Management position regarding the valuation of OTPP and OPSEUPP pension assets

Management continues to believe that the assets resulting from the application of PS 3250 to OTPP and OPSEUPP have value and can be recognized in the Public Accounts with no valuation allowance.

PS 3250 provides the guidance on accounting for joint benefit pension plans and requires that a government's portion of the plan is accounted for in accordance with PS 3250. Based on the equitable sharing of risks, rewards and contributions of the plan, the Province shares on a 50:50 basis for each of OTPP and OPSEUPP. Both of these plans are in an accrued benefit asset position when PS 3250 is applied. In order to ensure that the amount of an asset recognized does not exceed its future economic benefit, paragraphs .50 to .59 of PS 3250 provide guidance on assessing whether a pension asset is impaired. This guidance must also be applied in measuring the Province's share of the accrued benefit assets to determine if a valuation allowance is required. To comply with paragraph 81, the Province must recognize its 50% portion of the accrued benefit asset of each of OTPP and OPSEUPP, net of any valuation allowance.

The Auditor General has noted that the Province does not have the unilateral legal right to use the pension assets because its ability to reduce future minimum contributions or withdraw any pension plan surplus is subject to agreement with the respective pension plans' joint sponsors. In addition the Auditor General has noted that as at March 31, 2016, there were no such agreements in place.

Management does not agree with these interpretations of PS 3250:

a) A unilateral legal right to use the assets is required to recognize an asset or,
b) In the absence of a unilateral legal right to use the assets, the Province must have an agreement with the joint sponsor to reduce future minimum contributions or withdraw any pension plan surplus in order to support an expected future benefit.

Management has not asserted that any amount of the two assets is supported by the ability to withdraw pension plan surplus. Paragraph .59 speaks only to the withdrawal of surplus and while it does note that "The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal" as noted, the value of the asset is not being supported by the Province's ability to withdraw surplus from the plan. Management's view is that the guidance in paragraph .59 is specific to the withdrawal of funds from a plan and does not apply to the use of contribution reductions to support the pension assets.

With respect to the requirement to have an agreement in place with the joint sponsor, it is management's view that this is not a requirement of the standard. The standard requires that management take into consideration "uncertainties as to a government's legal right to use a plan's accounting surplus." (3250.52). The standard does not require that there be no uncertainty in order to recognize an asset. This interpretation would not be consistent with the balance of the framework developed to account for defined benefit pension plans. Pension plans, by their nature, include significant estimates -- whether they be related to the value of assets held by the plan that are not publicly traded (e.g. investments in private companies and real assets) or in the present value of the projected benefit obligation that is based on a series of economic assumptions related to inflation, salary escalation, mortality and the rate of return that the assets in the plan will earn over the period that benefit payments are paid to pensioners. Any change in these assumptions will have an impact on the accounting surplus, so to apply a test requiring no uncertainty to the recognition of an asset is inconsistent with the accounting for pension plans as a whole. Further the term used to describe the cap in the asset ceiling test is "**expected** future benefit". Expected does not equate to certainty.

Further, paragraph .52 is an explanatory paragraph to explain how a government may benefit from an accrued benefit asset and why an impairment may be needed. However paragraph .52 does not provide guidance on how to test for impairment only a justification for why the test is required. It is paragraphs .55-.59 that provide a prescriptive test under PS 3250, specifically that the amount of an asset is limited to the "expected future benefit" and the expected future benefit is defined in paragraph .56. As noted above management is not asserting that any amount of plan surplus can be withdrawn under the requirements of paragraph .56 (b). Management is asserting that there is a positive amount of expected future benefit calculated using the amount determined by paragraph .56 (a) based on the current plan arrangements, even in the absence of a specific agreement with the joint sponsor to reduce future minimum contributions or withdraw any pension plan surplus.

We acknowledge that the existence of a jointly sponsored plan is not explicitly contemplated in the paragraphs .50 to .59 that deal with the evaluation of whether a pension asset is impaired and believe that this intersection of the guidance should be further clarified in the project that PSAB has on its current agenda with respect to PS 3250 and PS 3255.

