OPSEU Pension Plan Expansion: OPTrust Select

CONFIDENTIAL

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Ministry of Finance

Income Security and Pension Policy Division

Ontario

Purpose

- To provide analysis of a proposal to expand the OPSEU Pension Plan by adding a reduced defined benefit schedule called OPTrust Select to the Plan, for employers of lower wage earners and their employees.
    - The target market is the broader public and Not For Profit sectors.

- TBS has asked for recommendations in three areas:
    1. Implementation concerns.
    2. Impact on retirement security in general.
    3. PBA and policy implications.

- This analysis was conducted without the benefit of an analysis regarding the impact of Select on the OPSEU Pension Plan.

Context

- The Treasury Board Secretariat has been directed to expand the OPSEU Pension Plan by adding a modest defined-benefit schedule called OPTrust Select (Select) to the OPSEU Pension Plan.
  - The proposal is scheduled for the Treasury Board on April 24th.
- According to OPTrust, a series of factors such as plan maturity, government divestments and restructuring pose challenges to the plan's funding.
  - Active membership has declined from approximately 64,000 in 1992 to 44,000 in 2016.
  - Retirees have increased from 23,000 in 2007 to 36,000 in 2016.
- In response, OPTrust has been pursuing opportunities to expand. In addition to Select, some of the proposals to address sustainability are:
  - merging with smaller plans;
  - providing investment management and administrative services to other plans;
  - providing investment management and administration services to the PBGF; and
  - administering the pension benefits of beneficiaries of wound up plans.

Details of OPTrust Select

- In addition to BPS employers, Select targets employers in Ontario's Not For Profit sector which has about 55,000 employers and approximately 600,000 employees.
- Details of Select are being negotiated among TBS, OPSEU and OPTrust.

	OPTrust Select	OPSEU Pension Plan
Contribution Rate	3% from each of employer and employee	9.4% up to YMPE, and 11% above YMPE from each of employer and employee
Accrual Type	Based on career earnings with ad hoc upgrades (i.e., wage indexing)	Based on highest consecutive 5-year average
Accrual Rate	0.6%	1.345% up to average YMPE and 2% above YMPE
Early Retirement Benefits	None	Yes
Joint and Survivor Benefits	None	Yes
Indexation	Conditional (If the plan can afford it)	Yes
Representation on Board	No	Yes

Implementation Concerns

- Select supports plan sustainability by increasing the number of employers and active members.
  - According to OPTrust, Select requires 20,000 new members to be fully self-sufficient and avoid any cross-subsidy with the main plan.
  - If OPTrust is unable to register the 20,000 new Select members, it is unclear what will become of Select or the employers and members who do join.
  - The PBA does not permit the partial wind up of a pension plan so Select would have to be funded and administered even if does not meet its membership target.

- There is a likelihood that Select employers terminate their participation in the plan either because they have gone out of business, or because they are not able to fulfil their financial obligations.
  - Their pension liabilities will stay in the plan. Remaining employers and employees, including OPSEU and the government, would fund these pension liabilities.
  - It is not clear how this risk would be mitigated.

- It is not clear who would approve participation in the plan, (OPTrust, and or sponsors), what the terms of participation would be or the circumstances under which participation could be terminated and who would be responsible for terminating participation
  - In the case of Teachers', the partners approve participation and termination in the plan.
  - There are no criteria proposed that would dictate who is admitted or removed from Select.

Retirement Security Implications

- Select adds value for members as their income rises. At lower incomes, Select retirement income is offset by the loss of government assistance, such as the Guaranteed Income Supplement (GIS).

- Case examples show the retirement income that a lower earner in Select's target group would receive from Select compared with alternative arrangements.

    - For lower earners, Select benefits reduce income from seniors' income programs, such as the GIS, and low income tax credits. This means a lower income earner is unlikely to receive a higher retirement income with Select.

