Briefing Note

Centre for Public Sector Labour Relations and Compensation
Total Compensation Strategies Branch

Ontario Pension Board - Public Service Pension Plan Solvency Funding Proposal

Issue:

The Ontario Pension Board (OPB) is proposing to make a submission to the Deputy Minister of Finance suggesting that the Public Service Pension Plan (PSPP) be subject to the same funding requirements under the *Pension Benefits Act* as a public sector jointly sponsored pension plan.

Current Status:

The PSPP is a defined benefit single employer pension plan (DB SEPP) which is currently operating under Stage 1 solvency funding relief and has current going concern special payments of $99M annually to cover the interest on the solvency deficiency. (Absent stage 1 funding relief, an additional amount of $198M annually would have been contributed.) The PSPP will be exiting Stage 1 funding relief with the filing of the next actuarial valuation report and may then qualify for Stage 2. The OPB currently expects a significant increase in solvency payments, even if it receives funding relief provided by Stage 2, due to the decline in long-term interest rates, increased longevity of plan members and the expected increase in the solvency deficiency.

The Ministry of Finance (MOF) has proposed a new funding approach for Ontario registered pension plans that would impact the PSPP going concern deficiency with its "fresh start" and 10 year amortization period. The draft solvency ratio for the PSPP as at December 31, 2016 is 84%; therefore the government would be required to continue to make solvency payments to the PSPP. (The impact on the going concern deficiency would need to be calculated and updated by the plan actuary. Since long-term interest rates have declined over the past year, it is expected that the current solvency ratio may have declined since 2016, and therefore the Enhanced Going Concern funding model would have a negative impact.)

During MOF's solvency funding review process, the OPB submitted its view that the PSPP should be exempt from solvency funding due to its unique nature and subject to the same funding requirements as a public sector jointly sponsored pension plan. Other public sector jointly sponsored pension plans are currently exempt from solvency funding and are not expected to be subject to the Enhanced Going Concern funding model. The OPB also made this proposal in March, 2010 and in December, 2012.

By comparison, the OPSEU Pension Plan, a jointly sponsored pension plan, is exempt from solvency funding requirements through the *Ontario Public Service Employees' Union Pension Act, 1994*.

Background:

OPB Briefing Note Summary:
The OPB's Briefing Note (attached) took the position that the PSPP should have the same funding requirements as other public sector jointly sponsored pension plans because it:

- like public sector jointly sponsored pension plan, is not covered by the PBGF,
- has peer pension plans who are all jointly sponsored pension plans, and
- has benefits that are more secure than a regular DB SEPP since it is sponsored by the Government of Ontario, an entity that is not likely to fail to fund the plan in the future.

Prior letters also pointed out that the PSPP:

- has multiple agencies participating in the plan (though it is still technically a single employer plan), and
- has a Board of Directors which includes appointees who are representatives of various bargaining agents, resulting in a quasi-jointly governed governance model.

Both of which are atypical for a DB SEPP.

As a result, the OPB takes the position that it is more appropriate to treat the PSPP in a manner similar to other public sector jointly sponsored pension plans and exempt it from both the solvency funding requirements and the proposed Enhanced Going Concern funding requirements.

Analysis:

The argument put forward by the OPB is reasonable. The counter arguments are:

- the PSPP is a DB SEPP and should be subject to the same rules as other DB SEPPs (i.e. government to lead by example);
- the government has a fiduciary duty to the plan members and beneficiaries to properly provide stable and secure funding for its defined benefit pension plan;
- the more contributions made to a pension plan, the more funds are available for investment opportunities;
- continuing to fund on a solvency basis would eliminate any scrutiny from the investment community regarding pension plan deficits and the potential impact on credit ratings; and
- solvency funding provides for the ease of a transfer of assets related to former members.

A process that removes solvency funding can ultimately result in a deterioration of the solvency position, regardless of the financial status on a going-concern basis. It should therefore be understood that funding on the same basis as a public sector jointly sponsored pension plan, the risk of having a deficit and the risk of larger deficits will be higher. This may, in the long term, lead to potential cash flow issues when paying benefits from the PSPP.

As plan sponsor, the government has a fiduciary duty to the plan members and beneficiaries. However, as employer/government, the government also has a responsibility to the people of Ontario with regard to the stewardship of tax revenues. Unfortunately, as both the plan sponsor and the government, the government has a conflict in that it is the only plan sponsor that can legislate solvency relief for itself (putting its stewardship of tax revenue above its fiduciary duty to the PSPP membership). As such, any government analysis on applying funding requirements to the PSPP may be considered tainted by this conflict.

Since the OPB is an impartial, independent board and it has a fiduciary duty to the PSPP members and beneficiary, its analysis on subjecting the PSPP to the same funding requirements applied to a public sector jointly sponsored pension plans is not subject to any conflict of interest and can be accepted by the government.

Cash Flow:

It should be noted that solvency funding relief impacts cash flow and does not provide direct savings. Since the proposed Enhanced Going Concern funding model has not yet been applied, it is not clear how it would affect the cash flow of the PSPP or providing savings to the government.

Solvency funding does not change the total cost (actuarial liabilities) of a pension plan. Instead, any solvency relief impacts the employer's cash flows by changing the timing of payments.

For example, solvency contributions that are made in one year that turn out not be needed (because a pension plan has excellent investment returns in later years) provides a surplus that the employer can use to offset future going concern contributions.

On the other hand, failing to make a solvency contribution now may require funds to be contributed to the pension plan at a later date. (Although it should be noted that being exempt from solvency funding can significantly delay certain cash payments for as long as the pension plan can continue to pay annual retirement benefits. However this might require the liquidation of investments at some point in order to have the cash necessary to pay benefits and may negatively impact a pension plan's rate of return, resulting in a greater solvency deficiency.)

Indirect Savings:

Although funding relief does not provide direct savings, it does provide the opportunity for some indirect savings.

Opportunity for Investment Returns:

Potential savings to the government would come from investment returns above the pension plan's expected rate of return. Funding relief provides time for excess investment returns to materialize, but does not directly provide cost savings by itself.

Interest Savings:

Additional savings may come from a reduction in borrowing costs. If the PSPP continues to be subject to solvency funding or is subject to Enhanced Going Concern funding, then the government could be required to contribute substantial amounts to the PSPP over the next several years. It is likely that the government would need to borrow the funds and therefore incur interest costs on the amounts borrowed.

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