RE: Summary of discussion with EY on pension issues

From: "Petsche, Nadine (TBS)" <nadine.petsche@ontario.ca>
To: "Sun, Alicia (TBS)" <alicia.sun@ontario.ca>
Cc: "Ma, Patricia (TBS)" <patricia.ma2@ontario.ca>, "Fong, Pauline (TBS)" <pauline.fong@ontario.ca>, "Chan, Vanessa W. (TBS)" <vanessa.w.chan@ontario.ca>, "Patel, Bharat (TBS)" <bharat.patel3@ontario.ca>
Date: Wed, 12 Apr 2017 18:56:15 -0400

Thanks Alicia.
Did E&Y provide a quantitative analysis of the impact of the adjustments? I thought that they were going to share one today. If so, please send a copy.
Also, for tomorrow's discussion with the OAG, I would prefer that we just walk through the OAG's memo and focus on the issues they have identified. We will then plan to brief Cindy on both the OAG items as well as the incremental items identified by E&Y. As part of Cindy's briefing, I would like to have the quantitative analysis as input.
Thanks all.
Nadine

From: Sun, Alicia (TBS)
Sent: April-12-17 4:43 PM
To: Petsche, Nadine (TBS)
Cc: Ma, Patricia (TBS); Fong, Pauline (TBS); Chan, Vanessa W. (TBS); Patel, Bharat (TBS)
Subject: Summary of discussion with EY on pension issues

Hi Nadine,

Please see below a summary of key points from today's discussion with EY. Pauline is preparing materials for tomorrow's meeting with the OAG.

I also attached EY's email for your reference.

OTPP
Due to the fact that the employer (Province) contribution lags behind the employee contribution by 19 months (across fiscal year-end), the Province currently recognizes more pension asset than it should have been. The lag was accounted for previously but however only a 50% share of the payable with the concept that the Province only taking 50% of the assets. However E&Y suggest that we should have backed out not just the 50% in contributions payable but the full 100% to take in account the employee portion. EY proposed to make a one-time opening balance sheet adjustment. Further discussion is need w.r.t. how to make this adjustment on the Province's books.

The Province should also reflect the credit to pension expense to reflect the benefit from contributions paid by other employers (i.e. private schools) in the model. The Province has already recognized the 50% of the current service cost of these other employers however have not recognized the benefit of the cash contributions made by the employers.

This will eliminate the need to track the cumulative unamortized difference in contributions from other employers going forward and the write off of the cumulative balance is warranted to reflect the benefit to the province for the other employers that was not previously recognized.

OPSEUPP and PSPP
The Province should make an adjustment (credit to pension expense) to reflect contributions from other

employers (other than the Province). This is similar to the OTPP treatment for contributions from private schools as mentioned above.

By following this approach, the current year-end agency adjustment will discontinue. We can also eliminate the amortization of contribution differences from the forecast model for OPSEUPP, similar to the OTPP treatment.

OPSEUPP's Rate Stabilization Fund ("RSF")
Province's contribution to the RSF should be considered when calculating the Province's portion of the pension assets rather than using the 50/50 split as a default.

Thanks,
Alicia

Email from EY on these issues:
Hi Pauline,

As discussed in our call earlier today, please find below our comments related to the year-end adjustments applied to the Province's pension plans.

OTPP
Based on the information we have received, the asset values at 31 December 2016 include contributions receivable from the province as follows:

In respect of 2015 service: $1,635M – this contribution was remitted by the Province in January 2017
In respect of 2016 service: $1,638M – this amount is an estimate and is anticipated to be remitted by the Province in January 2018

We understand that the corresponding employee contributions in respect of the above years have already been contributed to the OTPP and included in 31 December 2016 assets.

As the contribution of $1,635M (in respect of 2015 service) has already been remitted prior to March 31, 2017, it is appropriate to reflect this amount in Plan assets.

In our view, a downward balance sheet adjustment of $1,638M should be applied to the Province at the 31 March 2017 year-end to reflect the contribution in respect of 2016 service (anticipated to be made in January 2018). This can be applied within pension accounting or separately as a payable to the OTPP elsewhere in the Province's books (as suggested by the OAG).

Why adjust by $1,638M and not 50% of $1,638M?

You noted correctly that the Province's share of the OTPP is 50% and suggested that the balance sheet adjustment should be 50% of the outstanding contribution of $1,638. Recall however, that the $1,638M is 50% of the 2016 contribution and the employee sponsor has already contributed their share. As such, we would expect the entire adjustment to be applied to the Province, rather than 50%. This is illustrated below:

	Plan assets (accrued)	Receivable after 3/31/2017	Plan assets disclosed
Province share	86,142	1,638	87,781
Employee sponsor share	87,781	0	87,781
Total assets	173,923	1,638	175,562

We understand that the Province is currently applying year-end adjustments of $913M in respect of “difference in year-ends” and an adjustment of $247M in respect of “unamortized difference in contributions”.

The “difference in year-ends” appears to track the historical fiscal year contributions (“cash basis”) made by the Province against the Province’s calendar year contributions (“accrual basis) included in the asset determination. Further, 50% is applied to this difference to reflect the Province’s share of the Plan. This appears to track the shortfall on a retrospective basis rather than a prospective basis as we have shown above. Further, we would not expected the application of 50% to this figure as it is already in respect of the Province’s share of contribution.

The “unamortized difference in contributions” compares the Province’s contribution versus that of the employees with any difference being amortized through P&L over expected average remaining service life (EARSL). This amount appears to be accumulating as the Province’s contribution does not reflect contributions of other employers (private schools) participating in the Plan. For this reason, the provinces contribution will always be less than that of employee contribution. However, this does not represent a shortfall, as the other employers make up the difference. We suggest that the Province consider removing this adjustment. Further, the expense in each year should be adjusted to reflect the contribution of other employers, i.e. OTPP expense should be reduced by an amount equal to the contribution of other employers. The reduction in expense and contributions will offset in the balance sheet reconciliation, leaving the net balance sheet position at any point unchanged.

OPSEUPP and PSPP
For the OPSEUPP and PSPP, a balance sheet adjustment in respect of the “unamortized difference in contributions” is determined, similar to OTPP. These adjustments appear to be accumulating as the Province’s contribution does not reflect contributions of other agencies participating in the Plan. Similar to OTPP, the Province’s contributions tend to be lower than that of the employees, while not representing a shortfall on the part of the Province. However, many of the other agencies are consolidated in the Province’s reporting and contributions to these agencies are separately tracked and offset against the balance sheet adjustments for OPSEU and PSPP. For simplicity, we suggest that the Province consider removing these adjustments altogether. Further, the expense in each year should be adjusted to reflect the contribution of other employers to the extent that they are making contributions and recording an expense.

For the OPSEUPP, we suggest applying a balance sheet adjustment to reflect the differential use of the Rate Stabilization Fund (“RSF”). The joint sponsors agreement allows for separate tracking of the RSF with each joint sponsor entitled to their portion. In our view, the differential in RSF is a better representation of the additional share of balance sheet belonging to the Province (relative to employee sponsor) and can be more easily determined that through the tracking of historical contribution differences.

We are also preparing illustrations of how the numbers will be impacted by our above suggestions for our discussion tomorrow. In the meantime, please do not hesitate to call either myself or Christina if you wish to discuss further.

Regards,

Shayan

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