Ontario

Submissions and Documents Review/Approvals Form — Ministry of Education

Title: OTPP 2016 Funding Valuation	Log # 2016 064576	Date Prepared: July 12, 2016	Date Due:
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Once signed return to: Wendy Samuel	Tel No. 2-1818	Division: FPBD	

	Submission Type:	New	Revised	Final		Document Type:	New	Revised
( )	Cabinet Specify Committee: ________	☐	☐	☐	( )	Letter - Minister's Signature	☐	☐
( )	MB20	☐	☐	☐	( )	Letter - Deputy's Signature	☐	☐
( )	Legislation/Regulation	☐	☐	☐	( )	Deputy Information Item	☐	☐
(✓)	Decision Note	✓	☐	☐	( )	Other: ____________	☐	☐
( )	Briefing/Info Note	☐	☐	☐				

Note:
This note seeks approval to file the 2016 funding valuation of the OTPP with the Financial Services Commission of Ontario.

MO Staff were consulted on this item? X Yes No — If yes, who? Sam Andrey and Christopher Humphries

Briefing scheduled? Date: ____________ ☐ Minister ☐ Deputy — To be posted on website? ☐ Yes X No

Review/Approval requirements

	R ✓	A ✓	Approving Official	Name	Signature	Date In	Date Out
As Required		✓	Lead Author	S. Di Renzo	S Di Renzo	07-12-16	07-12-16
		✓	Lead Manager	N. Roberto	N Roberto	07-12-16	07-12-16
			Lead Director	A. Bright	N. Roberto for A. Bright	"	"
		✓	Executive Director	J. Paul	wed.t	July 15	July 15
			CMSD				
			CSIIT				
			ELRD				
			EYD				
			FLALRD				
			FPBD				
			LCD				
			LLED				
			SAD				
Corporate sign-off as required			Director – Comms	M. Leaning			
			Director – Legal	P. Rajan			
			Director – HR	S. Henderson			
Req'd		✓	Lead ADM	G. Sékaly		July 17/16	
		✓	Deputy Minister	N. Matthews	for NM	July 17/16	
As required		✓	Minister's Office Staff	C. Humphries			
		✓	Minister	M. Hunter	MH		

EDU-DMO

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Ontario

MEMORANDUM TO: The Honourable Mitzie Hunter
Minister of Education

THROUGH: Nancy Matthews
Deputy Minister

FROM: Gabriel F. Sékaly
Assistant Deputy Minister
Financial Policy and Business

DATE: July 14, 2016

SUBJECT: Funding Valuation of the Ontario Teachers' Pension Plan

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Attached is a decision note seeking direction to file the 2016 funding valuation of the Ontario Teachers' Pension Plan (OTPP) with the Financial Services Commission of Ontario (FSCO), the Provincial pension plan regulator.

The funding valuation is an assessment of the long-term financial health of the pension plan. The valuation uses a number of assumptions to compare the value of pension plan assets (such as stocks and bonds, as well as future contributions) to the value of pension plan liabilities (the amount required to pay accrued and future pension benefits). Pension plans in Ontario are required under the *Pension Benefits Act* to undertake a valuation annually and file a balanced valuation with FSCO once every three years. A balanced valuation must show that the plan has enough assets to pay out the projected cost of future pension benefits.

It is the responsibility of the OTPP sponsors, the Ontario Teachers' Federation and the Ontario government, to determine when to file the annual valuation with FSCO. The sponsors are also responsible for negotiating the use of any surplus funds and, when there is a funding shortfall, implementing a strategy to eliminate it.

The preliminary valuation of the OTPP as of January 1, 2016 indicates a surplus of about $13.2 billion. This means the pension plan has 107% of the assets it needs to pay future pensions to all members, based on current contribution and benefit levels. The surplus is primarily the result of strong returns on plan investments in 2015. Because the Plan is financially balanced, it is recommended that this valuation be filed with FSCO and that a portion of the surplus be used to continue to restore member benefits. This is consistent with the past two valuation filings, where the sponsors agreed to use surplus to partially restore inflation protection for members in accordance with the Plan's Funding Management Policy.