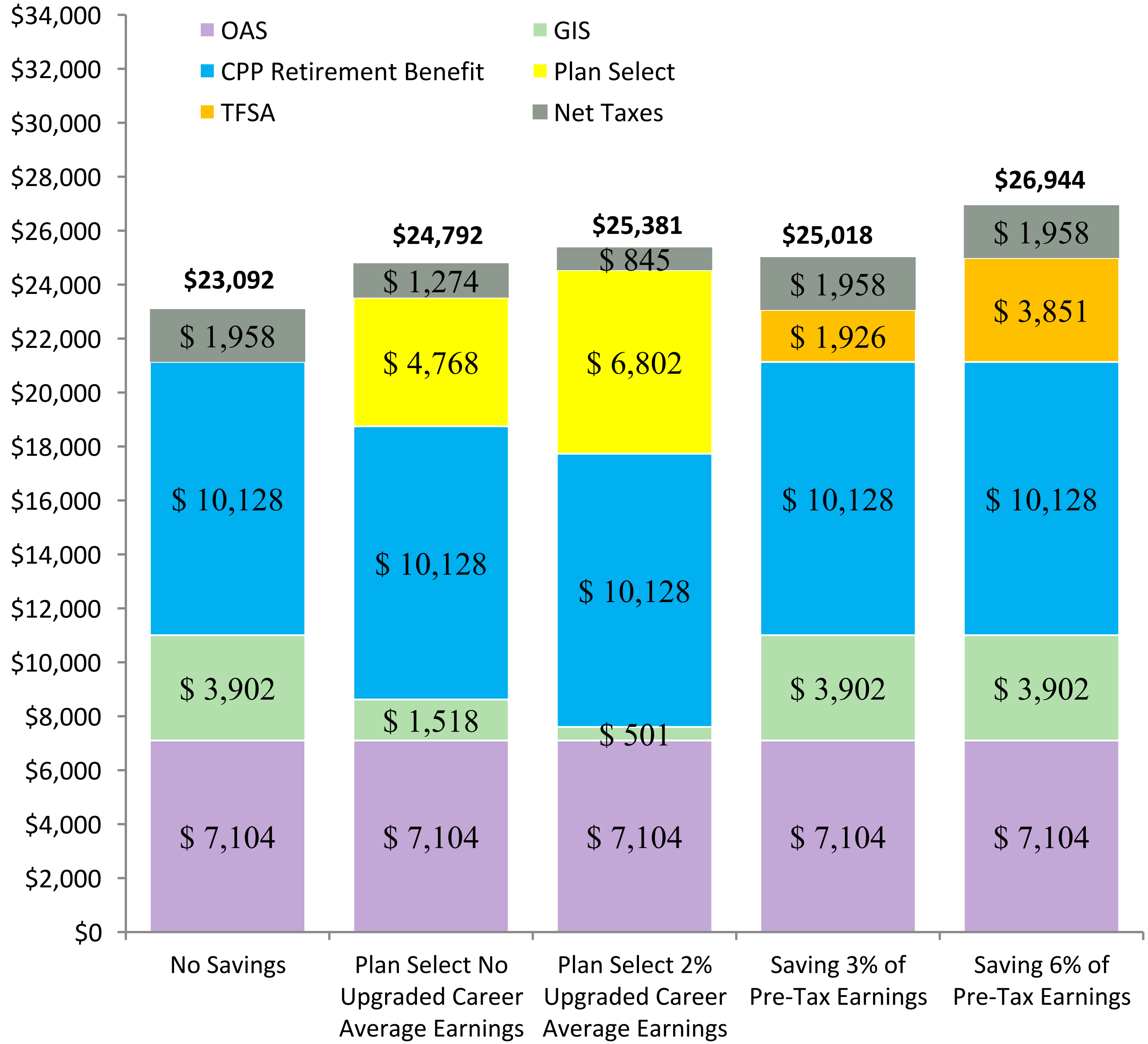
    - Additionally, a low earner who contributes to Select for 40 years and collects benefits for 25 years would receive $18,500 less than the total contributions on a net present value basis. (See Appendix I)

- Lower income employees would be as well off with Select as they would be saving 3% of their earnings in a TFSA. This is because TFSA withdrawals are not taxable and do not reduce GIS benefits.

