Re_ Request for Advice on AG Information Requirements.rtf

From: Veinot, Cindy (TBS) []
To: Uros Karadzic [uros.karadzic@ca.ey.com]
Subject: Re: Request for Advice on AG Information Requirements
Date: Monday, June 12, 2017 23:12:34
Attachment 1: image001.gif

Thanks Uros.

Cindy

Sent from my BlackBerry 10 smartphone on the Rogers network.
From: Uros Karadzic
Sent: Monday, June 12, 2017 1:08 PM
To: Veinot, Cindy (TBS)
Cc: Angus, Helen (TBS); Hughes, Karen (TBS); Petsche, Nadine (TBS); Shayan Jafrani; Christina Chan; Blake Langill
Subject: Request for Advice on AG Information Requirements

Hi Cindy,

Further to Nadine's request from 6 June, please find the attached document. Please let me know if you have any questions or would like to discuss further.

Uros

Uros Karadzic, FSA, FCIA | Partner | People Advisory Services

Ernst & Young LLP

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image001.pdf

AG says 4 pm may be possible tomorrow.rtf

From: Petsche, Nadine (TBS) []
To: Colley, Matthew (CA - Toronto) (mcolley@deloitte.ca) [mcolley@deloitte.ca]; kdanyluk@deloitte.ca [kdanyluk@deloitte.ca]
CC: Veinot, Cindy (TBS) [Cindy.Veinot@ontario.ca]
Subject: AG says 4 pm may be possible tomorrow
Date: Tuesday, September 20, 2016 23:20:43

RE_ Do you have time to chat about Bonnie’s message_.rtf

From: Petsche, Nadine (TBS) []
To: Colley, Matthew (CA - Toronto) [mcolley@deloitte.ca]
CC: Veinot, Cindy (TBS) [Cindy.Veinot@ontario.ca]
Subject: RE: Do you have time to chat about Bonnie's message?
Date: Tuesday, September 20, 2016 17:00:55
Attachment 1: image001.jpg

Just on our way to a meeting. Will be tied up until about 6:30/7:00. n

From: Colley, Matthew (CA - Toronto) [mailto:mcolley@deloitte.ca]
Sent: September 20, 2016 5:00 PM
To: Veinot, Cindy (TBS); Petsche, Nadine (TBS)
Subject: Do you have time to chat about Bonnie's message?

Matthew Colley

Sr. Manager | Audit Advisory

Deloitte LLP

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Toronto, Ontario,

M5H 4E3

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Please consider the environment before printing.

image001.pdf

Accepted_ OPSEUPP - AG letter follow-up.rtf

From: Christina Chan [Christina.Chan@ca.ey.com]
To: Virani, Shyrose (TBS) [Shyrose.Virani@ontario.ca]
Subject: Accepted: OPSEUPP - AG letter follow-up
Date: Tuesday, June 26, 2018 18:58:53

Opinion dated September 20, 2016.pdf

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September 20, 2016

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PRIVILEGED AND CONFIDENTIAL

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Dear Sirs:

Accounting Treatment of Surplus in the Ontario Teachers' Pension Plan

I. BACKGROUND

We understand the pertinent background facts to be the following:

1. The Ontario Teachers' Pension Plan (the **"OTPP"**) is a jointly-sponsored defined benefit pension plan established under the *Teachers' Pension Act* (Ontario) and is, subject to certain exceptions, required to comply with the *Pension Benefits Act* (Ontario) as well as the *Income Tax Act* (Canada).

2. The sponsors of the OTPP are the Province of Ontario (the **"Province"**) and the Ontario Teachers' Federation (the **"OTF"**) (collectively, the **"Sponsors"**).

3. We understand that as at March 31, 2016 the Province's Statement of Financial Position (the **"Public Accounts"**) includes a pension asset totalling $10.6 billion (the **"Pension Asset"**) related in part to an accounting surplus under the OTPP.[1]

4. The Office of the Auditor General has indicated that because the Province does not have the legally enforceable right to unilaterally access the assets of the plan, and in the absence of that right, because the Province does not have an agreement in place with the OTF as of March 31, 2016 with respect to how the surplus would be utilized such that it would provide a benefit to the Province, the Pension Asset as presented in the Public Accounts should be removed.[2]

You asked us to consider the processes pursuant to which the Province may utilize surplus assets in the OTPP in accordance with the Plan Documentation (as defined below), and to identify any considerations that might inform the expectations of the Province as a Sponsor regarding the basis upon which decisions will be made relating to surplus utilization. We are not providing an opinion on the proper application of the accounting standards to the present situation, as that is an issue for the accountants to address.

II. SCOPE OF OPINION

For the purposes of our opinion, we considered the following documentation (collectively, the **"Plan Documentation"**):

1. The Ontario Teachers' Pension Plan (the **"OTPP"** or **"plan"**);

2. The Agreement between Her Majesty the Queen in right of the Province of Ontario represented by the Minister of Education and Training and The Ontario Teachers' Federation represented by its Executive (the **"Partners' Agreement"**);

3. The Funding Management Policy (the **"FMP"**), which forms Appendix "A" to the Partners' Agreement; and

4. The Term Sheet agreed to by the Sponsors dated March 13, 2013 (the **"2013 Term Sheet"**) describing the implications of the Freeze Period (as defined below) on the FMP.

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1 See letter from Bonnie Lysyk (Auditor General) to Greg Orencsak (Deputy Minister, Treasury Board) and Scott Thompson (Deputy Minister, Ministry of Finance), dated September 13, 2016. Part of the surplus relates to another pension plan; we understand that $10.1 billion relates to the OTPP.

2 *Ibid.*

We have also considered the following legislation/regulations:

1. The *Teachers' Pension Act* (Ontario) (the **"Teachers' Act"**); and
2. The *Pension Benefits Act* (Ontario) (the **"PBA"**) and the regulations thereunder (the **"PBR"**).

As per your instructions, we have not evaluated the ability of the Province to benefit from the *withdrawal* of surplus assets from the OTPP (although certain provisions of the FMP cited herein relate to both the withdrawal and other utilization of surplus). Rather, this opinion identifies the processes pursuant to which the Province may receive a financial benefit through the *utilization* of OTPP surplus (e.g., as a result of either a temporary reduction in the Province's contribution obligations (a contribution holiday) or through changes to the contribution formula that reduce the Province's contribution obligations).

We note that the concept of an *accounting* surplus is distinct from surplus identified in a funding valuation prepared in respect of the OTPP (a **"Funding Valuation"**). Where surplus has been identified in a Funding Valuation, the Plan Documentation provides the Sponsors with certain avenues pursuant to which the Funding Valuation surplus can be utilized. Any reference to "surplus" in this opinion, unless expressly stated otherwise, relates to the surplus identified by the actuary for the OTPP in a Funding Valuation and not to the accounting surplus identified in the Public Accounts. We understand that pursuant to the applicable accounting standards, the recognition of part or all of the accounting surplus on the Public Accounts depends on the ability of the Province to benefit from any surplus in the pension fund over the life of plan.

This opinion does not purport to draw any conclusions, express or implied, about the application of the accounting standards to the present circumstances; rather, it is solely intended to provide the Province with information concerning the legal framework governing the utilization of surplus under the OTPP so as to allow the Province's accountants to determine whether a related Pension Asset should appear on the Public Accounts.

III. SUMMARY OF OUR CONCLUSIONS

A brief summary of our material conclusions is set forth below (all capitalized terms are defined herein):

1. Paragraph 10(1)3 of the Teachers' Act provides that the Minister of Education and the executive of the OTF may enter into an agreement that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a

fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized. We note that the Sponsors have in fact entered into such an agreement, in the form of the Partners' Agreement (to which is appended the FMP).

2. The Plan Documentation (specifically the FMP) and applicable legislation allow for the Sponsors to utilize surplus in a variety of ways, depending on the funded status of the OTPP. These surplus utilization options include the following avenues through which the Province may receive a financial benefit through the utilization of surplus (the three "zones" describe different levels of surplus, a greater amount of surplus being required in order for the next "zone" to come into play):

    a. In the Restoration Zone, a Restoration Contribution Reduction may be approved once certain other requisite conditions have been met.

    b. In the Temporary Improvement Zone, surplus may be utilized to provide a temporary contribution reduction (i.e., a contribution holiday), either as a stand-alone measure or in combination with other surplus utilization options (i.e., benefit improvements or surplus withdrawal).

    c. In the Permanent Improvement Zone, surplus may be utilized to permanently reduce the current contribution obligations of the employers and the members, either as a stand-alone measure or in combination with changes to benefits.

    Notwithstanding the foregoing, under the FMP the Sponsors have the discretion to, by mutual agreement, utilize surplus in any other manner.

3. Any enforceable legal right to obtain some value from any surplus pursuant to the Partners' Agreement (and FMP appended thereto) would be grounded in the law of contract. As the relevant provisions of the FMP require the Sponsors to agree upon the manner in which surplus is to be utilized, neither Sponsor has a legally enforceable right to unilaterally utilize surplus in the OTPP. As such, the provisions in the FMP that contemplate the ability for the Province to receive a financial benefit through the utilization of surplus would not, in and of themselves, give rise to a legally enforceable right. What the Province does have, however, is a right to negotiate with the OTF the use of surplus that may arise under the plan, at least in the context of an actuarial valuation that discloses surplus and that is to be filed with the regulators.

4. Notwithstanding the foregoing, the Plan Documentation and applicable legislation give rise to the following considerations which may shape the Sponsors' expectation as to the basis upon which surplus will be utilized (and potentially lead to an expectation of equal sharing of the benefit of any surplus, at least over time):

    a. The Teachers' Act prohibits the total amount of the contributions payable by the Province (and other participating employers) to exceed the amount of contributions paid by or on behalf of active members in respect of credited service for the year (subject to certain exceptions for payment of a solvency deficiency and where there are insufficient cash and liquid assets in the fund).[3] In practice, this has resulted in 50/50 sharing of the regular contribution costs between the participating employers (including the Province) and plan members since the OTPP became jointly sponsored.[4]

    b. The history of surplus utilization after the OTPP became a jointly-sponsored plan and prior to the date that the FMP was established demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the financial benefits of surplus utilization, although surplus was not shared equally each time. Since the time the FMP was established, the OTPP has not reached the requisite level of surplus such that the Sponsors could negotiate its utilization under the Temporary Improvement Zone or Permanent Improvement Zone.

    c. The inability for either party to unilaterally require surplus to be utilized in a particular manner (subject to the OTF Call Right), and the requirement to negotiate and agree (or in the absence of agreement, arbitrate) presents the Sponsors with an equal opportunity to benefit from surplus utilization.

    d. One could argue that the obligation to bargain in "good faith" found in the Partners' Agreement may include the obligation to take into account the

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3 Teachers' Act, subsections 5(1.1), (3) and (7).

4 We note that for the period from January 1, 2008 to December 31, 2008, the employee contribution rate was slightly lower than the employer contribution rate for earnings both above and below the Year's Maximum Pensionable Earnings (**"YMPE"**) (9.6%/11.2% versus 10.4%/12%, respectively). It is our understanding that member contribution rates in 2008 were partially subsidized by the OTF with a credit reserve from the 1998 to 2001 pension negotiations, which accounts for this difference. See, Ontario Teachers' Pension Plan: "How Contribution Rates Have Evolved" available at: https://www.otpp.com/documents/10179/20940/-/5e471c2b-23f1-44e6-b5c1-d22e3e50dbc3/How+Contribution+Rates+Have+Evolved.pdf

"sharing" principles described elsewhere in this opinion, given that the OTPP is a jointly-sponsored plan.

We note that it is our understanding that it is certainly the Province's expectation that the benefit of any surplus under the plan will in fact be shared equally between the Province and the members, over time.

5. In the event that the Sponsors cannot agree upon how surplus is to be utilized in the Restoration Zone, the Temporary Improvement Zone or the Permanent Improvement Zone, the matter can be submitted to an arbitration board of three arbitrators. Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, the arbitral award must meet certain mandatory conditions set forth in the Partners' Agreement. Among other things, the arbitral award is required to ensure that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners' Agreement).

