billion in losses (the 2008 smoothing adjustment). Even if financial markets improve, investment returns aren't expected to cover the annual cost of paying pensions, as well as the 2008 investment losses that must be recognized in the future.

ADDRESSING A SHORTFALL

So what can be done?

If pension plan shortfalls continue as expected, the OTF and government have options. They can:

- increase contribution rates;
- invoke (apply) conditional inflation protection for future pension credit;
- change other benefits members will earn in future years; or
- adopt a combination of these options.

"The plan sponsors are united in their resolve to ensure that pensions are safeguarded, but that doesn't mean contributions and future benefits won't change from time to time," said Jim Leech, President and CEO of the Ontario Teachers' Pension Plan. "I don't want to speculate on what options the sponsors may consider, but with the voluntary filing of the 2009 funding valuation, they are giving themselves time to examine alternatives without being rushed."

For more information about these issues, visit www.otpp.com/funding. ■

New inflation provision can ease funding pressures

Conditional inflation protection is a permanent provision of the Teachers' pension plan, and will affect credit earned after this year.

The Ontario Teachers' Federation (OTF) and Ontario Government can invoke conditional inflation protection for pension credit earned after 2009 to help address funding shortfalls in the pension plan.

When you begin to collect a pension, your annual inflation adjustment will be based on two components:

1. The portion of your pension credit earned until the end of 2009 is 100 per cent protected against increases in the cost of living, as measured by the Consumer Price Index (CPI).

2. As long as the plan has sufficient assets, the portion of your pension credit earned after 2009 will be 100 per cent protected against increases in the cost of living. If the plan has insufficient assets, annual cost-of-living increases for pension credit earned after 2009 will be between 50 and 100 per cent of the change in CPI, depending on how much the plan can pay.

For example, Maria will have 20 years of pension credit on Jan. 1, 2010. She plans to retire in five years. Guaranteed 100 per cent inflation protection will apply to 80 per cent of Maria's pension (20 of 25 years) and 50 to 100 per cent inflation protection will apply to the remaining 20 per cent (five of 25 years).

In the latest funding valuation filed with the pension regulator, plan assets were sufficient to cover plan liabilities (future pension costs) as of Jan. 1, 2009. Since the plan is considered "balanced," conditional inflation protection does not need to be used next year. However, if a future valuation shows a shortfall, the OTF and government can invoke conditional inflation protection to eliminate it. ■

You Asked Us...

Q. What is a funding valuation?
A. A funding valuation is an assessment of the long-term financial health of a pension plan. The valuation shows whether the plan has a surplus of funds, a shortfall of funds, or just the right amount of funds.

The valuation uses a number of assumptions to compare the value of pension plan assets (such as stocks, bonds and future contributions) to the value of pension plan liabilities (the amount required to pay accrued and future pension benefits).

The valuation is a good measure of the pension plan's bottom line because it looks ahead more than 70 years, which is how long the plan is expected to pay future benefits promised to all current members and their survivors.

The plan's most recent funding valuation showed plan assets and liabilities were in balance as of Jan. 1, 2009. However, funding shortfalls are projected in future because the cost of future benefits is growing faster than plan assets.

Q. What happened to the $2.5 billion funding shortfall reported in early 2009?
A. The funding valuation filed with the regulator in September 2009 assumes the Teachers' pension plan will earn a slightly higher long-term rate of return on investments than assumed in a preliminary valuation conducted earlier. This change eliminated most of the estimated shortfall and other minor changes, reflecting recent plan experience, eliminated the rest.

Q. What will happen if there is another shortfall in the future?
A. The Ontario Teachers' Federation (OTF) and the Ontario Government, in consultation with pension plan management, will be developing a plan by mid-2010 to deal with the plan's recurring funding challenges. To address a future shortfall, the OTF and government could:

- increase contribution rates;
- invoke conditional inflation protection for pension credit earned after 2009;
- change other benefits members will earn in future years; or
- adopt a combination of these options.

Members will be kept apprised of developments as they occur.

Q. Should I retire now before conditional inflation protection takes effect?
A. Don't rush into retirement because of fears of losing inflation protection. The change in the cost-of-living provision will affect only that portion of your pension earned after 2009. It will not apply to any pension credit earned before then.

For example, let's say you have 20 years of pension credit on Jan. 1, 2010, and you retire five years later. Guaranteed 100 per cent inflation protection will apply to 80 per cent of your pension (20 of 25 years) and 50 per cent to 100 per cent inflation protection will apply to the remainder (5 of 25 years).

Q. Should I delay retirement until economic conditions improve?
A. Many people around the world plan to retire later because the 2008 market downturn eroded their retirement savings. However, your Teachers' pension is not based on day-to-day market performance or the value of the pension fund when you retire.