- In Appendices II and III, similar analyses are conducted with average and higher earners respectively. These analyses show that OPTrust Select becomes relatively favourable as income rises.

Lower Earner : Steady-Career Earnings of $31,500 (2018 dollars) – Single Person

Earnings of $31,500 represents a full time worker earning $15 per hour



- This worker would be better off by $1,700 to $2,289 annually, compared to having no workplace pension plan.
- This does not account for contributions made to Select while working – which would be $945 annually in 2018. Low-income earners find it more difficult to forego consumption during their working years to save for retirement compared to those with higher earnings.
- The “upgraded” pension (middle bar) assumes the earnings upgrade is implemented every year. It is not clear that this would actually occur in Select.
- In this scenario, the lower-earnings worker be as well off saving in a TFSA compared to Select, assuming consistent TFSA contributions throughout their working career.
- However, research shows that most people, particularly lower and middle income earners, do not save consistently for retirement.

PBA Implications

PBA Registration as Jointly Sponsored Pension Plan (JSPP)

- Under the PBA, a JSPP is a contributory defined benefit plan where members share funding responsibility, including any special payments. OPSEUPP meets this test.

- In addition, a JSPP must satisfy requirements set out in the regulations which require that the employers or their representatives and the members or their representatives are jointly responsible for:
    - making all decisions about the terms and conditions of the pension plan.
    - making all decisions regarding the appointment of the administrator of the plan.

- Select, which would be part of the OPSEUPP, would not meet these requirements. Select employers and members would not have a role in decision making relating to the terms and conditions of the plan or in the appointment of the administrator of the plan even though they would be responsible for making contributions in respect of any unfunded liability of the plan.
    - The decision-making parties (TBS and OPSEU) would be making decisions that would affect unrepresented employers and employees.
    - There is the potential that, in certain circumstances, the interests of the government and OPSEU may be in conflict with the interests of Select employers and members.

- Select members cannot be included in decision making as OPSEU is unwilling to reduce it's 50% control over decision-making.

- Similarly, the government will not reduce its decision making authority to create room for Select employers.

PBA Implications (cont'd)

- MOF Legal Services Branch has advised that:
  - The OPSEU Plan will cease to meet the PBA JSPP criteria, unless the proposal is amended to give such employers and their employees a role in decision-making about the terms and conditions of the pension plan and any amendments to the plan and decisions regarding the appointment of a plan administrator.
  - The legal issue is whether the OPSEU Act and Sponsorship Agreement could override these PBA JSPP criteria and allow the OPSEU Plan to continue to be a JSPP for purposes of the PBA notwithstanding the fact that the OPSEU Plan would not meet a fundamental requirement for a pension plan to be a JSPP under the PBA.
    - There is a risk that the Financial Services Tribunal or a reviewing court would find that they do not.
    - If the FST or the court were to make such a finding, the consequences of such a finding would be significant for the sponsors.
  - It is not clear whether the OPSEU Pension Plan's status as a JSPP could be maintained by an amendment to the regulations, given that joint-governance is a fundamental aspect of the legal definition of a JSPP and also given that the OPSEU pension plan would become a pension plan where some employers and employees would have greater rights than others even though they all contribute to the funding of the pension plan.
    - MOF would not support an amendment to continue the plan as a JSPP without the proper governance as it would undermine a fundamental element of the JSPP model.
    - This policy position has been conveyed to stakeholders in other sectors.