My staff and I are available to provide you or your staff with further information as required.

Gabriel F. Sékaly,
Assistant Deputy Minister

Attachments (1): Minister's Decision Note

Ministry of Education
MINISTER'S DECISION NOTE

2016 Preliminary Funding Valuation of the
Ontario Teachers' Pension Plan (OTPP)

Confidential Advice to Minister

PURPOSE:

To provide an overview of the OTPP's preliminary valuation as at January 1, 2016 and seek direction to pursue the filing of the valuation, with partially restored inflation protection measures.

KEY INFORMATION:

Valuation of the OTPP

- Each year, the OTPP is required to undergo a funding valuation to determine the status of the plan. The OTPP retains Mercer, a third party actuary, to perform the valuation.
- The funding valuation looks ahead 70+ years to assess the actuarial value of the OTPP's assets and liabilities. Assets are what the pension plan owns (stocks, bonds, real estate, future contributions) while liabilities are the present value of members' and retirees' pension benefits.
    - If the assets are equal to or exceed the liabilities, the plan is financially balanced. An excess of assets represents a surplus, while an excess of liabilities represents a deficit.
- According to the OTPP's preliminary funding valuation (as at January 1, 2016) the Plan has a surplus of about $13.2B with a discount rate of 2.75%. This surplus means the Plan has about 107% of the funds required to meet its long-term pension obligations.
    - The surplus is primarily due to steps the sponsors previously took to adjust plan provisions (i.e. introducing inflation protection conditional on the health of the Plan and special contributions). Without these measures the Plan's funded status would be in deficit.
- The discount rate plays a key role in projecting whether the pension plan has enough assets to meet its future pension obligations by assessing how much the plan's assets can reasonably be expected to earn over the long term. The higher the discount rate, the lower the projected cost of future pensions and vice versa (eg. a 0.25% decrease in the discount rate would increase the projected future pension obligation by about $7B).
    - For the 2014 valuation, the discount rate was increased from 2.75% to 2.85% in acknowledgement of the aforementioned steps taken by the sponsors, which improved the sustainability of the Plan. This discount rate was maintained in 2015.
    - For the 2016 valuation, the Plan has reduced the discount rate back to 2.75% given the volatile global investment outlook and the plan's demographic profile.

Restoring Inflation Protection

- Conditional Inflation Protection (CIP) was first introduced in 2008 as a lever to give the sponsors the ability to manage deficits by decreasing inflation protection on pension payments for future service. Under these provisions:

- Service accrued prior to 2010 fully inflation protected; and
- Service accrued after 2009 is subject to conditional inflation protection:
  - Inflation protection for service accrued during 2010-2013 is guaranteed at 50% and can be adjusted upwards to 100% depending on the financial status of the plan; and
  - Inflation protection for service accrued after 2013 is not guaranteed. CIP can be adjusted upwards to 100% or downwards to 0% depending on the financial status of the plan.

- It is the stated intention of the sponsors that inflation protection will be reinstated as the funded status of the OTPP improves. Consistent with this commitment, last year's preliminary surplus was used to restore inflation protection from 60% to 70% beginning in 2016.
  - The sponsors also decided to restore the level of base pensions, for the purposes of future CIP calculations, to what would have been payable if full inflation protection had been provided since retirement (known as restoring the run-rate).
- The sponsors propose to use a portion of this year's surplus to partially restore inflation protection to 90% and restore the run rate. This change would begin in 2017 and would remain in place until the next funding valuation is filed.
  - The OTF have indicated that they are not willing to file the valuation with CIP at 85% or lower. The OTPP is supportive of filing the valuation with the CIP increase to 90%, but cautioned the sponsors that should the plan experience future deficits, they would be forced to make changes (invoke further CIP again and/or increase contributions).

