Statement of Facts and Assumptions

It should be noted that the following background and facts represent a high level summary of the situation and represent those facts that we considered important in reaching our opinion. They do not purport to be a complete representation of all of the terms of the OTPP or the agreements between the government and the Ontario Teachers' Federation (OTF). Management has acknowledged their agreement with this summary. If these facts are incomplete or incorrect, then our conclusions may change.

"The (Ontario Teachers') pension plan is jointly sponsored by the Ontario government, through the Minister of Education, and the executive of the Ontario Teachers' Federation (OTF). The OTF represents teachers, while the government represents employers.

OTF and the government are equally responsible for ensuring the pension plan has enough money to meet its long-term pension obligations. In addition, they appoint experienced, professional experts to the pension plan's Board.

Through a six-member Partners' Committee, the sponsors jointly:

- Set benefit levels
- Establish the contribution rate paid by working teachers (which is matched by the Ontario government and other designated employers)
- Decide how to address funding shortfalls or use surplus funds when they arise"

(Source: https://www.otpp.com/corporate/plan-governance)

The governing and other documents that are relevant to the accounting analysis are as follows:

- Teachers' Pension Act (TPA), including Schedule 1
- Partners' Agreement
- Funding Management Policy (FMP)
- Osler's letter dated September 20, 2016; we have not summarized this letter as it should be read in its entirety.

The assets of the pension plan are held by Ontario Teachers' in trust for the beneficiaries of the plan – teachers. The Government does not have unilateral access to the assets of the trust (including changing contribution amounts, taking contribution holidays, or withdrawals). Actions of this nature require negotiation and agreement between the two sponsors.

The following facts and assumptions have been accepted without further analysis or verification:

- As a jointly sponsored plan, the Plan meets the definition of a joint benefit plan under S. 3250 of the Public Sector Handbook.
- The actuarial and other assumptions that factored into the valuation used for accounting purposes, before considering the appropriateness of the recognition of an asset or the need for a valuation allowance related to any asset, are appropriate and meet the requirements of PS 3250.
- The Plan's most recent preliminary funding valuation reported a preliminary funding surplus of $13.2 billion as at January 1, 2016, as reported on the OTPP website. The OTPP's public financial statements showed a deficit for accounting purposes of $1.8 billion in its financial

statements as at December 31, 2015. These financial statements are prepared under accounting standards for pension plans in Part IV of the CPA Canada Handbook, which is a different accounting framework than the Province uses for its financial reporting and is also a different framework than is used to calculate the funding surplus or deficit.

- As at March 31, 2016, there were no written agreements in place to access the Plan surplus to reduce future minimum contributions or withdraw any amounts from the Plan.
- The OTPP is regulated by the Financial Services Commission of Ontario. Valuation reports must be filed with this regulator to monitor that assets of the fund are reasonably sufficient to meet the liabilities of the pension plan on a continuing basis. Per 78(1) of the Pension Benefits Act: No money that is surplus may be paid out of a pension fund to the employer without the prior consent of the Superintendent.
- Management has received legal commentary about the role of the Superintendent. From this advice, management has concluded that despite this regulation the Province could utilize a surplus through contribution reductions as "Neither the PBA nor the regulations to the PBA (the "Regulations") require the Superintendent's consent for surplus to be *utilized* for a contribution holiday or to amend the contribution formula under the OTPP." Further, although changes to the OTPP text would be required to be registered with the Superintendent, "The authority of the Superintendent to refuse to register an amendment under the PBA (in whole or in part) is limited to circumstances where the amendment is void or if the pension plan with the amendment would cease to comply with the PBA and the Regulations." (Source: Osler memo dated September 26, 2016).
- The Auditor General's Office provided a letter dated September 26, 2016 setting out their views. We have read and considered the contents of that letter.

Relevant Extracts from the TPA

Section 5 (1.1) of the TPA states that the total amount of contributions payable by the Minister of Education and the employers who contribute under the pension plan in respect of any year shall not exceed the amount of contributions payable by or on behalf of active plan members in respect of credited service for that year. There can be instances where contributions would not be equal between the sponsors, such as the government's payments in connection with forgone inflation adjustments.

Section 10 of the TPA provides that the Minister of Education and the executive of OTF may enter into an agreement that provides for, among other things, the joint management of the Plan and the sharing of entitlement to gains or surplus under the Plan and of liability for deficiencies in the pension fund.

Pursuant to Section 10 of the TPA, the Minister of Education and the OTF (collectively the Partners) have entered into an agreement for the management of the Plan (Partners' Agreement), to which is appended a Funding Management Policy (FMP) that is deemed to form part of the Partners' Agreement.[1] The FMP provides a framework for the funding of the Plan and how deficits and surpluses will be addressed. The Partners can deviate from the FMP by agreement.