Pension Policy Implications (cont'd)

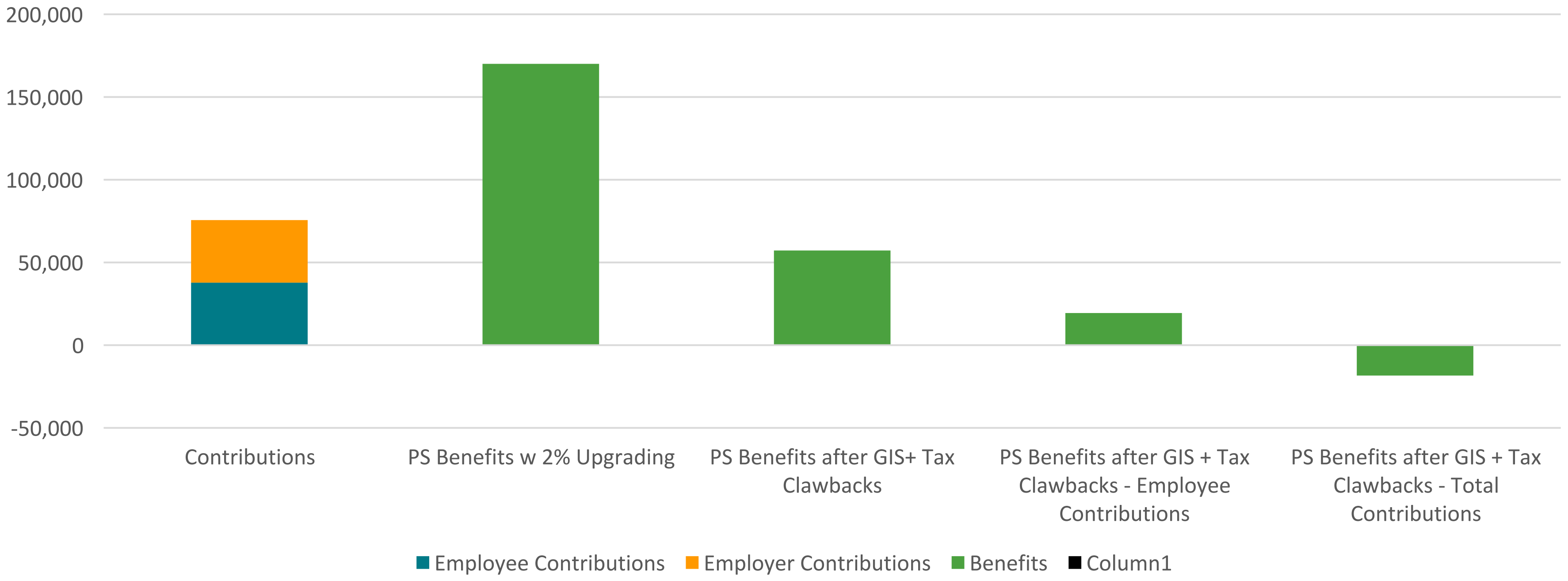
- Any legislative remedy under the PBA to facilitate OPTrust's request, may impact the core nature of the JSPP model which is based on the principle joint governance.
  - Such a change would essentially create a new model which is not a JSPP model and may have an impact on the current governance structure of other JSPPs.
- Despite the fact that Select of 20,000 could account for 30% of the total active membership base who are responsible for funding deficits, Select members and employers would not have a say or input into the plan from both governance and funding perspectives.
  - Without input in the governance of the plan, the Select employers and members are basically purchasing an 'off the shelf' financial product with others making decisions.

Next Steps

- OPTrust has provided sustainability analysis in support of Select. The results of the OPTrust analysis indicate that Select is sustainable as a self contained pension plan. However, it is not clear how these results support the claim that Select will make the OPSEU plan more sustainable.
- Additional analysis is needed to understand the impact of Select on the OPSEU Pension Plan. OPTrust will be providing this additional analysis, for issues such as:
  - What assumptions support the requirement for 20,000 Select members to be sustainable?
  - How do Select members address concerns regarding the main plan?
  - What is the likelihood of registering enough Select members and what would be the impact on the OPSEU plan if the targeted Select membership is not met?
  - Are considerations being given to the nature and finances of select employers or any stress tests applied to determine eligibility of a participating employer.
- The JSPP model is based on joint governance. Both to mitigate the risk of losing the OPSEU Plan's JSPP status as a result of Select, and to ensure that employers and members have input into decisions, the Sponsors should consider governance reforms that provide representation to Select members on decisions that affect Select.
- Sponsors could share in decision making, including decisions around contributions and Plan amendments, which could have significant financial implications.

