INFORMATION NOTE:
ONTARIO { SEQ CHAPTER \h \r 1}TEACHERS' PENSION PLAN (OTPP):
FUNDING VALUATION AS AT JANUARY 1, 2017

ISSUE

The preliminary valuation for the OTPP, as at January 1, 2017 showed an $11.5 billion surplus. The Ontario Teacher's Federation (OTF) is seeking the government sponsor's agreement to use most of this surplus to restore inflation protection and to reduce contributions.

If this valuation is filed, what would be the implications for the OTPP and the government?

CURRENT STATUS

The preliminary valuation is based on current OTPP plan provisions. Those provisions include a reduced level of inflation protection for service after 2009 (currently set at 90%) and an additional special contribution from both employees and government (contributions of 1.1% of pay in addition to basic contributions).

- The special 1.1% additional contribution was introduced to address a prior funding shortfall and is currently scheduled to be eliminated at the end of 2026.

The OTPP's surplus is mainly due to higher than expected investment returns in recent years.

The OTPP preliminary valuation is performed according to the Funding Management Policy (FMP), a funding agreement between the government, the OTF and the OTPP Board.

The FMP stipulates, among other things, that:

- investment gains and losses are to be recognized over a three-year period instead of immediately at the date of the valuation (i.e., the assets are smoothed); and

- the discount rate is to be calculated with a three-year average Canadian government real return bond yields with an adjustment.

The OTPP's last valuation was filed on January 1, 2016; the next filing is not required until January 1, 2019. However, the "sponsors" (the Ontario government and the OTF) can choose to file the January 1, 2017 valuation.

OTF Proposal

The OTF is seeking agreement from the government sponsor to file the 2017 valuation.

The government sponsor is represented by the Minister of Education (EDU). EDU has historically sought the approval of the Ministry of Finance (MOF) for decisions relating to proposed changes to the OTPP as well as the filing of the valuation.

MOF's role is to work with and advise EDU on the financial aspect of the OTPP as it is the Minister of Finance who makes contributions to the OTPP on behalf of the Minister of Education. Decisions to amend benefits also impact the Province's pension expense.

The proposed filing would:

(1) Completely restore the inflation protection (from 90% to 100%) from 2018 onward until the next report is filed. This would use approximately $5 billion of surplus.

- With the complete restoration of inflation protection, the government's "share the pain" payments would cease from 2018 onward until a decision is made in the future to reduce indexation again.
    - For each year full indexation is not paid, the government is required to make a "share the pain" payment to the OTPP in the amount equivalent to the amount of inflation protection forgone by retired teachers in that year, up to 50%. Any amount of inflation protection beyond 50% is not matched by the government.

(2) The OTF also proposes that the filing eliminate the 1.1% special contribution for the prior shortfall which would use approximately $3 billion of surplus.

- The elimination of the special contribution would reduce the rate contributed by teachers and matched by the Province from 13.1% to 12%.

The remainder of the surplus (approximately $3.5 billion) would remain in the OTPP and could be used to help address any future funding shortfall.

RECOMMENDATION AND IMPLICATIONS FOR THE GOVERNMENT

EDU staff support filing this valuation and MOF staff agree:

- As noted above, filing this valuation would eliminate the government's "share the pain" payments.

- Even with the restoration of inflation protection and the elimination of the special contributions, the valuation would be filed with a small surplus (approximately. $3.5 billion).

- If this valuation is filed, it would be the first time, since the inception of the Partners' Agreement in 1992, that contributions have been reduced as a result of a plan surplus.

    - Such a contribution reduction would support the government's position with respect to the accounting for the OTPP as it would demonstrate that the government can benefit from surplus in the pension fund.

NEXT STEPS

The deadline for filing this valuation is September 30, 2017. However, the OTF is interested in filing sooner.

Pending MOF approval, staff will work with EDU to advise the OTF that the government sponsor agrees with the proposed approach, including restoring inflation protection to 100% and eliminating special contributions. EDU and the OTF will subsequently inform the Board of OTPP of the sponsors' decision and the Board will initiate filing.

BACKGROUND

OTPP reported its first funding deficit in 2005, after a period of small but steady funding surpluses.

The deficit was exacerbated by the 2008 financial turmoil as well as the OTPP's unique demographic situation (i.e., a declining ratio of active teachers to retired teachers and continued mortality improvements).

To address these issues, the sponsors agreed in 2009 to make future inflation protection conditional on the financial health of the OTPP, known as conditional inflation protection (CIP). Amendments to the provision were made in 2012.

- Reducing the guaranteed level of inflation protection reduces the OTPP's future liabilities, making it more affordable.

The following is a summary of the CIP provision (***table 1***):

Service	Guaranteed Level of	Current Inflation	Levels in

	Inflation Protection	Protection Provided	2018
Before 2010	100%	100%	100%
2010 to 2013	50%	90%	TBD
After 2013	No guarantee	90%	TBD

The following is a summary of the government's "share the pain" payments (***table 2***):

2010	2011	2012	2013	2014	2015	2016
$0.04 M	$0.22 M	$0.77 M	$1.05 M	$1.04 M	$1.12 M	$1.59 M

($ millions)

CIP has proven to be an effective tool for the sponsors to manage deficits. With this tool, as well as the subsequent recovery of the financial markets, the OTPP has reported four consecutive funding surpluses since 2013.

- OTPP has achieved an average return of approximately 8% over the last 10 years, compared to the average benchmark return of 4.6% over the same period.

- The better than expected return has contributed to the recent funding surplus.

Future deficits, if any, could be addressed by reducing inflation protection to the minimum guaranteed level for service after 2009 (***see table 1****).* Future surplus could be used to restore CIP and the government's "share the pain" payments would be reduced accordingly.

BPS Pensions Branch
May 8, 2017