In the meantime, we continue to believe that we have appropriately interpreted PSAB that an asset exists and is measured using the asset ceiling guidance. It is a management judgement with respect to whether a valuation allowance is required by the application of this guidance.

In connection with valuing the asset, we believe uncertainties should be evaluated taking into consideration the following:

- The contractual agreements between the sponsors that provide for the sharing of risks and benefits
- The specific framework within the FMP for OTPP that contemplates specific funding zones and when contribution reductions will be discussed by the sponsors
- The historical actions of the parties which reflect a history of working together to resolve both funding deficits and to use funding surpluses. As discussed most recently in 2014, 2015 and 2016 with respect to OTPP the sponsors agreed to restore indexation, which resulted in a decrease in the amount of future contributions that the Province would have otherwise had to pay to the plan in the amount of $7.8 Billion ($4.3 for the 2016 change, $1.9B for the 2015 change, and $1.6B for the 2014 change)
- The requirement with respect to OTPP for the sponsors to meet at least every three years to negotiate changes to the plan (section 10 of the Partners' Agreement)

- Other regulatory requirements, such as provisions in the Income Tax Act that limit the accumulation of surplus in a plan.

As previously provided to you, actuarial reports were completed to assess the requirement for a valuation allowance. The results of those reports are summarized here:

Plan	Asset recorded by Province (in billions)	Asset ceiling computed (in billions) and assumption re: years of contributions	Number of years contributions could be made without resulting in a valuation allowance
OTPP	$ 10.1	$ 29.3 (based on 11 years of contributions)	33
OPSEU	$ 0.5	$ 2.8 (based on 17 years of contributions)	35

The number of years that contributions are assumed in determining the asset ceiling are those that the Province "is required make regardless of any surplus" (3250.56(a)). A key element of judgment in the calculations above is interpreting what are the minimum contributions required to be made regardless of any surplus under the terms of the joint defined benefit plans.

Minimum contributions may arise both from statutory requirements (under the *Pension Benefits Act*) but also from agreements with other parties, such as employees. To the extent that future contributions have been agreed by the joint sponsors that are required to be made regardless of any surplus these would constitute minimum contributions that should be taken into account in the asset ceiling test. The OTPP Partnership agreement governs all aspects of the plan and the fund (OTPP partner's agreement, Section 4) and requires that every three years the joint sponsors will meet and negotiate changes to the plan (OTPP partner's agreement, Section 10). These negotiations are not optional; they are required to take place under the partner's agreement. The timing of the negotiations coincides with the requirement for an actuarial valuation to be completed and filed with the superintendent of financial institutions, which must also occur at least once every three years (although one can be filed more frequently on a voluntary basis). The partner's agreement also requires that any actuarial valuation filed must be "actuarially balanced" (OTPP partner's agreement, Section 57). This means that any funding surplus (or equally, deficit) expected in a preliminary actuarial valuation must be dealt with by agreement of the joint sponsors through the negotiations before filing the final actuarial valuation. If there is a preliminary funding surplus in excess of any contingency reserve agreed upon by the parties then this would result in an agreement to increase benefits, decrease contributions or a combination of both. As the resolution must be agreed upon by both joint sponsors it cannot be determined now whether contributions would stay the same as they are currently stated in OTPP Schedule 1. The Province has the right to negotiate lower contributions in order to ensure an actuarially balanced valuation. Therefore, the contributions stated in Schedule 1 are minimum contributions that must be made in respect of any surplus up to the next mandatory negotiation date, but the terms of the partner's agreement mean they are not minimum contributions that must be made, regardless of any surplus, for years after the next mandatory negotiation date, as no other party can require the province to agree to maintain the same level of contributions into the future when the plan is in a surplus position.

Based on the above analysis, the minimum contributions required to be made regardless of any surplus is the sum of the Schedule 1 minimum contributions for three years plus any minimum funding contributions in excess of this that would be required by pension regulation. The minimum contributions used in the calculations previously provided to you (as noted above) take the most conservative view (11 years for OTPP, 17 years for OPSEUPP) of the minimum funding requirement consistent with the terms of the partner's agreement and the expectations of statutory funding requirements.