APPENDIX

Appendix I: Net Present Value of OPTrust Select after Interaction with GIS and Tax Benefits



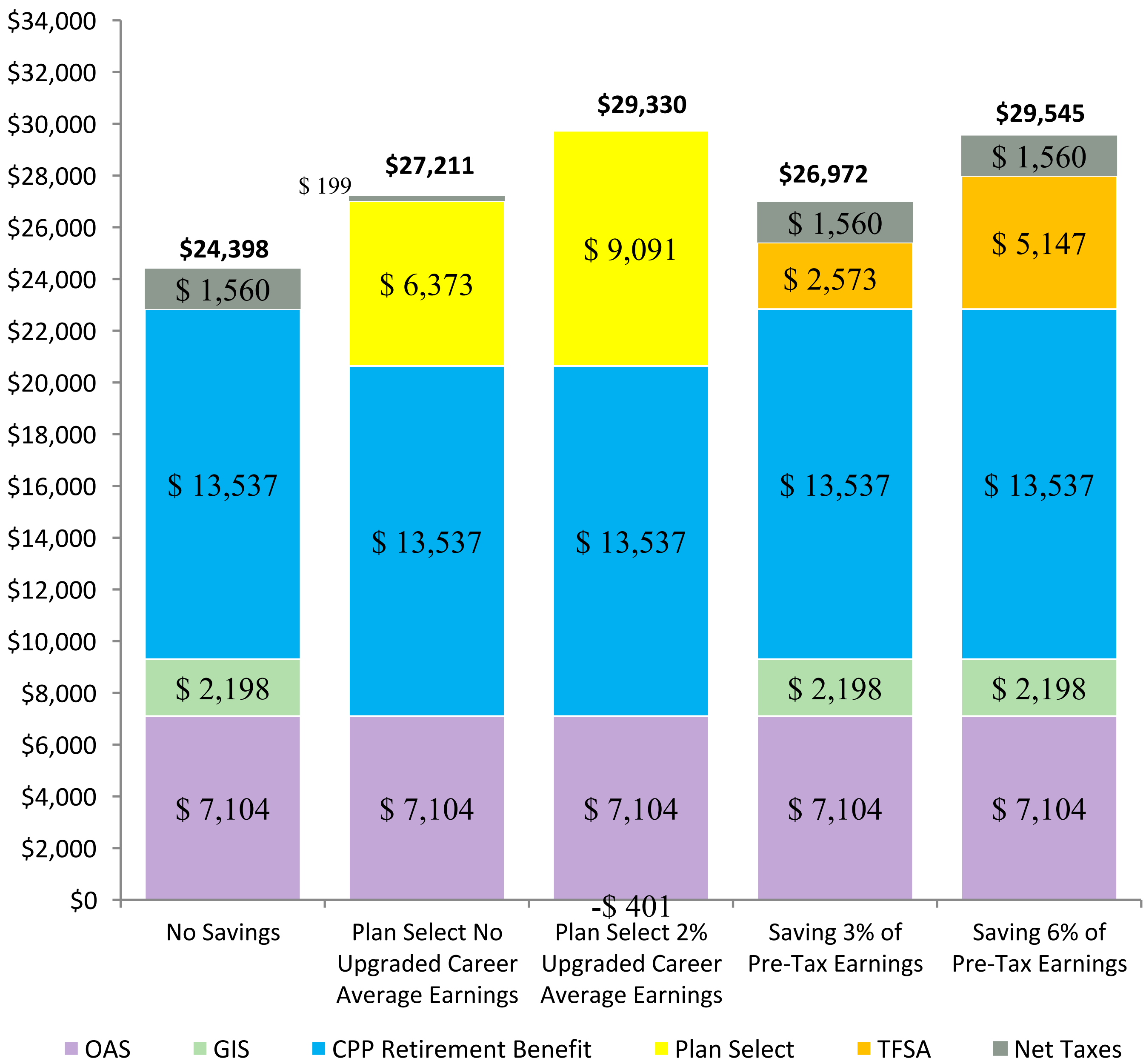
- Overall, a lower-earner ($31,500) who contributes to Plan Select for 40 years and collects benefits for 25 years (from age 65 to 90) will be better off by about $19,500 when comparing their total contributions paid against their net benefits received.
  - Net benefits are Plan Select payments less GIS and tax benefit clawbacks.