   As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described herein: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

IV. FRAMEWORK IN THE PLAN DOCUMENTATION FOR SURPLUS UTILIZATION BY THE SPONSORS

1. Joint Sponsorship Plan Design and Cost Sharing

The OTPP qualifies as a "jointly sponsored pension plan" (**"JSPP"**) under the PBA, which has three material implications relevant to the present analysis:

1. Plan Governance – Under a JSPP, the employers (or any persons or entities who make contributions on behalf of the employers or represent the employers) and the members of the pension plan (or any representatives of the members) are jointly responsible for making all decisions about the terms and conditions of the pension plan and any amendments to the pension plan.[5]

2. Funding – The OTPP (and certain other prescribed JSPPs) are exempt from solvency funding requirements under the PBR.[6]

3. Cost Sharing – In a defined benefit pension plan which does not qualify as a JSPP, the employer is solely responsible for funding any going concern unfunded liability or solvency deficiency. Given that the OTPP qualifies as a JSPP, however, the PBA permits members to be required to make contributions in respect of any going concern unfunded liability or solvency deficiency.[7]

With respect to the cost-sharing principle referred to in #3 above, the Teachers' Act contains limitations on the contributions that the Province (and other participating employers) may make under the OTPP:

> 5(1.1) The total amount of the 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.

Despite this general principle, under the Teachers' Act the Province is required to make additional contributions to the OTPP fund in the event that there are insufficient assets to make required payments out of the fund in any particular year.[8] The Province is also permitted to make additional contributions in respect of a solvency deficiency[9] (although, as noted above, solvency funding is not required under the OTPP). Notwithstanding that subsection 5(1.1) of the OTPP provides a *cap* on the Province's normal cost contribution obligation, rather than requiring 50/50 cost sharing, we understand that in practice there has been 50/50 cost sharing of the normal contribution cost under the OTPP since the OTPP became jointly sponsored (and for the majority of periods of time since the

[5] PBR, subsection 3.1(1).

[6] PBR, subsection 1.3.1(3).

[7] See PBA, subsection 1(2) and subsection 55(4).

[8] Teachers' Act, subsection 5(3).

[9] Teachers' Act, subsection 5(7).

inception of the plan in 1917).[10] The plan text itself also provides for equal contributions, at the basic level (see sections 25(1) and 26(1)).

Currently, the Sponsors are also required to mutually agree upon how any plan deficits are to be addressed.[11] While not binding upon the Sponsors, the FMP indicates that deficits may be addressed through increases to the contribution rates, lowering the amount of indexation and/or other decreases in benefits.

Joint governance and cost sharing form two of the core features of the OTPP. Consistent with the equal sharing of risk permitted under the JSPP plan design, there is a requirement for decisions relating to plan design and plan amendments to be made jointly by the Sponsors. In this regard, the FMP requires the Sponsors to negotiate and agree upon decisions relating to surplus utilization. Accordingly, the Sponsors can be said to have equal *opportunity* to benefit from surplus utilization through the negotiation process.

2. Provisions in the Legislation and Plan Documentation Relating to the Utilization of Surplus

(a) *Pension Benefits Act*

While they do address surplus withdrawals (which are not addressed in this opinion), the PBA and PBR do not otherwise mandate any particular use of ongoing surplus that may arise in a pension plan, e.g. for benefit improvements or contribution holidays. One must therefore look to the Teachers' Act, and to the Partners' Agreement and FMP in order to determine how ongoing surplus is dealt with under the OTPP.

(b) *Teachers' Pension Act* (Ontario)

Paragraph 10(1)3 of the Teachers' Act provides that the Minister of Education and the executive of the OTF may enter into an agreement (i.e., the Partners' Agreement) that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a

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10 See, Ontario Teachers' Pension Plan: "How Contribution Rates Have Evolved" available at: https://www.otpp.com/documents/10179/20940/-/5e471c2b-23f1-44e6-b5c1-d22e3e50dbc3/How+Contribution+Rates+Have+Evolved.pdf As noted above, for the period from January 1, 2008 to December 31, 2008 the employee contribution rate was slightly lower than the employer contribution rate for earnings both above and below the YMPE (9.6%/11.2% versus 10.4%/12%, respectively). It is our understanding that member contribution rates in 2008 were partially subsidized by the OTF with a credit reserve from the 1998 to 2001 pension negotiations, which accounts for this difference.

11 See, for example, Section 3.09 and 3.11 of the FMP.

fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized.

(c) Partners' Agreement and FMP

While the Partners' Agreement itself does not address the utilization of surplus, the notion that the Sponsors have "agreed to establish a partnership" for the purposes of designing and administering the OTPP and managing the OTPP fund[12] is reinforced throughout the Partners' Agreement. For example, Section 4 of the Partners' Agreement provides that "[t]he partnership established by this agreement is intended to govern all aspects of the plan and the fund…" Similarly, Section 8 of the Partners' Agreement notes that the partners are jointly 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, making changes to the plan, this agreement or other plan documents, deciding whether or not to file a valuation more frequently than required by the *Pension Benefits Act*, appointing the Board, and defining the role of the Board". The expectations of the Sponsors regarding how surpluses are to be utilized are presumably informed by the commitment noted above for the partnership established "to govern all aspects of the plan and the fund".

The procedures pursuant to which surplus may be withdrawn or utilized from the OTPP are identified in the FMP (which forms Appendix "A" to the Partners' Agreement).

We understand that the FMP was first established in March 2003, as a supplement to the Partners' Agreement, to provide a guidance framework to the Sponsors for decision-making when the OTPP has a funding surplus or shortfall. Prior to the creation of the FMP, the OTPP was considered fully funded (and surplus could be utilized, including through permanent benefit improvements) where assets equalled at least 100% of liabilities. The FMP is intentionally conservative through prioritizing the preservation of assets until a sufficient surplus "cushion" has been built to justify the utilization of surplus for contribution reductions or benefit improvements.

The FMP contemplates five "funding zones", each defined by a range. These funding zones provide the Sponsors with guidance as to when, based upon the funding level of the plan, it may be appropriate to (amongst other things) increase or decrease benefits, raise or lower contribution rates or conserve assets. The Sponsors always have the discretion, however, to agree to pursue a course of action that is not expressly provided for in the

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12 Partners' Agreement, section 1.

FMP. As will be discussed below, the ultimate discretion of the Sponsors is reflected throughout various provisions of the FMP.[13]

In the context of plan surpluses, three funding zones are of relevance, each of which is discussed below in greater detail.

(i) Restoration Zone

Article III of the FMP (Funding Zone – Restoration) (the **"Restoration Zone"**) is the "fully funded" zone where assets equal at least the liabilities, determined on the basis set out in the FMP. It is our understanding that the OTPP is currently in the Restoration Zone.

In the Restoration Zone, benefits cannot be improved and contributions cannot be reduced until certain actions are taken to restore past benefit reductions or past contribution increases. In this regard, Section 3.06 of the FMP provides the following:

> Section 3.06 *Application of Restoration Basis Excess*: For purposes of clarity, excesses identified pursuant to Section 3.05 shall be applied in the following order, provided that the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors:
>
> (a) *Bring Escalated Adjustments to 50% for Post-2013 Service*: to provide escalated adjustments up to 50% of the CPI adjustment in respect of service accrued after 2013 for the period covered by the valuation, and assumed thereafter at the same rate;
>
> (b) *Bring Escalated Adjustments to 100%*: to provide escalated adjustments up to 100% of the CPI adjustment for the period covered by the valuation, and assumed thereafter at the same rate;
>
> (c) *Restore Escalated Adjustments for Post-2013 Years*: to provide escalated adjustments to increase, to the extent possible, the current accumulated adjustment ratio for each year after 2013, to the current accumulated adjustment ratio for the period from 2010 to 2013, beginning with the first year in which current escalated adjustments were less than 50% of the run-rate escalated adjustments;
>
> (d) *Restore Escalated Adjustments for Post-2009 Years*: to provide escalated adjustments to increase, to the extent possible, the current

[13] See, for example, the opening words of Section 3.06 of the FMP, which section provides for various uses of surplus: "… provided that the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors". See also Section 4.05 and 5.05.

accumulated adjustment ratio for each year after 2009 to the run-rate accumulated adjustment ratio, beginning with the first year in which current escalated adjustments were less than run-rate escalated adjustments;

(e) *Provide Benefit Increases or Contribution Rate Reductions*: to provide the following:

(i) an increase in benefits, where the present value of current benefits is less than the present value of run-rate benefits,
(ii) a reduction in contribution rates, where the present value of current contributions exceeds the present value of basic contributions, or
(iii) a combination of (i) and (ii).

In summary, the Restoration Zone allows for surplus to be utilized to "restore" foregone indexation (Sections 3.06(a)-(d))[14] and then to either increase benefits to the "run-rate benefit" level (i.e., the long-term target level) or to lower contributions to the basic target rate (or a combination of these two options) (Section 3.06(e)). While the FMP contemplates that the actions will typically be taken sequentially (i.e., starting with Section 3.06(a) and ending with the actions in Section 3.06(e)), the Sponsors are required to first agree to the actions taken under Section 3.06 and have the discretion to apply the actions in a different order or to take different action (or to take no action to utilize the surplus).[15]

As noted, under Section 3.06(e), surplus can be utilized to reduce contribution rates "where the present value of current contributions exceed the present value of basic contributions" (the **"Restoration Contribution Reduction"**). We understand that in 2001 the Sponsors agreed to a 1.1% increase to both member/employer contributions (phased in over a three year period) to address a funding deficit in the OTPP and that the Restoration Contribution Reduction under Section 3.06(e) would permit these additional contributions to be eliminated, thus restoring contributions to the "basic" level.

The 2013 Term Sheet sets out an agreement between the Sponsors that is in effect from December 31, 2012 to December 30, 2017 (the **"Freeze Period"**), the terms of which are reflected in the FMP. Under Section 3.08 of the FMP, there are certain limits (relating to

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[14] This is achieved by first increasing go-forward indexing to 50% for the post-2013 service period, then to 100% on all post-2009 service periods and next, by restoring current pension amounts to a certain prescribed level starting with the years where indexing was less than 50% until all years of partial indexation are restored to the same level and then by restoring indexation to 100% for all service periods.

[15] As noted above, pursuant to Section 3.06 of the FMP, "the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors..."

the funded status of the OTPP) on the ability to make escalated adjustments or to improve benefits pursuant to Section 3.06 during the Freeze Period.

As noted below, no action can be taken under the Temporary Improvement Zone (as defined below) or the Permanent Improvement Zone (as defined below) until all restorative actions under Section 3.06 of the FMP have been provided for (subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP).

(ii) Temporary Improvement Zone

Article IV of the FMP (Funding Zone – Temporary Improvements) (the **"Temporary Improvement Zone"**) was added to the FMP in March 2015 and allows for: (i) temporary contribution decreases (a contribution holiday), (ii) surplus distribution, and/or (iii) benefit improvements, provided in each case that the plan's funding level reaches thresholds set out in the FMP.

We understand that in this zone the plan is considered well-funded and able to afford temporary changes, so long as they do not increase the long-term cost of the OTPP. Surplus cannot be utilized under the Temporary Improvement Zone until the Sponsors have provided for all of the changes specified in Section 3.06 of the Restoration Zone (again, subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP).[16]

In all cases the Sponsors' prior agreement is required in order for there to be a temporary contribution decrease, a surplus distribution or a benefit improvement.[17] Where the Sponsors agree to a change that would result in surplus being distributed or utilized for a temporary benefit improvement, the Sponsors are required to enter into a written agreement "governing the manner in which the contributions by the Minister and employers may be adjusted to offset any surplus distribution or temporary improvement of benefits that is reflected in the value of the liabilities."[18] We understand that this provision is a recognition of the partnership of the Province and the OTF, and requires the Sponsors to enter into an agreement addressing the possible value to be obtained by the Province where there is a decision to provide value to the members (but the provision is not a guarantee that such value will in fact be provided to the Province).