In addition to the scenario above we considered an alternative interpretation to minimum contributions in response to the Auditor General's concerns. An alternative interpretation indicated by the Auditor General's comments is that the current contribution amounts as set out in Schedule 1 (for OTPP) [make reference to equivalent for OPSEUPP] as at March 31, 2016 are required, regardless of any surplus, as Schedule 1 /[OPSEUPP equivalent] can only be changed if both joint sponsors agree to a change. Notwithstanding that we do not believe this is the appropriate interpretation of minimum contributions required by the plan arrangements, this represents the "worst case" scenario for the Province. While this interpretation takes into account that the province cannot be sure of any contribution holidays until such reductions are agreed, similarly no increases in contributions or increases in benefits to employees can be assumed until they are agreed. As the province has joint control it has the right and ability to *prevent* such increases in benefits (or increases in contributions) at its discretion in the same manner that the other joint sponsor must agree to any future contribution reductions. The current Schedule 1 section 19 (2a) /[OPSEUPP equivalent] states that contributions cannot be made if it exceeds the maximum contributions permitted under the Income Tax Act. Therefore, in addition, we have considered the impact of the provision in the Income Tax Act that limits the amount of surplus that can be held in a plan. Based on preliminary analysis, we believe that the OTPP Plan will be required to begin using its surplus through a reduction in contributions in between 10 and 15 years into the future. Taking this timing into account, the pension asset ceiling is in excess of the pension asset recognized (pension asset ceiling of between $19.9 Billion and $22.3 Billion), therefore, indicating that no valuation allowance is required.   We would be happy to share this analysis with you.

We have also requested that additional modelling be prepared on the assumption that 50% of the surplus is used for benefit improvements and the balance is used for contribution reductions and will share that analysis and its impact on the valuation allowance once complete.

We acknowledge that the estimate of the valuation allowance, and in fact pension plan accounting as a whole, is subject to measurement uncertainty. As previously noted, accounting for pension plans involves significant estimates in all aspects of the accounting whether that be in valuation of non-traded assets, estimation of the economic assumptions used to value current service cost and the projected benefit obligation or the valuation allowance.

PS 2130 provides guidance on dealing with measurement uncertainty through additional disclosure in the financial statements, which we believe would be a useful addition to the current year financial statements.

PS 2130 also provides guidance on how to deal with measurement uncertainty and includes the following guidance:

> .12 The estimation of the amount of an item to be accrued or disclosed in financial statements may be based on information that provides a range of amounts. When a particular amount within such a range appears to be a better estimate than any other, that amount would be used. When uncertainty exists, estimates used would attempt to ensure that assets, revenues and gains are not overstated and that liabilities, expenses and losses are not understated. Estimates of the financial effect are determined using professional judgment, supplemented by experience of similar transactions and, in some cases, reports from independent experts. Estimates include any additional evidence provided by subsequent events occurring after the financial statement date.
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> .13 As a result of the estimation process, a government would be able to determine a range of reasonably possible amounts in accordance with assumptions that are realistic, supportable, internally consistent, and consistent with planned courses of action. The range of reasonably possible amounts would exclude amounts at the outer edges of possibility since such amounts, while possible, are considered to be outside the best estimate range. Relevant information available to the government to develop a reasonable range includes past experience, precedents, and opportunities to reach alternative arrangements.

We believe this guidance needs to inform our conclusion on the appropriate valuation of the pension assets.

In conclusion, we continue to believe that the two pension assets recorded on the books of the Province have value, and disagree with the Auditor General's interpretation of the requirements of PS 3250 with respect to whether an asset exists. We recognize that the estimation and judgement used in the assessment of whether a valuation allowance is required is significant. We have sought out actuarial modelling to assess reasonable estimates of value of the assets and continue to work through additional scenarios to assess the impact on the value of the asset.

We welcome the opportunity to have a conversation with the Auditor General with respect to the appropriate assumptions and modelling to undertake to value these assets.