Your Teachers' pension is defined by a formula based on your pension credit and average earnings. This makes it easier to estimate the pension you will get when you retire. Many other types of retirement savings, including RRSPs, do not provide predictable retirement income. In other arrangements, retirement income depends on many factors, including how much you have in your retirement account and interest rates when you convert your savings to an income stream.

Q. Will pension funding problems disappear when markets rebound?

A. A recovery in financial markets will not solve the plan's funding problems. There are two sides to the pension equation—assets and liabilities—and both sides are contributing to the plan's current funding challenges.

Liabilities

Liabilities represent the cost of providing future pensions to all current members and their survivors.

The cost of future pensions has been growing faster than plan assets because of low interest rates, increased life expectancy and other factors. To address the high cost of pensions, the OTF and the government changed the plan's inflation provision, effective next year (see page 3). However, it will take many years before this change has any significant impact on the plan's bottom line because it applies only to future pension credit.

Pension costs are unaffected by the size of the pension plan's assets. That's why a pension plan can have a shortfall —as the Teachers' pension plan did in 2005—when its invested assets are achieving high returns.

Assets

Assets are the other side of the pension equation. Despite good long-term returns on the plan's invested assets, members cannot rely on investment performance alone to solve the plan's funding problems. It is unrealistic to expect investment returns to be high enough to cover the annual cost of pensions, plus make up for $19.5 billion in investment losses that must be recognized over the next four years.

Teachers' and other pension plans are allowed to "smooth" investment gains and losses over five years. This avoids having to adjust contribution or benefit levels frequently because of volatile investment returns. However, it also means that over the next four years the Teachers' pension plan must recognize $19.5 billion in losses held back in the smoothing adjustment last year. We cannot predict how long it will take to earn back losses.

Q. I've heard assumptions used to conduct the valuation can be changed to make the numbers say what you want?

A. To determine the value of the plan's assets and liabilities, the independent actuary makes assumptions about inflation rates, salary increases, investment returns, retirement rates, life expectancy and a host of other factors. To ensure members pay the right amount into the plan for the benefits provided, the assumptions must be realistic and provide a plausible snapshot of the plan's future health.

Choosing prudent assumptions is critical. For example, if the assumption for future investment returns is too low, today's teachers will pay more than required to their future pension. If the assumption is too high, future generations will bear the burden of funding shortfalls.

Funding valuation rules are defined by the Pension Benefits Act, the Teachers' Pension Act, regulators and the actuary's standard of practice. Assumptions are carefully selected, within a range of reasonableness, based on detailed mathematical models.

Q. How can the pension plan pay more to members than it collects?

A. The Teachers' pension plan collects more than $2 billion in annual contributions, or half the amount required to pay pensions each year. While this negative cash flow isn't good, contributions are not the only source of income for the Teachers' pension fund.

Because the plan has been prudently funded, there is a large fund that generates substantial investment income. Investment returns account for about 80 per cent of pension income, while contributions account for only about 20 per cent.

Q. Is my pension secure?

A. You will receive a pension when you retire. Ontario legislation protects the value of pension benefits both working and retired members have already earned. Only contribution rates and pension benefits to be earned in future years can be adjusted during a teacher's career in response to funding surpluses or shortfalls.

Q. How do we know the government will not change the law that protects the pensions we've already earned?

A. The amount or commuted value of an accrued pension benefit cannot be reduced retroactively under Ontario's Pension Benefits Act. This legislation applies to all Ontarians, not just teachers.

Some members have noted that legislation can be changed by the government. While that is true, we have not heard of any intent to change the law to allow for reductions in accrued benefits.

Remember, the OTF and government, which jointly sponsor the pension plan, have various options for addressing plan funding challenges (see page 3). ■

*i*Access Web: Time well spent

Your time is important to you. That's why *i*Access Web, the secure members-only section of our website, is such a powerful tool.

It's safe, simple and available 24/7. Whether you only have a few seconds to spare or a few minutes, *i*Access Web is a quick and invaluable way to keep informed about your financial future.

10 SECONDS TO ACCESS YOUR PENSION STATEMENT

As a registered *i*Access member, your most up-to-date Personal Statement of Benefits is available 365 days a year. Find out how much credit you've accumulated and how much you've contributed to the plan, all without printing a single piece of paper.

45 SECONDS TO DESIGNATE A BENEFICIARY

A name and a birth date is all that is required to name a beneficiary. "It only takes a moment, but it's such an important thing that you can do," said Angie Sharma-Lowe, a Senior Pension Benefits Specialist. "This will help ensure your benefits are paid as you wish should you die before you start your pension."

90 SECONDS TO SEE YOUR FINANCIAL FUTURE

With the pension calculator, you can create multiple scenarios for your retirement: what will happen if you retire at 50, 55, 60? How much pension can you expect to receive? There are endless combinations and possibilities that can be computed.