- When factoring in the total contributions (employer and employee), the individual is worse off by about $18,500.

- Because Plan Select is a DB, the value of net benefits against contributions will be determined by the number of years the benefit is collected. In this example, the individual's lifespan exceeded the average age of death.

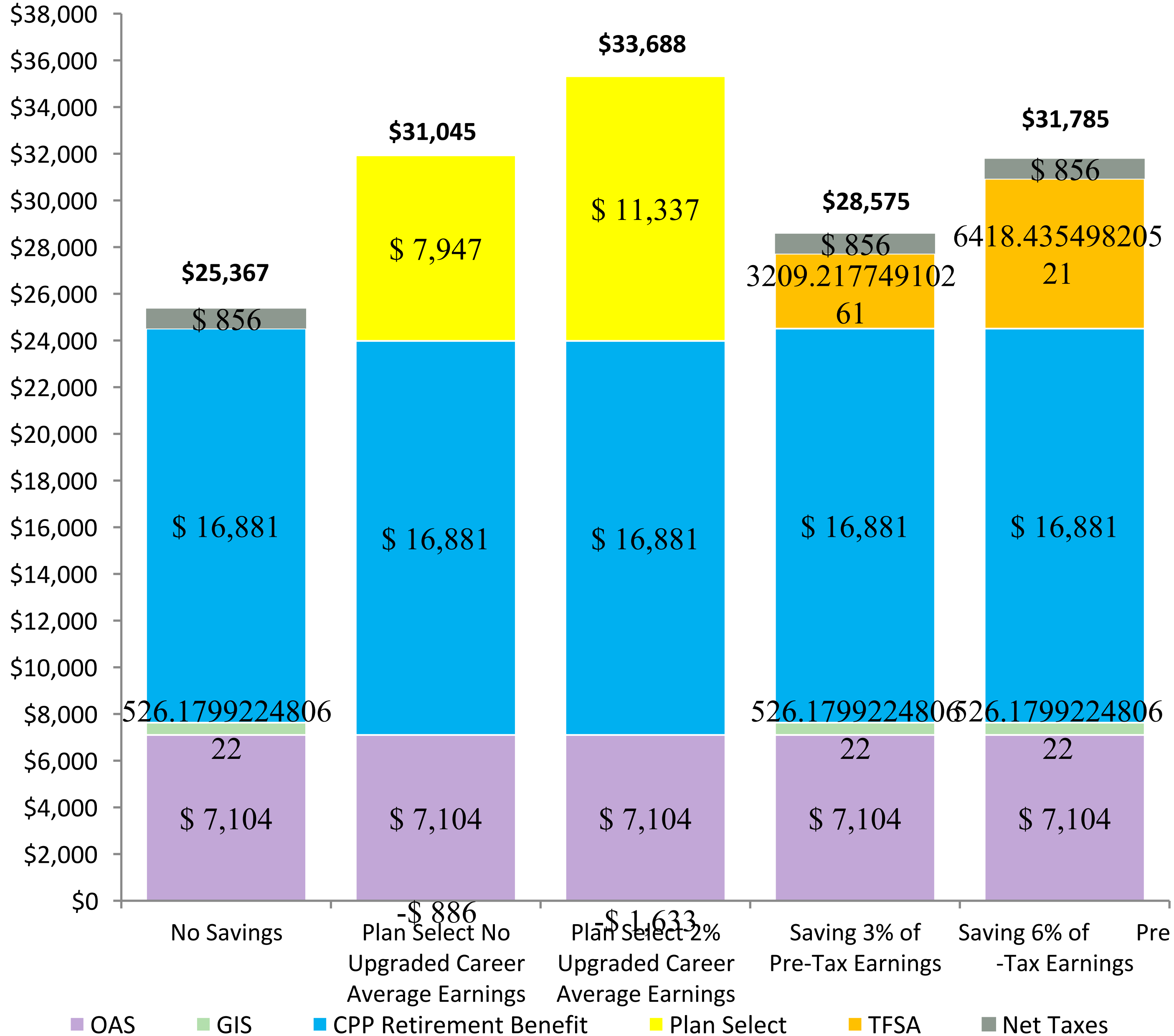
- The methodology in this example uses:
  - Aggregate contributions are the amount paid in 2018 multiplied by 40.
  - Aggregate Plan Select payments are the 2018 amount multiplied by 25.
  - Aggregate GIS and tax benefits also assume 2018 amounts multiplied by 25.