We note that, as a temporary measure, the OTF has "first call" rights on 100% of the surplus disclosed in valuation report with a valuation date after December 30, 2017, up to

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16 FMP, section 4.03

17 FMP, section 4.05.

18 FMP, section 4.06

certain amounts as set out in the FMP (the **"OTF Call Right"**).[19] The 2013 Term Sheet indicates that "[t]his is a one-time arrangement intended to compensate Plan members for absorbing 100% (rather than 50%) of funding shortfalls arising in the government initiated Freeze Period." In other words, this one-time opportunity to benefit from surplus utilization is directly linked to the asymmetrical assumption of risk by OTPP plan participants during the Freeze Period. In light of the Freeze Period and the OTF Call Right, it is our understanding that no actions under the Temporary Improvement Zone will be permitted until the Freeze Period has ended and the OTF Call Right in Article VI of the FMP has been satisfied.[20]

To summarize, the OTF has a contractual right to the future utilization of surplus, up to the value of the OTF Call Right. OTF cannot utilize any surplus available in the OTPP under this negotiated right until the Freeze Period has ended (on December 30, 2017) and a valuation after such date identifies the existence of surplus available for utilization. In light of this negotiated right, surplus cannot be utilized under the Temporary Improvement Zone or the Permanent Improvement Zone (e.g., to cause a temporary or permanent reduction to contributions) until the OTF Call Right has first been satisfied. Once the OTF Call Right has been satisfied, the *status quo* under the FMP will be restored (i.e., the agreement of the parties will be required for any utilization of surplus). In other words, the OTF Call Right reflects a "one-time" agreement and is expressly "without prejudice or precedent for any future situation".[21] It is our understanding that the quantum of the OTF Call Right is not presently expected to be material.

(iii) Permanent Improvement Zone

Where the surplus reaches certain levels as set out in the FMP, Article V of the FMP (Funding Zone – Permanent Improvements) (the **"Permanent Improvement Zone"**) will apply. We understand that in the Permanent Improvement Zone adequate funding security is considered to exist to support permanent changes (either an improvement in benefits or a reduction in contributions).

Under the FMP framework, these changes can be introduced only once the Sponsors have already provided for the changes specified in Section 3.06 (i.e., no further action to restore benefits remains to be taken under the Restoration Zone), subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP.[22]

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19 FMP, section 6.03.

20 See FMP, subsection 1.05(f) and sections 4.05 and 4.09.

21 2013 Term Sheet, paragraph 11(d).

22 FMP, section 5.03.

The Sponsors are required to mutually agree to any change made in the Permanent Improvement Zone. As in the Temporary Improvement Zone, where the Sponsors have agreed to a change which would result in an improvement to member benefits, the Sponsors would be required to enter into a written agreement "governing the manner in which the contributions by the Minister and employers may be adjusted to offset any change in current benefits that is reflected in the value of the liabilities."[23]

In light of the Freeze Period and the OTF Call Right, it is our understanding that no actions under the Permanent Improvement Zone will be permitted until the Freeze Period has ended and the OTF Call Right in Article VI of the FMP has been satisfied.[24]

3. History of Surplus Utilization

The history of OTPP surplus utilization from the time the OTPP became a jointly-sponsored pension plan[25] to the date that the FMP was established (in March 2003) demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the benefits of surplus utilization:

Valuation Date	Surplus/(Deficit)	OTF	Ontario Government	Surplus Remaining
1990	$(7.8 billion) unfunded liability	Increased contributions by 1% to 8.9%	Agreed to make a series of special payments to eliminate the unfunded liability and match increased contributions	Special payments considered an asset bringing the plan to a $0 surplus
1993	$1.5 billion	$325 million to offset social contract days	Eliminated special payments for $1.2 billion saving	$0
1996	$0.7 billion	$0.6 billion for benefit improvements and RCA contributions	N/A	$0.1 billion
1998	$6.8 billion	$2.2 billion for benefit improvements	$4.6 billion to reduce the value of remaining special payments	$0

23 FMP, section 5.05(b).

24 See FMP, sections 5.05 and 5.08.

25 The Partners' Agreement is dated July 15, 1991.

1999	$3.5 billion	N/A	$3.5 billion to reduce the value of remaining special payments	$0
2001	$6.8 billion	$6.2 billion for benefit improvements	N/A	$0.6 billion
2002	$1.9 billion	Sponsors agreed not to make any changes to benefits or contributions		$1.9 billion
Total		**$9.3 Billion**	**$9.3 Billion**	

* Source: Ontario Teachers' Pension Plan Board "Report on Funding" (April 2002)

Although surplus utilization prior to 2003 may not have been 50/50 each time, from 1990 to 2002 the aggregate value obtained by each of the Sponsors was equal. In certain instances where the Province received a disproportionate share of the financial benefits from surplus utilization, a commitment was made to the OTF that they would receive future surplus available for utilization. In 1998, $6.8 billion in surplus was utilized to cause a $2.2 billion benefit improvement and to provide the Province with a $4.6 billion reduction in the value of special payments owed by the Province. As part of this negotiation, the OTF and the Province agreed to allow future surplus to be utilized to eliminate the Province's remaining special payments (which resulted in $3.5 billion surplus being utilized in 1999 to reduce the value of the Province's remaining special payments) and a commitment was made for the next $6.2 billion in surplus to be available to OTF for benefit improvements (such surplus being utilized for benefit improvements in 2001).[26]

As noted above, the FMP was introduced in March 2003 to provide a guidance framework to the Sponsors when the OTPP has a funding surplus or shortfall. It is our understanding that there have been at least 2 material amendments to the FMP framework since its introduction. Below is a summary of the key funding decisions since the introduction of the FMP:

Year	Valuation Status and Key Decisions
2003	$1.5 billion surplus; no changes to benefits or contribution levels. Funding Management Policy adopted by plan sponsors.
2005	A preliminary $6.1 billion shortfall was resolved, leaving plan with a $0.1 billion surplus. Shortfall resolved with special contribution rate increases, totalling 3.1% of base earnings by

[26] See Ontario Teachers' Pension Plan, "Key Funding Decisions Since 1990", available at: https://www.otpp.com/documents/10179/765840/-/d4e2fea5-624d-420f-af15-e2daf9bc2711/Key+Funding+Decisions.pdf

	2009 for teachers, the Ontario government and other employers. OTF used the $76 million contingency reserve set aside in 2001 to reduce contribution rate increases for members in 2008.
2008	A preliminary $12.7 billion shortfall was resolved with the introduction of conditional inflation protection for pension benefits earned after 2009 and an increase in the basic contribution rate for members and the government to 9% from 8%. Employers agree to make special payments equal to any annual pension increases retirees forgo to a maximum of 50% missed inflation.
2009	A preliminary $2.5 billion shortfall was resolved primarily by assuming a slightly higher long-term rate of return on investments: yield on real-return bonds plus 1.5%, versus real-return bonds plus 1.4%. Other minor changes made to assumptions to reflect recent plan experience.
2011	A preliminary $17.2 billion shortfall was resolved with a 1.1% contribution rate increase (phased in over three years), slightly smaller annual cost-of-living increases for teachers who retired after 2009, and recognition of current contribution rate as the permanent base rate.
2012	$9.6 billion preliminary shortfall adjusted to reflect changes in mortality assumptions and impact of two-year freeze on teachers' salaries. 2012 shortfall resolved by making inflation protection for pension credit earned after 2013 fully conditional on plan's funded status and providing slightly smaller pension increases, beginning in 2014, for members who retired after 2009. These changes enabled the plan to assume a slightly higher discount rate. The changes left the plan with a $200 million surplus at Jan. 1, 2012.
2014	$5.1 billion preliminary funding surplus used to boost pensions of members who retired after 2009 to the level they would have been at if full inflation protection had been provided each year since they retired. The surplus funds were also used to raise conditional inflation protection to 60% of the increase in the cost of living for the portion of retirees' pensions earned after 2009. Both changes are effective with January 2015 pension payments.
2015	Some of the $6.8 billion preliminary funding surplus was used to boost pensions of members who retired after 2009 to the level they would have been at if full inflation protection had been provided on January 1, 2015. The surplus funds were also used to raise conditional inflation protection for pension credit earned after 2009 to 70% from 60% of the increase in the cost of living. Both changes were effective January 2016. In addition, some surplus funds were reserved to help facilitate stability in contribution and benefit levels should a future funding valuation show a decline in assets or increase in pension costs.

* Source: Ontario Teachers' Pension Plan, "Key Funding Decisions Since 1990"

In September 2016, the Sponsors announced that a portion of the $13.2 billion in funding surplus would be utilized to restore inflation increases, with the remaining surplus funds to be reserved "to help facilitate stability in contribution and benefit levels should a future funding valuation show a decline in assets or increase in pension costs".[27]

In summary, surplus has been utilized three times since the FMP was introduced – in each of 2014, 2015 and 2016 escalated adjustments were provided to increase the pensions of members who had retired after 2009. As noted above, the OTPP is currently in the Restoration Zone which, pursuant to Section 3.06, prioritizes the utilization of surplus to "restore" foregone indexation before any other actions are taken with respect to surplus. In other words, since the FMP was established the OTPP has not reached a level of surplus under the FMP which would allow for the Sponsors to enter into an agreement regarding its utilization under the Temporary Improvement Zone or the Permanent Improvement Zone.

It is also notable that, consistent with the 50/50 cost sharing principle under the plan, there is recent precedent for the Sponsors agreeing to equally share in the cost of funding a plan deficit (as with the case of surplus utilization, the Sponsors are required to mutually agree upon how to address any funding deficit in the OTPP). Specifically, the preliminary $17.2 billion shortfall identified in 2011 was resolved through a 1.1% increase to the contribution rate for both the participating employers and plan members (phased in over a three-year period).

Given the historical use of surplus under joint sponsorship of the OTPP prior to the adoption of the FMP, and the fact that over that time the Sponsors shared equally in surpluses, it may be that the Sponsors will expect to also share future surpluses on an equal basis, at least over time (we understand that it is certainly the Province's expectation that this will happen). In any event, based on the Plan Documentation, both parties will have an equal opportunity to benefit from surplus utilization through the negotiation process.

V. LEGAL RIGHT OF THE PROVINCE TO UNILATERALLY UTILIZE SURPLUS

As discussed in Part IV of this opinion, the Plan Documentation allows for the Sponsors to agree to utilize surplus in a variety of circumstances, depending on the funded status of the OTPP. These surplus utilization options include the following avenues through which the Province may potentially receive a financial benefit through the utilization of surplus:

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27 Ontario Teachers' Pension Plan, "Funding News", available at: https://www.otpp.com/corporate/plan-funding/funding-updates. We assume that a written agreement was reached by the Sponsors in this regard; however, we have not been provided with a copy of such agreement.

1. In the Restoration Zone, a Restoration Contribution Reduction may be agreed upon, once certain other requisite conditions have been met.

2. In the Temporary Improvement Zone, surplus may be utilized to provide a temporary contribution reduction (a contribution holiday), either as a stand-alone measure or in combination with other surplus utilization options (i.e., benefit improvements or surplus withdrawal).

3. In the Permanent Improvement Zone, surplus may be utilized to permanently reduce the current contribution obligations of the employers and the members, either as a stand-alone measure or in combination with changes to benefits.

Notwithstanding the foregoing, as noted above, the Sponsors have the discretion to, by mutual agreement, utilize surplus in any other manner agreed upon. (For example, Section 5.05 which relates to the Permanent Improvement Zone provides that "the partners may apply all or part of the [surplus] to change current benefits, current contributions, or both", subject to certain conditions.)

Any enforceable legal right of the Province to utilize surplus pursuant to the Partners' Agreement (and FMP appended thereto) would be grounded in the law of contract, the Partners' Agreement and the appended FMP being a contract between the Sponsors. A contract is an agreement "...which gives rise to an obligation that may be enforced in the courts."[28] It is our view that the relevant provisions in the Partners' Agreement[29] that contemplate the ability for the Province to receive a financial benefit through the utilization of surplus do not, by themselves, give rise to a legally enforceable right to unilaterally dictate the use of surplus. Such a legally enforceable right would only arise by agreement between the Sponsors, either through negotiations or mediation, or if an order were issued by a board of arbitration as contemplated by the dispute resolution mechanisms found in the Partners' Agreement (see Section VI of this Opinion for further discussion of the impact of binding arbitration on the Sponsors' legal rights).

In this regard, the FMP can be thought of as being similar to an "agreement to agree," which does not create an enforceable legal interest in relation to the utilization of surplus.[30] What the Province does have, however, is a right to negotiate with the OTF the

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28 CED – Contracts – I Basis of Contract – 1 – Contract Defined.

29 Article III, Section 3.06; Article IV, Section 4.05; and Article V, Section 5.05.

30 For a statement of the principle that an "agreement to "agree" is not an enforceable legal interest, see, for example: *Simpson v. Canada (Attorney General)*, 2011 ONSC 5637 at para. 60 citing *Ward v. Ward*, 2011 ONCA 178 and *Bawitko Investments Ltd. v. Kernels Popcorn Ltd.*, 1991 CanLII 2734 (Ont CA). See also G. H. L. Fridman, *The Law of Contract in Canada*, 6th ed (Toronto: Carswell

use of surplus that may arise under the plan, at least in the context of an actuarial valuation that discloses surplus and that is to be filed with the regulators.