10 MINUTES TO RETIRE ONLINE

Did you know that 93 per cent of our June 2009 retirees applied online? And 60 per cent of those applications were processed in the same day they were received! *i*Access Web guides you through six simple steps to complete your application quickly and easily. ■

HOW TO REGISTER

1. Call 416-226-2700 or 1-800-668-0105 weekdays from 8 a.m. to 5:30 p.m. or
2. Download and complete a registration form, available at www.otpp.com

DID YOU KNOW?

29%
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89
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"I found using *i*Access so helpful in planning my retirement. I had all the information and resources that I needed to make the final decision, which came down to knowing exactly what my pension would be through the pension calculator and choices for survivor benefits. I applied for my pension online and when I received my first pension cheque, there were no surprises."

MARY KOPPEL,
Holy Spirit Elementary School,
Toronto Catholic District School Board
Retired in 2008

Taking flight in Britain

The Teachers' pension plan is set to increase its ownership of Bristol International Airport to approximately 50 per cent after signing an agreement to acquire Macquarie Airports' 35.5 per cent stake. The deal is expected to close before year-end, subject to a number of conditions and anti-trust clearance.

The airport, located about 200 kilometres west of London, is the ninth busiest in Britain. The investment will complement other airport holdings in Teachers' infrastructure portfolio. Teachers' currently owns approximately 48 per cent of Birmingham Airport with a partner, as well as 11 per cent of Sydney Airport, Australia's premier gateway airport.

"We are a substantial long-term investor in key infrastructure assets around the world, including other leading airports, and we are very pleased to be increasing our investment in Bristol Airport," said Stephen Dowd, Senior Vice-President and head of infrastructure investing. "As an experienced investor in the sector and a Bristol shareholder for several years, we have strong confidence in the airport's outlook and future prospects."

Dowd added that long-term infrastructure investments, such as airports, water and power plants, electricity and gas distribution networks and port facilities, provide stable returns that correlate well with inflation. ■

Pension plan applauds change in TSX rule

Good governance is good business

The Toronto Stock Exchange (TSX) recently announced a rule change that will give shareholders a meaningful say in certain transactions and improve governance standards at Canada's leading stock exchange.

"We and other shareholder groups encouraged the TSX to make this change, and we're very pleased with the decision," said Wayne Kozun, Senior Vice-President of Teachers' public equities portfolio.

Beginning November 2009, public companies are required to obtain shareholder approval for certain acquisitions that result in the issuance of 25 per cent or more of their outstanding shares.

Under the old rule, the TSX did not specifically limit the number of new shares that could be issued without shareholder approval. When a company issues more shares, it reduces the earnings per share for shareholders.

The Teachers' pension plan promotes good governance on behalf of plan members because we believe improved governance leads to better long-term company performance. ■

Leech is a Champ

Jim Leech, President and CEO, was honoured recently as a Champion of Public Education by The Learning Partnership (TLP).

Recipients of the award are honoured for their dedication to public education.

Actively involved in education initiatives throughout his career, Jim currently serves on the board of Right to Play Canada. This humanitarian organization uses sport and play programs to improve the lives of children in disadvantaged areas of the world. He also volunteers for Youth Without Shelter, and is involved with the Queen's Business School as an advisor and a mentor to MBA students.

TLP is a not-for-profit organization dedicated to bringing together education, government, labour, policy makers, employers and the community to develop partnerships that strengthen public education in Canada.

New board members appointed

Eileen Mercier, Chair of the Board, is pleased to announce the addition of **David Smith** and **Rod Albert** as new members.

Mr. Smith is former Chair and Senior Partner at PricewaterhouseCoopers and

former CEO of the Canadian Institute of Chartered Accountants. He is Chair of the Government of Canada's Audit Committee and Acting Chair of the federal Small Departments Audit Committee. A Chartered Accountant, Mr. Smith earned a B.Comm. (Honours) from the University of Windsor and is a graduate of the Institute of Corporate Directors.

Mr. Albert, a retired English teacher, was a driving force in the establishment of Teachers' as an independent corporation in 1990, when

he was president of the Ontario Teachers' Federation (OTF). In addition, he has served on the OTF Board of Governors, the OTF executive and was general secretary of the Ontario Secondary School Teachers' Federation. His appointment is effective Jan. 1, 2010.

Deadline looms for 2009 buybacks

Tax receipts are issued for buybacks on a January-to-December calendar year. With this in mind, ensure you submit any buyback payments you want included in your 2009 tax receipt by the end of the year. Payments will be accepted for transactions and mail that is date-stamped Dec. 31, 2009 or earlier. ■

Pensionwise™ is published for members of the Ontario Teachers' Pension Plan.

We appreciate your comments about anything you read in *Pensionwise*. Please contact Linda Keon at lkeon@otpp.com

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