Appendix II:
Average Earner (Steady-Career Earnings of $42,000 (2018 dollars) - Single Person)



- Earnings of $42,000 represents the average earnings for the Plan Select target group.
- Depending on the ad hoc earnings upgrades of Plan Select, this worker would be better off by $2,894 to $4,937 annually compared to if they had no workplace pension plan.
- The "upgraded" pension (middle bar) assumes the earnings upgrade is implemented every year. It is not clear that this would actually occur in Plan Select.
- In this scenario, the average earnings worker would be about as well off saving through a TFSA compared to Plan Select, assuming consistent 6% contributions of pre-tax earnings in a TFSA throughout their working career.
- However, research shows that most people, particularly lower and middle income earners, do not save consistently for retirement.

Appendix III:
Higher Earner (Steady-Career Earnings of $52,000 (2018 dollars) – Single Person)



- Earnings of $52,000 is meant to represents a higher earning worker within the Plan Select target group.
- Depending on the ad hoc earnings upgrades of Plan Select, this worker would be better off by $5,678 to $8,321 annually compared to if they had no workplace pension plan.
- The “upgraded” pension (middle bar) assumes the earnings upgrade is implemented every year. It is not clear that this would actually occur in Plan Select.
- The higher earner would likely be better off as a Plan Select member compared with trying to save through a TFSA.
- The reason for this is that due to a higher CPP benefit, they are mostly out of the “GIS clawback” income range in retirement, and therefore are not experiencing a clawback due to the Plan Select income.

Appendix IV: Notes on Case Examples

1. Values in case examples are illustrative and will vary considerably depending on underlying assumptions.
2. Individuals are assumed to have no other sources of income.
3. Individuals are assumed to have worked and contributed to all savings vehicles for 40 years.
4. OPTrust Select pension and CPP retirement benefit payments and TFSA withdrawals are assumed to begin when the individual reaches age 65.
5. Case examples are net of taxes (i.e., tax credits are subtracted from income taxes owed). Tax credits include:
   - Federal Goods and Services Tax Credit
   - Ontario Sales Tax Credit
   - Ontario Energy and Property Tax Credit, assuming the Ontario average property tax rate
   - Ontario Senior Homeowners' Property Tax Grant

7. OPTrust Select total contribution rate is 6% of pre-tax earnings, which is split 50/50 between the employee and employer at 3% each.
8. The case example “earnings upgrade” scenarios assumes 2% annual upgrade (as provided by OPTrust Actuarial Services) compared to an expected average industrial wage of 2.5%.
9. Calculations use after-tax savings rate for TFSA of 2.4 %, i.e., 3% * (1 – federal tax rate – provincial tax rate) = 0.03 * (1 – 0.15 – 0.0505) = 0.024. Personal savings rate for TFSA of 6.0% works in the same way.
10. TFSA and RRSP assets are assumed to grow at a 3% nominal rate.
11. TFSA and RRSP withdrawals are amortized over 25 years (i.e., from age 65 to age 90).