In addition, when a valuation is prepared to be filed and the Sponsors have to discuss the treatment of a surplus disclosed in the valuation, section 74 of the Partners' Agreement requires the Sponsors "to bargain in good faith and make every reasonable effort to reach an agreement on the changes, if any, that will be made to the plan". One might therefore argue that that obligation of good faith may include the obligation to take into account the "sharing" principles described elsewhere in this opinion, given that the OTPP is a jointly-sponsored plan.

As will be discussed below, where the Sponsors are unable to agree upon the utilization of surplus pursuant to the negotiation/mediation processes set forth in the Partners' Agreement, there is an ability for the Sponsors to submit the matter to arbitration. The issuance of an order by an appointed board of arbitration regarding the use of surplus funds under the OTPP would create a legally enforceable right, as the submission to the board of arbitration would constitute a proceeding under the *Arbitrations Act* – as specified in paragraph 87 of the Partners' Agreement – that is enforceable by a court.[31]

VI. IMPACT OF BINDING ARBITRATION ON THE SPONSORS' LEGAL RIGHTS

Section 8.01 of the FMP provides the following:

> Section 8.01 Unless the partners mutually agree to the contrary, they shall follow the procedures described in paragraphs 74 to 100 when determining the plan changes arising from Section 3.07.

We first note that the mediation/arbitration process would not be triggered unless there is an actuarial valuation to be filed with the regulators that requires the Sponsors to agree on how any surplus or deficit is to be addressed. If a valuation is prepared in a year when no filing is required (filings generally only being required every three years), and the Sponsors do not agree to file the valuation, then the Sponsors do not necessarily have to address funding and benefit issues and therefore no negotiations may occur.

The processes in paragraphs 74 to 100 of the Partners' Agreement that are referred to in Section 8.01 of the FMP provide, amongst other things, for the following:

Publishing, 2011) at 23 where the author states "There cannot be a contract to enter into a contract. Nor can there be a contract to negotiate, i.e., an agreement to agree."

31 Section 50(1) of the *Arbitration Act, 1991*, SO 1991, c 17 states "A person who is entitled to enforcement of an award made in Ontario or elsewhere in Canada may make an application to the court to that effect."

- The Sponsors are required to meet to bargain in good faith and make every reasonable effort to reach an agreement on the changes, if any, that will be made to the plan (section 74);

- The parties may at any point appoint a mediator by agreement of the parties or by a method to which they agree at that time (section 77);

- If the parties agree, the mediator may be appointed as a mediator/arbitrator in which case the appointee will decide on the process and time frame for conducting mediation/arbitration (section 80);

- Within 30 days of appointment, the mediator will prepare a confidential report setting out his or her views on the positions of the two partners and containing a recommendation (section 82);

- If the partners do not accept the report within 14 days of its being delivered to them it will be destroyed and an arbitration board will be appointed (section 84);

- This agreement together with a referral to a board of arbitration constitutes a submission under the *Arbitration Act, 1991*[32] (section 87);

- The board of arbitration in making an award will consider prevailing economic conditions and the overall state of the provincial economy (section 91);

- The award made by the board of arbitration, must comply with certain prescribed requirements, including to "provide that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members" (section 92(c));

- The Board will prepare a final valuation of the plan which implements all of the changes to the plan which have been awarded or agreed to by the partners (section 94);

- The Sponsors may agree to change the procedure described in this agreement, either for one round of negotiations or for all future negotiations; and

- Pursuant to Section 8.02 of the FMP, certain limitations on amendments set out in the FMP also apply to an award made by a board of arbitration (generally, these limitations are intended to ensure that the plan is adequately funded after providing for the utilization of surplus).

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[32] SO 1991, c. 17 (the "***Arbitration Act***").

The Partners' Agreement and the FMP contain no general arbitration clause governing all disputes relating to the agreement, although Section 14 of the Partners' Agreement provides for the possibility of voluntary arbitration. We are not aware of any instance where the arbitration provisions have been invoked by the parties since the FMP was established. It is not immediately clear whether disputes relating to the utilization of surplus under Article IV of the FMP (i.e., the Temporary Improvement Zone) and under Article V of the FMP (i.e., the Permanent Improvement Zone) would be subject to arbitration.[33] It is our understanding from discussions with OTPP's internal legal counsel, however, that the arbitration provisions in the FMP would be expected to apply to disputes relating to the utilization of surplus under each of these provisions.

Where a matter has been submitted to arbitration, case law has established that the agreement between the parties that is being arbitrated is the fundamental source of subject matters that come within the arbitration board's jurisdiction.[34] The parties are free to design their own procedures, including setting the scope of the arbitration board's jurisdiction and specifying the potential outcomes of the arbitration (subject to certain default appeal rights and mandatory grounds to set aside an award under the *Arbitration Act*). The arbitration board is empowered to make binding decisions because of the arbitration agreement, including any limitations on that authority. Canadian courts have traditionally granted deference to arbitration awards.

Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, as noted above, under section 92 of the Partners' Agreement, the arbitral award must meet certain mandatory conditions. Among other things, the arbitral award is required to provide that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners'

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33 On the one hand, Section 8.01 of the FMP provides for the procedures in the Partners' Agreement relating to arbitration to apply "when determining the plan changes arising from Section 3.07". This may suggest that only disputes relating to the utilization of surplus under Article III (i.e., the Restoration Zone) can be arbitrated. On the other hand, Section 8.03 of the FMP provides that "Subject to the 2013 Term Sheet, nothing in Article II to Article IX affects the timing of the triennial negotiation, mediation and arbitration process referred to in paragraph 72 to 100", which may suggest that any agreement relating to the utilization of surplus, including under Article IV or Article V of the FMP, may be subject to arbitration (when a valuation is to be filed the parties have to agree on how any surplus – including surplus in the Temporary Improvement Zone and Permanent Improvement Zone, if any – will be used).

34 See for example: *Desputeaux v. Éditions Chouette* (1987) Inc., [2003] 1 SCR 178, para. 22.

Agreement). The arbitration board does not have discretion to ignore this mandatory provision, although the provision would need to be given effect within the context of the relevant documents and applicable statutes, interpreted as a whole, and other relevant factors, such as past conduct of the parties. As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described above: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

Yours truly,

Osler, Hoskin & Harcourt LLP

Osler, Hoskin & Harcourt LLP
JS/DR/JM:jm

Osler opinion re_ OTPP surplus.rtf

From: Petsche, Nadine (TBS) []
To: Colley, Matthew (CA - Toronto) (mcolley@deloitte.ca) [mcolley@deloitte.ca]
Subject: Osler opinion re: OTPP surplus
Date: Tuesday, September 20, 2016 12:59:49
Attachment 1: Opinion dated September 20, 2016.pdf

Hi Matt.

Please find attached a copy of the external legal firm's opinion for your reference.

Please let me know if you have any questions.

Nadine

416 325 8027

Opinion dated September 20, 2016.pdf

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Dear Sirs:

Accounting Treatment of Surplus in the Ontario Teachers' Pension Plan

I. BACKGROUND

We understand the pertinent background facts to be the following:

1. The Ontario Teachers' Pension Plan (the **"OTPP"**) is a jointly-sponsored defined benefit pension plan established under the *Teachers' Pension Act* (Ontario) and is, subject to certain exceptions, required to comply with the *Pension Benefits Act* (Ontario) as well as the *Income Tax Act* (Canada).

2. The sponsors of the OTPP are the Province of Ontario (the **"Province"**) and the Ontario Teachers' Federation (the **"OTF"**) (collectively, the **"Sponsors"**).

3. We understand that as at March 31, 2016 the Province's Statement of Financial Position (the **"Public Accounts"**) includes a pension asset totalling $10.6 billion (the **"Pension Asset"**) related in part to an accounting surplus under the OTPP.[1]

4. The Office of the Auditor General has indicated that because the Province does not have the legally enforceable right to unilaterally access the assets of the plan, and in the absence of that right, because the Province does not have an agreement in place with the OTF as of March 31, 2016 with respect to how the surplus would be utilized such that it would provide a benefit to the Province, the Pension Asset as presented in the Public Accounts should be removed.[2]

You asked us to consider the processes pursuant to which the Province may utilize surplus assets in the OTPP in accordance with the Plan Documentation (as defined below), and to identify any considerations that might inform the expectations of the Province as a Sponsor regarding the basis upon which decisions will be made relating to surplus utilization. We are not providing an opinion on the proper application of the accounting standards to the present situation, as that is an issue for the accountants to address.

II. SCOPE OF OPINION

For the purposes of our opinion, we considered the following documentation (collectively, the **"Plan Documentation"**):

1. The Ontario Teachers' Pension Plan (the **"OTPP"** or **"plan"**);

2. The Agreement between Her Majesty the Queen in right of the Province of Ontario represented by the Minister of Education and Training and The Ontario Teachers' Federation represented by its Executive (the **"Partners' Agreement"**);

3. The Funding Management Policy (the **"FMP"**), which forms Appendix "A" to the Partners' Agreement; and

4. The Term Sheet agreed to by the Sponsors dated March 13, 2013 (the **"2013 Term Sheet"**) describing the implications of the Freeze Period (as defined below) on the FMP.

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[1] See letter from Bonnie Lysyk (Auditor General) to Greg Orencsak (Deputy Minister, Treasury Board) and Scott Thompson (Deputy Minister, Ministry of Finance), dated September 13, 2016. Part of the surplus relates to another pension plan; we understand that $10.1 billion relates to the OTPP.

[2] *Ibid.*

We have also considered the following legislation/regulations:

1. The *Teachers' Pension Act* (Ontario) (the **"Teachers' Act"**); and
2. The *Pension Benefits Act* (Ontario) (the **"PBA"**) and the regulations thereunder (the **"PBR"**).

As per your instructions, we have not evaluated the ability of the Province to benefit from the *withdrawal* of surplus assets from the OTPP (although certain provisions of the FMP cited herein relate to both the withdrawal and other utilization of surplus). Rather, this opinion identifies the processes pursuant to which the Province may receive a financial benefit through the *utilization* of OTPP surplus (e.g., as a result of either a temporary reduction in the Province's contribution obligations (a contribution holiday) or through changes to the contribution formula that reduce the Province's contribution obligations).

We note that the concept of an *accounting* surplus is distinct from surplus identified in a funding valuation prepared in respect of the OTPP (a **"Funding Valuation"**). Where surplus has been identified in a Funding Valuation, the Plan Documentation provides the Sponsors with certain avenues pursuant to which the Funding Valuation surplus can be utilized. Any reference to "surplus" in this opinion, unless expressly stated otherwise, relates to the surplus identified by the actuary for the OTPP in a Funding Valuation and not to the accounting surplus identified in the Public Accounts. We understand that pursuant to the applicable accounting standards, the recognition of part or all of the accounting surplus on the Public Accounts depends on the ability of the Province to benefit from any surplus in the pension fund over the life of plan.

This opinion does not purport to draw any conclusions, express or implied, about the application of the accounting standards to the present circumstances; rather, it is solely intended to provide the Province with information concerning the legal framework governing the utilization of surplus under the OTPP so as to allow the Province's accountants to determine whether a related Pension Asset should appear on the Public Accounts.

III. SUMMARY OF OUR CONCLUSIONS

A brief summary of our material conclusions is set forth below (all capitalized terms are defined herein):

1. Paragraph 10(1)3 of the Teachers' Act provides that the Minister of Education and the executive of the OTF may enter into an agreement that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a

fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized. We note that the Sponsors have in fact entered into such an agreement, in the form of the Partners' Agreement (to which is appended the FMP).

2. The Plan Documentation (specifically the FMP) and applicable legislation allow for the Sponsors to utilize surplus in a variety of ways, depending on the funded status of the OTPP. These surplus utilization options include the following avenues through which the Province may receive a financial benefit through the utilization of surplus (the three "zones" describe different levels of surplus, a greater amount of surplus being required in order for the next "zone" to come into play):

    a. In the Restoration Zone, a Restoration Contribution Reduction may be approved once certain other requisite conditions have been met.

    b. In the Temporary Improvement Zone, surplus may be utilized to provide a temporary contribution reduction (i.e., a contribution holiday), either as a stand-alone measure or in combination with other surplus utilization options (i.e., benefit improvements or surplus withdrawal).

    c. In the Permanent Improvement Zone, surplus may be utilized to permanently reduce the current contribution obligations of the employers and the members, either as a stand-alone measure or in combination with changes to benefits.