Relevant Extracts from the Partners' Agreement

The Partners' Agreement is between the Province of Ontario and the OTF and sets out the formal relationship between the partners in sponsoring the OTPP. Paragraph 8 of the Partnership Agreement

[1] Partners' Agreement, section 110.

states that the partners will be responsible for designing the Plan structure, setting the benefits of the Plan, developing new policy, deciding what the contribution rate will be, what the funding levels, margins and contingency reserves will be, how to makes changes to the Plan and other Plan documents, deciding whether or not to file a valuation more frequently than required by the *Pension Benefits Act,* appointing the OTTP Board, and defining the role of the Board.

Paragraph 74 requires negotiation in good faith regarding changes to the Plan that flow from a valuation that is be filed with the regulators.

Paragraph 75 of the Partners' Agreement requires the Partners to advise the Board of OTPP of what changes affecting benefits and contribution rates they are proposing so that the Board can provide cost estimates and comments on the administrative impact of the changes to both partners as soon as possible.

If the partners cannot agree on the changes required to the Plan, a mediator is appointed to assist the Partners in coming up with an agreement. The mediator is responsible for submitting a report to the partners on his or her views on the positions of the partners and provide a recommendation to the Partners. If the partners do not accept the mediator's report, the arbitration process will begin and an arbitration board will be appointed. The board will consist of 3 people, with each partner selecting one representative and two appointees will select the final member who is an umpire. Paragraph 94 of the Partners' Agreement indicates that the report created by the arbitration board will be implemented. Paragraph 92 sets some parameters for the arbitration, including part (c), which sets out that the parameters that the award of the arbitration will provide that the contributions from the Minister and employers be equal to those of the members.

In addition to the clauses identified above, the Partners' Agreement has an appendix called the Funding Management Policy which sets out the Partners' responsibilities in making funding decisions and surplus allocation regarding the Plan.

Relevant Extracts from the FMP

The FMP is an appendix to the Partners' Agreement that speaks to how the Plan should be funded and how surpluses should be utilized by both parties. The protocol for the use of a surplus under the OTPP is detailed in the FMP adopted by the Ontario Government and OTF as sponsors of the OTPP.

The FMP sets out a complex series of considerations surrounding funding management and the use of any excess of assets over liabilities. The FMP sets out a number of "funding zones", depending on the level of funding in the Plan. The following three are most relevant to addressing surpluses:

i) Restoration zone (Article 3 of the FMP) allows for a surplus to be utilized to "restore" foregone indexation and then to either increase benefits to the "run-rate benefit" level (i.e., the long-term target level) or to lower contributions (or a combination of these two options) (Section 3.06(e)).
ii) Temporary improvement zone (Article 4 of the FMP) is the zone where contributions can be temporarily reduced, a surplus distribution can be made on a temporary basis and/or benefits can be temporarily improved (as long as it does not create a long term cost) (Section 4.05).
iii) Permanent improvement zone is where the Plan is essentially fully funded and has the funding security desired to support permanent changes. Article V (Permanent Improvements) of the FMP provides for permanent actions that can be taken when Plan assets exceed current liabilities by more than 10% of current liabilities. In this regard Section 5.05 provides for

actions that can be taken in respect of the amount that assets exceed current liabilities. Such actions can include changes to current benefits, current contributions, or both.

The ability to reduce contributions or increase benefits through the temporary or permanent improvement zone are subject to ensuring that the requirements of 3.06 in the restoration zone are met. Article VIII of the FMP sets out that the parties must agree to any changes arising out of FMP decisions. For filing valuations, if the Partners are unable to agree the mediation process set out in the Partners' Agreement, the arbitration process outlined in the Partners' Agreement will be followed. For valuations that are not filed, either party can decide not to negotiate.

It is our understanding that the Plan is currently in the Restoration Zone. We understand that contributions to the OTPP currently include a 1.1% special contribution on all earnings and that the Restoration Contribution Reduction under Section 3.06(e) would if agreed to by both partners, permit this special contribution to be eliminated. This special contribution is scheduled to end in 2026.

If the Plan gets to either the temporary improvement zone or the permanent improvement zone, section 4.06 and subsection 5.05(b) of the FMP provides that a benefit improvement can only occur if the partners (the Ontario government and the OTF) have entered into a written agreement governing the manner in which the contribution by the government and other employers may be adjusted to offset any surplus distribution or benefit improvement (temporary or permanent) to be granted.