<u>CAVEATS</u>

1) CPP enhancement is assumed to be fully implemented. However, it should be noted that any OPTrust Select member who retires before 2065 would not achieve the maximum CPP enhancement benefit.

Appendix V: Background

- On October 22, 2012, the government entered into an agreement with OPSEU to implement the 2012 Budget initiative to freeze member and employer contribution rates for five years to the OPSEU Pension Plan (OPSEUPP).
  - Similar agreements were also reached with three other public sector jointly sponsored pension plans (JSPPs) consolidated in the Province's financial statements.
- As part of these negotiations, the government agreed to enter into a separate discussion regarding retention and expansion of membership in the OPSEUPP.
- Discussions began in November 2012 between MOF, MGS (now part of TBS), OPSEU and OPTrust.
  - These talks represent the first time that government considered expanding the membership of a JSPP it co-sponsors.
- On January 21, 2013, TB/MBC approved the terms of an expanded membership proposal, which formed the basis of a Letter of Agreement (LOA) between OPSEU and the government.
- The portion of the LOA addressing expansion of the "regular" Plan was implemented through a Framework Agreement.
- The LOA also included provisions related to the development of an "OPT Lite Plan", a similar proposal to OPTrust Select, but it was not implemented.

Appendix VI: External Legal Opinion

- TBS has received an external legal opinion regarding the risk that Select would jeopardize the JSPP status of the OPSEU pension plan.

- The opinion advises that this risk could be mitigated with the following steps:

  - Acknowledge Ontario's responsibility to OPTrust select employers in governance documentation and the participation agreement. Revise the Sponsorship Agreement to the extent that it precludes the sponsors (TBS and OPSEU) from taking into account the interests of OPTrust Select employers.

  - Provide clear disclosure to OPTrust Select employers regarding their restricted role in Plan governance in the participation agreement, and receive acknowledgement.

  - Provide a voice in decision making for OPTrust Select employers in decisions that affect OPTrust Select.

  - Establish an OPTrust Select employer advisory committee.

- **MOF LSB agrees with the external legal opinion that OPTrust Select employers and employees participating in the plan must be given a voice in decisions that affect OPTrust Select. However, MOF LSB does not think that merely requiring the sponsors to take into account the interests of OP Trust employers/employees or establishing an employer advisory committee would satisfy the requirements for the OPSEU Pension Plan to continue to be a JSPP. There may be instances where the interests of the sponsors will conflict with the interests of the OP Trust Select employers and employees and where decisions will need to be made that may affect one group more than another. MOF LSB is also not sure that the sponsors can contract out of the requirements of the PBA regulations by providing "clear disclosure to OPTrust Select employers regarding their restricted role in Plan governance in the participation agreement" or by appointing themselves to be representatives of OPTrust Select employers and employees without their consent.**

Appendix VII: MOF's Current Involvement in OPSEU Pension Plan

- Currently, applications for employer membership in the OPSEU Pension Plan are screened in a two-step process. MOF staff conduct the first screening and OPTrust conducts the second screening if required.

Step 1: MOF assesses "public interest" criteria, which involves an assessment of the following:

i. whether the employer provides a public service;
ii. the risk of fiscal impact or reduction of public services; and
iii. the risk of conflict with other public-sector pension plans.

Step 2: OPTrust assesses "plan-specific" criteria in accordance with its fiduciary duty (e.g. financial viability of the employer).

- The primary objective behind MOF's involvement in the screening process is to mitigate the fiscal risk that the addition of new employers to the OPSEU Pension Plan could pose.

- Since OPTrust Select is opened to organizations outside the BPS, there is no basis for MOF to be involved in the employer application screening process for OPTrust Select.

    - MOF has signalled to TBS that there is no basis for MOF to screen applicants.