    Notwithstanding the foregoing, under the FMP the Sponsors have the discretion to, by mutual agreement, utilize surplus in any other manner.

3. Any enforceable legal right to obtain some value from any surplus pursuant to the Partners' Agreement (and FMP appended thereto) would be grounded in the law of contract. As the relevant provisions of the FMP require the Sponsors to agree upon the manner in which surplus is to be utilized, neither Sponsor has a legally enforceable right to unilaterally utilize surplus in the OTPP. As such, the provisions in the FMP that contemplate the ability for the Province to receive a financial benefit through the utilization of surplus would not, in and of themselves, give rise to a legally enforceable right. What the Province does have, however, is a right to negotiate with the OTF the use of surplus that may arise under the plan, at least in the context of an actuarial valuation that discloses surplus and that is to be filed with the regulators.

4. Notwithstanding the foregoing, the Plan Documentation and applicable legislation give rise to the following considerations which may shape the Sponsors' expectation as to the basis upon which surplus will be utilized (and potentially lead to an expectation of equal sharing of the benefit of any surplus, at least over time):

    a. The Teachers' Act prohibits the total amount of the contributions payable by the Province (and other participating employers) to exceed the amount of contributions paid by or on behalf of active members in respect of credited service for the year (subject to certain exceptions for payment of a solvency deficiency and where there are insufficient cash and liquid assets in the fund).[3] In practice, this has resulted in 50/50 sharing of the regular contribution costs between the participating employers (including the Province) and plan members since the OTPP became jointly sponsored.[4]

    b. The history of surplus utilization after the OTPP became a jointly-sponsored plan and prior to the date that the FMP was established demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the financial benefits of surplus utilization, although surplus was not shared equally each time. Since the time the FMP was established, the OTPP has not reached the requisite level of surplus such that the Sponsors could negotiate its utilization under the Temporary Improvement Zone or Permanent Improvement Zone.

    c. The inability for either party to unilaterally require surplus to be utilized in a particular manner (subject to the OTF Call Right), and the requirement to negotiate and agree (or in the absence of agreement, arbitrate) presents the Sponsors with an equal opportunity to benefit from surplus utilization.

    d. One could argue that the obligation to bargain in "good faith" found in the Partners' Agreement may include the obligation to take into account the

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3 Teachers' Act, subsections 5(1.1), (3) and (7).

4 We note that for the period from January 1, 2008 to December 31, 2008, the employee contribution rate was slightly lower than the employer contribution rate for earnings both above and below the Year's Maximum Pensionable Earnings (**"YMPE"**) (9.6%/11.2% versus 10.4%/12%, respectively). It is our understanding that member contribution rates in 2008 were partially subsidized by the OTF with a credit reserve from the 1998 to 2001 pension negotiations, which accounts for this difference. See, Ontario Teachers' Pension Plan: "How Contribution Rates Have Evolved" available at: https://www.otpp.com/documents/10179/20940/-/5e471c2b-23f1-44e6-b5c1-d22e3e50dbc3/How+Contribution+Rates+Have+Evolved.pdf

"sharing" principles described elsewhere in this opinion, given that the OTPP is a jointly-sponsored plan.

We note that it is our understanding that it is certainly the Province's expectation that the benefit of any surplus under the plan will in fact be shared equally between the Province and the members, over time.

5. In the event that the Sponsors cannot agree upon how surplus is to be utilized in the Restoration Zone, the Temporary Improvement Zone or the Permanent Improvement Zone, the matter can be submitted to an arbitration board of three arbitrators. Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, the arbitral award must meet certain mandatory conditions set forth in the Partners' Agreement. Among other things, the arbitral award is required to ensure that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners' Agreement).

   As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described herein: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

IV. FRAMEWORK IN THE PLAN DOCUMENTATION FOR SURPLUS UTILIZATION BY THE SPONSORS

1. Joint Sponsorship Plan Design and Cost Sharing

The OTPP qualifies as a "jointly sponsored pension plan" (**"JSPP"**) under the PBA, which has three material implications relevant to the present analysis:

1. Plan Governance – Under a JSPP, the employers (or any persons or entities who make contributions on behalf of the employers or represent the employers) and the members of the pension plan (or any representatives of the members) are jointly responsible for making all decisions about the terms and conditions of the pension plan and any amendments to the pension plan.[5]

2. Funding – The OTPP (and certain other prescribed JSPPs) are exempt from solvency funding requirements under the PBR.[6]

3. Cost Sharing – In a defined benefit pension plan which does not qualify as a JSPP, the employer is solely responsible for funding any going concern unfunded liability or solvency deficiency. Given that the OTPP qualifies as a JSPP, however, the PBA permits members to be required to make contributions in respect of any going concern unfunded liability or solvency deficiency.[7]

With respect to the cost-sharing principle referred to in #3 above, the Teachers' Act contains limitations on the contributions that the Province (and other participating employers) may make under the OTPP:

> 5(1.1) The total amount of the 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.

Despite this general principle, under the Teachers' Act the Province is required to make additional contributions to the OTPP fund in the event that there are insufficient assets to make required payments out of the fund in any particular year.[8] The Province is also permitted to make additional contributions in respect of a solvency deficiency[9] (although, as noted above, solvency funding is not required under the OTPP). Notwithstanding that subsection 5(1.1) of the OTPP provides a *cap* on the Province's normal cost contribution obligation, rather than requiring 50/50 cost sharing, we understand that in practice there has been 50/50 cost sharing of the normal contribution cost under the OTPP since the OTPP became jointly sponsored (and for the majority of periods of time since the

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5 PBR, subsection 3.1(1).

6 PBR, subsection 1.3.1(3).

7 See PBA, subsection 1(2) and subsection 55(4).

8 Teachers' Act, subsection 5(3).

9 Teachers' Act, subsection 5(7).

inception of the plan in 1917).[10] The plan text itself also provides for equal contributions, at the basic level (see sections 25(1) and 26(1)).

Currently, the Sponsors are also required to mutually agree upon how any plan deficits are to be addressed.[11] While not binding upon the Sponsors, the FMP indicates that deficits may be addressed through increases to the contribution rates, lowering the amount of indexation and/or other decreases in benefits.

Joint governance and cost sharing form two of the core features of the OTPP. Consistent with the equal sharing of risk permitted under the JSPP plan design, there is a requirement for decisions relating to plan design and plan amendments to be made jointly by the Sponsors. In this regard, the FMP requires the Sponsors to negotiate and agree upon decisions relating to surplus utilization. Accordingly, the Sponsors can be said to have equal *opportunity* to benefit from surplus utilization through the negotiation process.

2. Provisions in the Legislation and Plan Documentation Relating to the Utilization of Surplus

(a) *Pension Benefits Act*

While they do address surplus withdrawals (which are not addressed in this opinion), the PBA and PBR do not otherwise mandate any particular use of ongoing surplus that may arise in a pension plan, e.g. for benefit improvements or contribution holidays. One must therefore look to the Teachers' Act, and to the Partners' Agreement and FMP in order to determine how ongoing surplus is dealt with under the OTPP.

(b) *Teachers' Pension Act* (Ontario)

Paragraph 10(1)3 of the Teachers' Act provides that the Minister of Education and the executive of the OTF may enter into an agreement (i.e., the Partners' Agreement) that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a

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10 See, Ontario Teachers' Pension Plan: "How Contribution Rates Have Evolved" available at: https://www.otpp.com/documents/10179/20940/-/5e471c2b-23f1-44e6-b5c1-d22e3e50dbc3/How+Contribution+Rates+Have+Evolved.pdf As noted above, for the period from January 1, 2008 to December 31, 2008 the employee contribution rate was slightly lower than the employer contribution rate for earnings both above and below the YMPE (9.6%/11.2% versus 10.4%/12%, respectively). It is our understanding that member contribution rates in 2008 were partially subsidized by the OTF with a credit reserve from the 1998 to 2001 pension negotiations, which accounts for this difference.

11 See, for example, Section 3.09 and 3.11 of the FMP.

fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized.

(c) Partners' Agreement and FMP

While the Partners' Agreement itself does not address the utilization of surplus, the notion that the Sponsors have "agreed to establish a partnership" for the purposes of designing and administering the OTPP and managing the OTPP fund[12] is reinforced throughout the Partners' Agreement. For example, Section 4 of the Partners' Agreement provides that "[t]he partnership established by this agreement is intended to govern all aspects of the plan and the fund..." Similarly, Section 8 of the Partners' Agreement notes that the partners are jointly 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, making changes to the plan, this agreement or other plan documents, deciding whether or not to file a valuation more frequently than required by the *Pension Benefits Act*, appointing the Board, and defining the role of the Board". The expectations of the Sponsors regarding how surpluses are to be utilized are presumably informed by the commitment noted above for the partnership established "to govern all aspects of the plan and the fund".

The procedures pursuant to which surplus may be withdrawn or utilized from the OTPP are identified in the FMP (which forms Appendix "A" to the Partners' Agreement).

We understand that the FMP was first established in March 2003, as a supplement to the Partners' Agreement, to provide a guidance framework to the Sponsors for decision-making when the OTPP has a funding surplus or shortfall. Prior to the creation of the FMP, the OTPP was considered fully funded (and surplus could be utilized, including through permanent benefit improvements) where assets equalled at least 100% of liabilities. The FMP is intentionally conservative through prioritizing the preservation of assets until a sufficient surplus "cushion" has been built to justify the utilization of surplus for contribution reductions or benefit improvements.

The FMP contemplates five "funding zones", each defined by a range. These funding zones provide the Sponsors with guidance as to when, based upon the funding level of the plan, it may be appropriate to (amongst other things) increase or decrease benefits, raise or lower contribution rates or conserve assets. The Sponsors always have the discretion, however, to agree to pursue a course of action that is not expressly provided for in the

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12 Partners' Agreement, section 1.

FMP. As will be discussed below, the ultimate discretion of the Sponsors is reflected throughout various provisions of the FMP.[13]

In the context of plan surpluses, three funding zones are of relevance, each of which is discussed below in greater detail.

(i) Restoration Zone

Article III of the FMP (Funding Zone – Restoration) (the **"Restoration Zone"**) is the "fully funded" zone where assets equal at least the liabilities, determined on the basis set out in the FMP. It is our understanding that the OTPP is currently in the Restoration Zone.

In the Restoration Zone, benefits cannot be improved and contributions cannot be reduced until certain actions are taken to restore past benefit reductions or past contribution increases. In this regard, Section 3.06 of the FMP provides the following:

> Section 3.06 *Application of Restoration Basis Excess*: For purposes of clarity, excesses identified pursuant to Section 3.05 shall be applied in the following order, provided that the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors:
>
> (a) *Bring Escalated Adjustments to 50% for Post-2013 Service*: to provide escalated adjustments up to 50% of the CPI adjustment in respect of service accrued after 2013 for the period covered by the valuation, and assumed thereafter at the same rate;
>
> (b) *Bring Escalated Adjustments to 100%*: to provide escalated adjustments up to 100% of the CPI adjustment for the period covered by the valuation, and assumed thereafter at the same rate;
>
> (c) *Restore Escalated Adjustments for Post-2013 Years*: to provide escalated adjustments to increase, to the extent possible, the current accumulated adjustment ratio for each year after 2013, to the current accumulated adjustment ratio for the period from 2010 to 2013, beginning with the first year in which current escalated adjustments were less than 50% of the run-rate escalated adjustments;
>
> (d) *Restore Escalated Adjustments for Post-2009 Years*: to provide escalated adjustments to increase, to the extent possible, the current

[13] See, for example, the opening words of Section 3.06 of the FMP, which section provides for various uses of surplus: "… provided that the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors". See also Section 4.05 and 5.05.

accumulated adjustment ratio for each year after 2009 to the run-rate accumulated adjustment ratio, beginning with the first year in which current escalated adjustments were less than run-rate escalated adjustments;

(e) *Provide Benefit Increases or Contribution Rate Reductions*: to provide the following:

(i) an increase in benefits, where the present value of current benefits is less than the present value of run-rate benefits,
(ii) a reduction in contribution rates, where the present value of current contributions exceeds the present value of basic contributions, or
(iii) a combination of (i) and (ii).