<u>Filing the January 1, 2016 Valuation</u>

- The *Pension Benefits Act* (PBA) requires a valuation to be filed with the Financial Services Commission of Ontario (FSCO), the government regulator responsible for overseeing the insurance and pension industries, at least once every 3 years.
- The OTPP last filed a valuation with the FSCO as of January 1, 2015. This means that the OTPP could either:
  - voluntarily file the valuation as of January 1, 2016 or 2017; or
  - file a mandatory valuation as of January 1, 2018.
- As co-sponsors of the OTPP, the government and the Ontario Teachers' Federation (OTF) must jointly decide on whether or not to file.
  - The OTF have indicated that they support filing the January 1, 2016 valuation and using part of the surplus to provide inflation protection at 90% for the period starting January 1, 2017 until the next valuation is filed.
  - Should the decision be made to file this year, the sponsors have until September 30, 2016 to officially file the valuation. To meet that legislated deadline, OTPP would need a decision in writing by September 1, 2016 to give Mercer sufficient time to prepare the formal valuation report.
- Filing this year's valuation would ensure that there is adequate time to continue to monitor the funded status of the OTPP, develop plans to address any potential shortfalls that arise over the next three years, and consult with OTPP members about their preferences before changes to pension benefits are made.

RISK SUMMARY:

- **Medium.** Filing the January 1, 2016 valuation and partially restoring inflation protection will likely be positively received by teachers and federations. However, should 2016 and beyond result in lower investment returns, the CIP lever could be reduced again to maintain the Plan's financial health and may be met with objection from teachers and federations.

RISK ANALYSIS:

Risk Factor	Context	Level of Risk	Mitigating Factor
Increase in benefits may have to be clawed back if there is a shortfall in the next filing.	When filed with FSCO, the valuation must show that the pension plan is balanced. If there is a deficit, the filing must outline actions that will be taken to address the shortfall and balance the plan, through increasing contribution rates or adjusting the accrual of pension benefits for future years. If there is a shortfall in the next filing, OTPP may have to reduce CIP again to balance the plan.	Medium	CIP is an established Plan provision that has been consistently invoked by the sponsors to keep the plan viable and affordable in the long-term. The sponsors have also honoured their commitment to restore inflation protection as the funded status of the Plan has improved.

FINANCIAL IMPLICATIONS:

- Providing inflation protection at 90% from 70% would cost approximately $8.6B of the Plan's identified surplus.
- OTPP contributions will continue to be frozen at the current rate until December 30, 2017, the end of the contribution freeze period in the Jointly Sponsored Pension Plans (JSPP) agreement.
- Providing inflation protection at 90% will mean the government will continue to make "sharing the pain" payments to OTPP.
    - As part of the 2008 agreement to introduce CIP, the government agreed to a "sharing the pain" provision. The provision states that for years where members receive less than 100% inflation protection, the government is required to make additional contributions to the Plan equal to the amount forgone by members. Contributions are made up to 50% for CIP on service accrued after 2013 (e.g. if CIP for this period was 40% the government is required to make additional contributions at 50%, not 60%).

COMMUNICATIONS STRATEGY:

- An OTPP Communications Working Group (CWG) made up of members of OTF, the Government and the OTPP is responsible for drafting the joint announcement of the valuation results.
- Once developed, the announcement will go through the appropriate approvals.
- The approach will follow the practices used for most filing announcements since the formation of CWG in 2009.

NEXT STEPS:

- Sponsors meet to confirm agreement on valuation terms as detailed above.
- If the sponsors decide to file the 2016 valuation, they will send a joint letter to the OTPP directing them to have the actuaries prepare a revised valuation based on the terms detailed above (i.e. partially restore inflation protection measures, and restore the run rate). The Plan would then file the revised valuation with FSCO.
    - Ministry staff will seek Ministerial approval of this letter once the valuation terms have been confirmed.

OPTIONS:

- Option 1: Direct the OTPP to file the January 1, 2016 valuation and restore inflation protection measures as described above. **(Recommended)**
- Option 2: Do not file the January 1, 2016 valuation of the OTPP.

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OPTION 1: Direct the OTPP to file the January 1, 2016 valuation and restore inflation protection measures as described above. (Recommended)

☑ Agree/Approve ☐ Do Not Agree/Approve

OPTION 2: Do not file the January 1, 2016 valuation of the OTPP.

☐ Agree/Approve ☐ Do Not Agree/Approve

The Honourable Mitzie Hunter

Aug. 2, 2016
Date