In summary, the Restoration Zone allows for surplus to be utilized to "restore" foregone indexation (Sections 3.06(a)-(d))[14] and then to either increase benefits to the "run-rate benefit" level (i.e., the long-term target level) or to lower contributions to the basic target rate (or a combination of these two options) (Section 3.06(e)). While the FMP contemplates that the actions will typically be taken sequentially (i.e., starting with Section 3.06(a) and ending with the actions in Section 3.06(e)), the Sponsors are required to first agree to the actions taken under Section 3.06 and have the discretion to apply the actions in a different order or to take different action (or to take no action to utilize the surplus).[15]

As noted, under Section 3.06(e), surplus can be utilized to reduce contribution rates "where the present value of current contributions exceed the present value of basic contributions" (the **"Restoration Contribution Reduction"**). We understand that in 2001 the Sponsors agreed to a 1.1% increase to both member/employer contributions (phased in over a three year period) to address a funding deficit in the OTPP and that the Restoration Contribution Reduction under Section 3.06(e) would permit these additional contributions to be eliminated, thus restoring contributions to the "basic" level.

The 2013 Term Sheet sets out an agreement between the Sponsors that is in effect from December 31, 2012 to December 30, 2017 (the **"Freeze Period"**), the terms of which are reflected in the FMP. Under Section 3.08 of the FMP, there are certain limits (relating to

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[14] This is achieved by first increasing go-forward indexing to 50% for the post-2013 service period, then to 100% on all post-2009 service periods and next, by restoring current pension amounts to a certain prescribed level starting with the years where indexing was less than 50% until all years of partial indexation are restored to the same level and then by restoring indexation to 100% for all service periods.

[15] As noted above, pursuant to Section 3.06 of the FMP, "the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors…"

the funded status of the OTPP) on the ability to make escalated adjustments or to improve benefits pursuant to Section 3.06 during the Freeze Period.

As noted below, no action can be taken under the Temporary Improvement Zone (as defined below) or the Permanent Improvement Zone (as defined below) until all restorative actions under Section 3.06 of the FMP have been provided for (subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP).

(ii) Temporary Improvement Zone

Article IV of the FMP (Funding Zone – Temporary Improvements) (the **"Temporary Improvement Zone"**) was added to the FMP in March 2015 and allows for: (i) temporary contribution decreases (a contribution holiday), (ii) surplus distribution, and/or (iii) benefit improvements, provided in each case that the plan's funding level reaches thresholds set out in the FMP.

We understand that in this zone the plan is considered well-funded and able to afford temporary changes, so long as they do not increase the long-term cost of the OTPP. Surplus cannot be utilized under the Temporary Improvement Zone until the Sponsors have provided for all of the changes specified in Section 3.06 of the Restoration Zone (again, subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP).[16]

In all cases the Sponsors' prior agreement is required in order for there to be a temporary contribution decrease, a surplus distribution or a benefit improvement.[17] Where the Sponsors agree to a change that would result in surplus being distributed or utilized for a temporary benefit improvement, the Sponsors are required to enter into a written agreement "governing the manner in which the contributions by the Minister and employers may be adjusted to offset any surplus distribution or temporary improvement of benefits that is reflected in the value of the liabilities."[18] We understand that this provision is a recognition of the partnership of the Province and the OTF, and requires the Sponsors to enter into an agreement addressing the possible value to be obtained by the Province where there is a decision to provide value to the members (but the provision is not a guarantee that such value will in fact be provided to the Province).

We note that, as a temporary measure, the OTF has "first call" rights on 100% of the surplus disclosed in valuation report with a valuation date after December 30, 2017, up to

16 FMP, section 4.03

17 FMP, section 4.05.

18 FMP, section 4.06

certain amounts as set out in the FMP (the **"OTF Call Right"**).[19] The 2013 Term Sheet indicates that "[t]his is a one-time arrangement intended to compensate Plan members for absorbing 100% (rather than 50%) of funding shortfalls arising in the government initiated Freeze Period." In other words, this one-time opportunity to benefit from surplus utilization is directly linked to the asymmetrical assumption of risk by OTPP plan participants during the Freeze Period. In light of the Freeze Period and the OTF Call Right, it is our understanding that no actions under the Temporary Improvement Zone will be permitted until the Freeze Period has ended and the OTF Call Right in Article VI of the FMP has been satisfied.[20]

To summarize, the OTF has a contractual right to the future utilization of surplus, up to the value of the OTF Call Right. OTF cannot utilize any surplus available in the OTPP under this negotiated right until the Freeze Period has ended (on December 30, 2017) and a valuation after such date identifies the existence of surplus available for utilization. In light of this negotiated right, surplus cannot be utilized under the Temporary Improvement Zone or the Permanent Improvement Zone (e.g., to cause a temporary or permanent reduction to contributions) until the OTF Call Right has first been satisfied. Once the OTF Call Right has been satisfied, the *status quo* under the FMP will be restored (i.e., the agreement of the parties will be required for any utilization of surplus). In other words, the OTF Call Right reflects a "one-time" agreement and is expressly "without prejudice or precedent for any future situation".[21] It is our understanding that the quantum of the OTF Call Right is not presently expected to be material.

(iii) Permanent Improvement Zone

Where the surplus reaches certain levels as set out in the FMP, Article V of the FMP (Funding Zone – Permanent Improvements) (the **"Permanent Improvement Zone"**) will apply. We understand that in the Permanent Improvement Zone adequate funding security is considered to exist to support permanent changes (either an improvement in benefits or a reduction in contributions).

Under the FMP framework, these changes can be introduced only once the Sponsors have already provided for the changes specified in Section 3.06 (i.e., no further action to restore benefits remains to be taken under the Restoration Zone), subject to the general discretion of the Sponsors to deviate from the guidelines set out in the FMP.[22]

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19 FMP, section 6.03.

20 See FMP, subsection 1.05(f) and sections 4.05 and 4.09.

21 2013 Term Sheet, paragraph 11(d).

22 FMP, section 5.03.

The Sponsors are required to mutually agree to any change made in the Permanent Improvement Zone. As in the Temporary Improvement Zone, where the Sponsors have agreed to a change which would result in an improvement to member benefits, the Sponsors would be required to enter into a written agreement "governing the manner in which the contributions by the Minister and employers may be adjusted to offset any change in current benefits that is reflected in the value of the liabilities."[23]

In light of the Freeze Period and the OTF Call Right, it is our understanding that no actions under the Permanent Improvement Zone will be permitted until the Freeze Period has ended and the OTF Call Right in Article VI of the FMP has been satisfied.[24]

3. History of Surplus Utilization

The history of OTPP surplus utilization from the time the OTPP became a jointly-sponsored pension plan[25] to the date that the FMP was established (in March 2003) demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the benefits of surplus utilization:

Valuation Date	Surplus/(Deficit)	OTF	Ontario Government	Surplus Remaining
1990	$(7.8 billion) unfunded liability	Increased contributions by 1% to 8.9%	Agreed to make a series of special payments to eliminate the unfunded liability and match increased contributions	Special payments considered an asset bringing the plan to a $0 surplus
1993	$1.5 billion	$325 million to offset social contract days	Eliminated special payments for $1.2 billion saving	$0
1996	$0.7 billion	$0.6 billion for benefit improvements and RCA contributions	N/A	$0.1 billion
1998	$6.8 billion	$2.2 billion for benefit improvements	$4.6 billion to reduce the value of remaining special payments	$0

23 FMP, section 5.05(b).

24 See FMP, sections 5.05 and 5.08.

25 The Partners' Agreement is dated July 15, 1991.

1999	$3.5 billion	N/A	$3.5 billion to reduce the value of remaining special payments	$0
2001	$6.8 billion	$6.2 billion for benefit improvements	N/A	$0.6 billion
2002	$1.9 billion	Sponsors agreed not to make any changes to benefits or contributions		$1.9 billion
Total		**$9.3 Billion**	**$9.3 Billion**	

* Source: Ontario Teachers' Pension Plan Board "Report on Funding" (April 2002)

Although surplus utilization prior to 2003 may not have been 50/50 each time, from 1990 to 2002 the aggregate value obtained by each of the Sponsors was equal. In certain instances where the Province received a disproportionate share of the financial benefits from surplus utilization, a commitment was made to the OTF that they would receive future surplus available for utilization. In 1998, $6.8 billion in surplus was utilized to cause a $2.2 billion benefit improvement and to provide the Province with a $4.6 billion reduction in the value of special payments owed by the Province. As part of this negotiation, the OTF and the Province agreed to allow future surplus to be utilized to eliminate the Province's remaining special payments (which resulted in $3.5 billion surplus being utilized in 1999 to reduce the value of the Province's remaining special payments) and a commitment was made for the next $6.2 billion in surplus to be available to OTF for benefit improvements (such surplus being utilized for benefit improvements in 2001).[26]

As noted above, the FMP was introduced in March 2003 to provide a guidance framework to the Sponsors when the OTPP has a funding surplus or shortfall. It is our understanding that there have been at least 2 material amendments to the FMP framework since its introduction. Below is a summary of the key funding decisions since the introduction of the FMP:

Year	Valuation Status and Key Decisions
2003	$1.5 billion surplus; no changes to benefits or contribution levels. Funding Management Policy adopted by plan sponsors.
2005	A preliminary $6.1 billion shortfall was resolved, leaving plan with a $0.1 billion surplus. Shortfall resolved with special contribution rate increases, totalling 3.1% of base earnings by

[26] See Ontario Teachers' Pension Plan, "Key Funding Decisions Since 1990", available at: https://www.otpp.com/documents/10179/765840/-/d4e2fea5-624d-420f-af15-e2daf9bc2711/Key+Funding+Decisions.pdf

	2009 for teachers, the Ontario government and other employers. OTF used the $76 million contingency reserve set aside in 2001 to reduce contribution rate increases for members in 2008.
2008	A preliminary $12.7 billion shortfall was resolved with the introduction of conditional inflation protection for pension benefits earned after 2009 and an increase in the basic contribution rate for members and the government to 9% from 8%. Employers agree to make special payments equal to any annual pension increases retirees forgo to a maximum of 50% missed inflation.
2009	A preliminary $2.5 billion shortfall was resolved primarily by assuming a slightly higher long-term rate of return on investments: yield on real-return bonds plus 1.5%, versus real-return bonds plus 1.4%. Other minor changes made to assumptions to reflect recent plan experience.
2011	A preliminary $17.2 billion shortfall was resolved with a 1.1% contribution rate increase (phased in over three years), slightly smaller annual cost-of-living increases for teachers who retired after 2009, and recognition of current contribution rate as the permanent base rate.
2012	$9.6 billion preliminary shortfall adjusted to reflect changes in mortality assumptions and impact of two-year freeze on teachers' salaries. 2012 shortfall resolved by making inflation protection for pension credit earned after 2013 fully conditional on plan's funded status and providing slightly smaller pension increases, beginning in 2014, for members who retired after 2009. These changes enabled the plan to assume a slightly higher discount rate. The changes left the plan with a $200 million surplus at Jan. 1, 2012.
2014	$5.1 billion preliminary funding surplus used to boost pensions of members who retired after 2009 to the level they would have been at if full inflation protection had been provided each year since they retired. The surplus funds were also used to raise conditional inflation protection to 60% of the increase in the cost of living for the portion of retirees' pensions earned after 2009. Both changes are effective with January 2015 pension payments.
2015	Some of the $6.8 billion preliminary funding surplus was used to boost pensions of members who retired after 2009 to the level they would have been at if full inflation protection had been provided on January 1, 2015. The surplus funds were also used to raise conditional inflation protection for pension credit earned after 2009 to 70% from 60% of the increase in the cost of living. Both changes were effective January 2016. In addition, some surplus funds were reserved to help facilitate stability in contribution and benefit levels should a future funding valuation show a decline in assets or increase in pension costs.

* Source: Ontario Teachers' Pension Plan, "Key Funding Decisions Since 1990"

In September 2016, the Sponsors announced that a portion of the $13.2 billion in funding surplus would be utilized to restore inflation increases, with the remaining surplus funds to be reserved "to help facilitate stability in contribution and benefit levels should a future funding valuation show a decline in assets or increase in pension costs".[27]

In summary, surplus has been utilized three times since the FMP was introduced – in each of 2014, 2015 and 2016 escalated adjustments were provided to increase the pensions of members who had retired after 2009. As noted above, the OTPP is currently in the Restoration Zone which, pursuant to Section 3.06, prioritizes the utilization of surplus to "restore" foregone indexation before any other actions are taken with respect to surplus. In other words, since the FMP was established the OTPP has not reached a level of surplus under the FMP which would allow for the Sponsors to enter into an agreement regarding its utilization under the Temporary Improvement Zone or the Permanent Improvement Zone.

It is also notable that, consistent with the 50/50 cost sharing principle under the plan, there is recent precedent for the Sponsors agreeing to equally share in the cost of funding a plan deficit (as with the case of surplus utilization, the Sponsors are required to mutually agree upon how to address any funding deficit in the OTPP). Specifically, the preliminary $17.2 billion shortfall identified in 2011 was resolved through a 1.1% increase to the contribution rate for both the participating employers and plan members (phased in over a three-year period).

Given the historical use of surplus under joint sponsorship of the OTPP prior to the adoption of the FMP, and the fact that over that time the Sponsors shared equally in surpluses, it may be that the Sponsors will expect to also share future surpluses on an equal basis, at least over time (we understand that it is certainly the Province's expectation that this will happen). In any event, based on the Plan Documentation, both parties will have an equal opportunity to benefit from surplus utilization through the negotiation process.

V. LEGAL RIGHT OF THE PROVINCE TO UNILATERALLY UTILIZE SURPLUS

As discussed in Part IV of this opinion, the Plan Documentation allows for the Sponsors to agree to utilize surplus in a variety of circumstances, depending on the funded status of the OTPP. These surplus utilization options include the following avenues through which the Province may potentially receive a financial benefit through the utilization of surplus:

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27 Ontario Teachers' Pension Plan, "Funding News", available at: https://www.otpp.com/corporate/plan-funding/funding-updates. We assume that a written agreement was reached by the Sponsors in this regard; however, we have not been provided with a copy of such agreement.

1. In the Restoration Zone, a Restoration Contribution Reduction may be agreed upon, once certain other requisite conditions have been met.

2. In the Temporary Improvement Zone, surplus may be utilized to provide a temporary contribution reduction (a contribution holiday), either as a stand-alone measure or in combination with other surplus utilization options (i.e., benefit improvements or surplus withdrawal).

3. In the Permanent Improvement Zone, surplus may be utilized to permanently reduce the current contribution obligations of the employers and the members, either as a stand-alone measure or in combination with changes to benefits.

Notwithstanding the foregoing, as noted above, the Sponsors have the discretion to, by mutual agreement, utilize surplus in any other manner agreed upon. (For example, Section 5.05 which relates to the Permanent Improvement Zone provides that "the partners may apply all or part of the [surplus] to change current benefits, current contributions, or both", subject to certain conditions.)

Any enforceable legal right of the Province to utilize surplus pursuant to the Partners' Agreement (and FMP appended thereto) would be grounded in the law of contract, the Partners' Agreement and the appended FMP being a contract between the Sponsors. A contract is an agreement "...which gives rise to an obligation that may be enforced in the courts."[28] It is our view that the relevant provisions in the Partners' Agreement[29] that contemplate the ability for the Province to receive a financial benefit through the utilization of surplus do not, by themselves, give rise to a legally enforceable right to unilaterally dictate the use of surplus. Such a legally enforceable right would only arise by agreement between the Sponsors, either through negotiations or mediation, or if an order were issued by a board of arbitration as contemplated by the dispute resolution mechanisms found in the Partners' Agreement (see Section VI of this Opinion for further discussion of the impact of binding arbitration on the Sponsors' legal rights).

In this regard, the FMP can be thought of as being similar to an "agreement to agree," which does not create an enforceable legal interest in relation to the utilization of surplus.[30] What the Province does have, however, is a right to negotiate with the OTF the

[28] CED – Contracts – I Basis of Contract – 1 – Contract Defined.

[29] Article III, Section 3.06; Article IV, Section 4.05; and Article V, Section 5.05.

[30] For a statement of the principle that an "agreement to "agree" is not an enforceable legal interest, see, for example: *Simpson v. Canada (Attorney General)*, 2011 ONSC 5637 at para. 60 citing *Ward v. Ward*, 2011 ONCA 178 and *Bawitko Investments Ltd. v. Kernels Popcorn Ltd.*, 1991 CanLII 2734 (Ont CA). See also G. H. L. Fridman, *The Law of Contract in Canada*, 6th ed (Toronto: Carswell

use of surplus that may arise under the plan, at least in the context of an actuarial valuation that discloses surplus and that is to be filed with the regulators.

In addition, when a valuation is prepared to be filed and the Sponsors have to discuss the treatment of a surplus disclosed in the valuation, section 74 of the Partners' Agreement requires the Sponsors "to bargain in good faith and make every reasonable effort to reach an agreement on the changes, if any, that will be made to the plan". One might therefore argue that that obligation of good faith may include the obligation to take into account the "sharing" principles described elsewhere in this opinion, given that the OTPP is a jointly-sponsored plan.

As will be discussed below, where the Sponsors are unable to agree upon the utilization of surplus pursuant to the negotiation/mediation processes set forth in the Partners' Agreement, there is an ability for the Sponsors to submit the matter to arbitration. The issuance of an order by an appointed board of arbitration regarding the use of surplus funds under the OTPP would create a legally enforceable right, as the submission to the board of arbitration would constitute a proceeding under the *Arbitrations Act* – as specified in paragraph 87 of the Partners' Agreement – that is enforceable by a court.[31]

VI. IMPACT OF BINDING ARBITRATION ON THE SPONSORS' LEGAL RIGHTS

Section 8.01 of the FMP provides the following:

> Section 8.01 Unless the partners mutually agree to the contrary, they shall follow the procedures described in paragraphs 74 to 100 when determining the plan changes arising from Section 3.07.

We first note that the mediation/arbitration process would not be triggered unless there is an actuarial valuation to be filed with the regulators that requires the Sponsors to agree on how any surplus or deficit is to be addressed. If a valuation is prepared in a year when no filing is required (filings generally only being required every three years), and the Sponsors do not agree to file the valuation, then the Sponsors do not necessarily have to address funding and benefit issues and therefore no negotiations may occur.

The processes in paragraphs 74 to 100 of the Partners' Agreement that are referred to in Section 8.01 of the FMP provide, amongst other things, for the following:

Publishing, 2011) at 23 where the author states "There cannot be a contract to enter into a contract. Nor can there be a contract to negotiate, i.e., an agreement to agree."

31 Section 50(1) of the *Arbitration Act, 1991*, SO 1991, c 17 states "A person who is entitled to enforcement of an award made in Ontario or elsewhere in Canada may make an application to the court to that effect."

- The Sponsors are required to meet to bargain in good faith and make every reasonable effort to reach an agreement on the changes, if any, that will be made to the plan (section 74);

- The parties may at any point appoint a mediator by agreement of the parties or by a method to which they agree at that time (section 77);

- If the parties agree, the mediator may be appointed as a mediator/arbitrator in which case the appointee will decide on the process and time frame for conducting mediation/arbitration (section 80);

- Within 30 days of appointment, the mediator will prepare a confidential report setting out his or her views on the positions of the two partners and containing a recommendation (section 82);

- If the partners do not accept the report within 14 days of its being delivered to them it will be destroyed and an arbitration board will be appointed (section 84);

- This agreement together with a referral to a board of arbitration constitutes a submission under the *Arbitration Act, 1991*[32] (section 87);

- The board of arbitration in making an award will consider prevailing economic conditions and the overall state of the provincial economy (section 91);

- The award made by the board of arbitration, must comply with certain prescribed requirements, including to "provide that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members" (section 92(c));

- The Board will prepare a final valuation of the plan which implements all of the changes to the plan which have been awarded or agreed to by the partners (section 94);

- The Sponsors may agree to change the procedure described in this agreement, either for one round of negotiations or for all future negotiations; and

- Pursuant to Section 8.02 of the FMP, certain limitations on amendments set out in the FMP also apply to an award made by a board of arbitration (generally, these limitations are intended to ensure that the plan is adequately funded after providing for the utilization of surplus).

---

32 SO 1991, c. 17 (the "***Arbitration Act***").

The Partners' Agreement and the FMP contain no general arbitration clause governing all disputes relating to the agreement, although Section 14 of the Partners' Agreement provides for the possibility of voluntary arbitration. We are not aware of any instance where the arbitration provisions have been invoked by the parties since the FMP was established. It is not immediately clear whether disputes relating to the utilization of surplus under Article IV of the FMP (i.e., the Temporary Improvement Zone) and under Article V of the FMP (i.e., the Permanent Improvement Zone) would be subject to arbitration.[33] It is our understanding from discussions with OTPP's internal legal counsel, however, that the arbitration provisions in the FMP would be expected to apply to disputes relating to the utilization of surplus under each of these provisions.

Where a matter has been submitted to arbitration, case law has established that the agreement between the parties that is being arbitrated is the fundamental source of subject matters that come within the arbitration board's jurisdiction.[34] The parties are free to design their own procedures, including setting the scope of the arbitration board's jurisdiction and specifying the potential outcomes of the arbitration (subject to certain default appeal rights and mandatory grounds to set aside an award under the *Arbitration Act*). The arbitration board is empowered to make binding decisions because of the arbitration agreement, including any limitations on that authority. Canadian courts have traditionally granted deference to arbitration awards.

Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, as noted above, under section 92 of the Partners' Agreement, the arbitral award must meet certain mandatory conditions. Among other things, the arbitral award is required to provide that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners'

---

[33] On the one hand, Section 8.01 of the FMP provides for the procedures in the Partners' Agreement relating to arbitration to apply "when determining the plan changes arising from Section 3.07". This may suggest that only disputes relating to the utilization of surplus under Article III (i.e., the Restoration Zone) can be arbitrated. On the other hand, Section 8.03 of the FMP provides that "Subject to the 2013 Term Sheet, nothing in Article II to Article IX affects the timing of the triennial negotiation, mediation and arbitration process referred to in paragraph 72 to 100", which may suggest that any agreement relating to the utilization of surplus, including under Article IV or Article V of the FMP, may be subject to arbitration (when a valuation is to be filed the parties have to agree on how any surplus – including surplus in the Temporary Improvement Zone and Permanent Improvement Zone, if any – will be used).

[34] See for example: *Desputeaux v. Éditions Chouette* (1987) Inc., [2003] 1 SCR 178, para. 22.

Agreement). The arbitration board does not have discretion to ignore this mandatory provision, although the provision would need to be given effect within the context of the relevant documents and applicable statutes, interpreted as a whole, and other relevant factors, such as past conduct of the parties. As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described above: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

Yours truly,

Osler, Hoskin & Harcourt LLP

Osler, Hoskin & Harcourt LLP
JS/DR/JM:jm

RE_ Factually incorrect.rtf

From:	Colley, Matthew (CA - Toronto) [mcolley@deloitte.ca]
To:	Petsche, Nadine (TBS) [Nadine.Petsche@ontario.ca]
Subject:	RE: Factually incorrect
Date:	Tuesday, April 25, 2017 14:15:36

Sorry- I have a call with S&P at 4:30pm. I am free at 5pm. Does that work for you?
416-817-1217 is the best number to reach me.

-----Original Message-----
From: Petsche, Nadine (TBS) [mailto:Nadine.Petsche@ontario.ca]
Sent: Tuesday, April 25, 2017 2:11 PM
To: Colley, Matthew (CA - Toronto) <mcolley@deloitte.ca>
Subject: RE: Factually incorrect

4:30 please. What's the best number for me to call you (and sm?). n

-----Original Message-----
From: Colley, Matthew (CA - Toronto) [mailto:mcolley@deloitte.ca]
Sent: April 25, 2017 2:08 PM
To: Petsche, Nadine (TBS)
Subject: RE: Factually incorrect

Yes- calls from 4-5pm if you can work around that.

-----Original Message-----
From: Petsche, Nadine (TBS) [mailto:Nadine.Petsche@ontario.ca]
Sent: Tuesday, April 25, 2017 2:07 PM
To: Colley, Matthew (CA - Toronto) <mcolley@deloitte.ca>
Subject: FW: Factually incorrect

Availability this pm?

-----Original Message-----
From: Colley, Matthew (CA - Toronto) [mailto:mcolley@deloitte.ca]
Sent: April 25, 2017 2:02 PM
To: Petsche, Nadine (TBS)
Subject: RE: Factually incorrect

I am not sure what off the record means either- I don't think it was professionally acceptable. I was hoping this would have gone more in the direction of what is the relevance of financial reporting or something like that.

I am troubled by:

1) Mentioning that an accounting firm could not support the pension asset valuation - going down that road is not her place and misleading the way that she left it.
2) The expert panel report - she stated it was done under IFRS.
3) Her real issue is with the discount rate that is used, and she pretty much came out and said it. Since she can't win the discount rate argument, she has come up with a convoluted way of questioning whether a pension asset meets the definition of an asset.

There were many other things that were troubling. Probably the most frustrating thing is that she makes comments but there is little substance behind them.

Matt

-----Original Message-----
From: Petsche, Nadine (TBS) [mailto:Nadine.Petsche@ontario.ca]
Sent: Tuesday, April 25, 2017 1:50 PM
To: Colley, Matthew (CA - Toronto) <mcolley@deloitte.ca>
Subject: Re: Factually incorrect

I actually think that the host of the event has to be held accountable. I also don't agree with this 'off the record' positioning. How does that lend itself to transparency and accountability.
If one were to look at this as an opportunity for a lesson to be learned, I think that the Institute needs to be educated on the facts, since they basically provided the platform for the remarks in question, without having done any (apparent) due diligence.
A debrief would be helpful to assess next steps, if any. I'll be speaking with Cindy. N

Original Message
From: Colley, Matthew (CA - Toronto)
Sent: Tuesday, April 25, 2017 1:22 PM
To: Petsche, Nadine (TBS)
Subject: Factually incorrect

She someone be holding her accountable for being factually incorrect or misleading?

Sent from my iPhone
 Confidentiality Warning:

This message and any attachments are intended only for the use of the intended recipient(s), are confidential, and may be privileged. If you are not the intended recipient, you are hereby notified that any review, retransmission, conversion to hard copy, copying, circulation or other use of this message and any attachments is strictly prohibited. If you are not the intended recipient, please notify the sender immediately by return e-mail, and delete this message and any attachments from your system. Thank

You

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Si vous ne voulez pas recevoir d’autres messages électroniques commerciaux de Deloitte à l’avenir, veuillez envoyer ce courriel à l’adresse unsubscribe@deloitte.ca
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If you do not wish to receive future commercial electronic messages from Deloitte, forward this email to unsubscribe@deloitte.ca

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Ce message, ainsi que toutes ses pièces jointes, est destiné exclusivement au(x) destinataire(s) prévu(s), est confidentiel et peut contenir des renseignements privilégiés. Si vous n’êtes pas le destinataire prévu

Re_ as discussed (letter to AG).rtf

From: lucy.durocher@ca.pwc.com [lucy.durocher@ca.pwc.com]
To: Petsche, Nadine (TBS) [Nadine.Petsche@ontario.ca]
Subject: Re: as discussed (letter to AG)
Date: Monday, October 03, 2016 11:04:17

Thanks Nadine.

I see that the final letter did not contain any of my suggested edits that I sent to you. It would be helpful to understand why - for example, that OPCD did not agree with my suggested positions. It would be useful feedback.

In the meanwhile you mentioned the possibility of doing a follow up call later this week. I am available on the afternoon of Friday 7th, if you would like to suggest a time that works for you.

Lucy

Lucy Durocher
PwC | Partner, National Accounting Consulting Services
T: +1 416 869 2311
Email: lucy.durocher@ca.pwc.com
Assistant: Tracey Whelan | T: +1 416 941 8383 ext. 14223
PricewaterhouseCoopers LLP
PwC Tower, 18 York Street, Suite 2600, Toronto ON M5J 0B2
http://www.pwc.com/ca

From: "Petsche, Nadine (TBS)" <Nadine.Petsche@ontario.ca>
To: Lucy Durocher/CA/ABAS/PwC@Americas-CA
Date: 09/29/2016 10:42 AM
Subject: as discussed (letter to AG)

[attachment "Bonnie Lysyk -- September 25.pdf" deleted by Lucy Durocher/CA/ABAS/PwC]

Statement of Work_Deloitte_2016.pdf

FORM OF STATEMENT OF WORK – OPS ENTITY

Statement of Work for Management Consulting Services

This Statement of Work no. **– RFS TBS-OTB-OPCD-15 made in duplicate and effective July 21, 2016 ending on March 31, 2017.**

Deloitte LLP (the "Vendor" or "Deloitte") and Her Majesty the Queen in right of Ontario as represented by the President of the Treasury Board (the "Client") enter into this Statement of Work pursuant to the Master Agreement for Management Consulting Services made as of **July 21, 2016** between the Vendor and Her Majesty the Queen in Right of Ontario as represented by the Minister of Government and Consumer Services (such Master Agreement, as from time to time amended, is referred to as the "Master Agreement").

In consideration of their respective agreements set out below, the parties agree as follows:

1. *Structure* - The terms and conditions of the Master Agreement are hereby incorporated by reference in this Statement of Work to the same effect as if fully set out in this Statement of Work. This document and the Master Agreement together comprise a separate Statement of Work between the Vendor and the Client. All capitalized terms used in this Statement of Work without definition have the meanings ascribed to them in the Master Agreement. In the event of any conflict or inconsistency between any term or provision of this Statement of Work and any term or provision of the Master Agreement, the terms and provisions of the Master Agreement shall govern.

2. *Statement of Work* - The Vendor agrees to provide to the Client, and the Client agrees to acquire from the Vendor, the Services and Deliverables described in this Statement of Work upon and subject to the terms of this Statement of Work.

3. *Maximum Price:* C$ $100,000.00 does not include HST

4. *Project Start Date:* July 21, 2016

5. *Project End Date:* March 31, 2017

6. *Scope of Services and Deliverables* - The Services and Deliverables to be provided by the Vendor under this Statement of Work include the following

   - Taking into account public sector accounting principles, advice and guidance on complex accounting and reporting matters related to accounting for pensions on the Province's consolidated financial statements.

   - The Vendor will participate in meetings as necessary to support the engagement objectives:

   - Working with management of OPCD's Accounting Policy and Financial Reporting Branch (APFR), the provider of complex accounting services related to the following possible areas:
     - Develop discussion and analysis material
     - Develop draft input/briefing materials/option papers
     - Provide accounting advice and guidance related to the accounting for pensions on the Province's financial statements
     - Participate in discussions with internal and external stakeholders, as required

   As part of this engagement, the consultant(s) would be expected to provide professional accounting expertise in assessing actuarial assessments for specified plans in relation to applying the ceiling test to the accrued pension benefit assets in accordance with PS3250 (3250.050 to PS3250.059).

7. *Ownership and Licences* - **Attachment D** of the Master Agreement forms a part of this Statement of Work.

8. *Communications and Reporting* - The structure of Deloitte's working relationship with OPCD is vital to the success of their engagement. The Project Lead that will handle OPCD work is Martin Raymond (partner), the leading consulting actuary for pension at Deloitte. In his work, Martin will be supported by Trevor Gary. Martin and Trevor will have access to some specific personnel of Deloitte that may be involved to limited extent depending on the needs. Clair Grindley and Matt Colley will be the 2 main subject matter experts that may have some implication.. Max Bazile, another actuarial resource is identified just as a support should a very large workload come in a short period of time and OPCD needing some urgent support. _Deloitte's communication strategy will be centred on periodic project update meetings, the frequency of which will be determined by the OPCD and Deloitte.

9. *Work Location* - All meetings will be within Greater Toronto Area.

10. *Working Hours* – The Client's normal working hours are 7.25 hours per day, between 8:15 a.m. to 4:30 p.m. Monday to Friday inclusive.

    If required by the Client, the Vendor must provide Services outside of the normal working hours and/or on non-Business days. The Vendor will not be entitled to charge more than the Fixed Price or Per Diem Rate.

11. *Administrative Services and Supplies* – All administrative services and supplies used by the Vendor to complete the Services will be provided to the Client at no additional charge.

12. *Billing and Payment Process* – The Vendor shall provide the Client with quarterly billing statements that outline the per diem charges [as provided Deloitte's response to RFS TBS-OTB-OPCD-15, no later than 10 Business Days after the end of each quarter.

    Billing statements should include all billing information as set out in the Master Agreement.

13. *Names and Roles of Vendor's Personnel:*

Name of Individual	**Level**
Martin Raymond (Project Lead)	Partner, Actuarial Services
Trevor Gary (Senior Analyst)	Senior, Actuarial Services
Matt Colley (subject matter expert on Ontario process and protocols)	Senior Manager, Audit

Clair Grindley (subject matter expert on pension accounting)	Partner, Audit
Max Bazile (backup resource for actuarial team)	Senior Manager, Actuarial Services

14. **Invoices** - Invoices for payment of any charges under this Statement of Work shall be sent to:

Client: Treasury Board Secretariat,
Office of the Provincial Controller Division
Branch: Accounting Policy and Financial Reporting
Representative: Nadine Petsche
Title: Director, Accounting Policy and Financial Reporting
Phone number: 416-325-8027
Email: Nadine.petsche@ontario.ca

15. *Knowledge Transfer:* The Vendor will work closely with the Client to ensure knowledge transfer to the Client's designated staff, and as necessary with the Auditor General.

16. *Destruction of Information* - The Vendor shall destroy all information contained on any media that was provided by the Client or at the direction of the Client, if requested to do so by the Client, except as required to be retained in accordance with professional standards requirements. The Client may choose to witness this destruction. The Vendor shall provide a certificate of destruction to the Client, if requested to do so by the Client.

17. *Indemnity* – the indemnity set out in the Master Agreement applies to this assignment.

18. *Client Representative and Receipt of Notices*

Client's address for receipt of notices: **Treasury Board Secretariat**
Client Representative: **Nadine Petsche**
Telephone number: **416-325-8027**
E-mail: **Nadine.petsche@ontario.ca**

19. *Vendor Representative and Receipt of Notices*

The name and title of the Vendor's Representative: Martin Raymond
1190 Avenue des Canadiens-de-Montréal,
Montréal, Quebec
Canada
H3B 0M7

IN WITNESS WHEREOF the parties hereto have executed this Statement of Work as of the date first above written.

Her Majesty the Queen in right of Ontario as represented by The President of the Treasury Board

Per:

Signature: N. Petsche

Name: Nadine Petsche

Title: Director, Accounting Policy + Financial Reporting.

Pursuant to delegated authority.

DELOITTE LLP.

Per:

Signature:

Name: **Martin Raymond**

Title: **Partner**

I have the authority to bind the Vendor.

Statement of Work_EY Actuarial Support Services_2017.pdf

FORM OF STATEMENT OF WORK – OPS ENTITY

Statement of Work for Management Consulting Services

This Statement of Work No. **RFS TBS-OTB-OPCD-20 made in duplicate and effective February 3, 2017 ending on September 30, 2017.**

Ernst & Young LLP (the vendor" or "EY") and Her Majesty the Queen in right of Ontario as represented by the President of the Treasury Board (the "Client") enter into this Statement of Work pursuant to the Master Agreement for Management Consulting Services made as of June 16, 2014 between the Vendor and Her Majesty the Queen in Right of Ontario as represented by the Minister of Government and Consumer Services (such Master Agreement, as from time to time amended, is referred to as the "Master Agreement").

In consideration of their respective agreements set out below, the parties agree as follows:

1. *Structure* - The terms and conditions of the Master Agreement are hereby incorporated by reference in this Statement of Work to the same effect as if fully set out in this Statement of Work. This document and the Master Agreement together comprise a separate Statement of Work between the Vendor and the Client. All capitalized terms used in this Statement of Work without definition have the meanings ascribed to them in the Master Agreement. In the event of any conflict or inconsistency between any term or provision of this Statement of Work and any term or provision of the Master Agreement, the terms and provisions of the Master Agreement shall govern.

2. *Statement of Work* - The Vendor agrees to provide to the Client, and the Client agrees to acquire from the Vendor, the Services and Deliverables described in this Statement of Work upon and subject to the terms of this Statement of Work.

3. *Maximum Price:* C$ $150,000 does not include HST

4. *Project Start Date:* February 3, 2017

5. *Project End Date:* September 30, 2017

6. *Scope of Services and Deliverables* - The Services and Deliverables to be provided by the Vendor under this Statement of Work include the following

    1. Taking into account public sector accounting principles, advice and guidance on complex accounting and reporting matters related to accounting for pensions on the Working with management of the Office of the Provincial Controller's Accounting Policy and Financial Reporting Branch (APFR), the Vendor will provide actuarial services related to the following possible areas:
        - Review APFR's calculation of estimated accounting valuations based on actuarial input for pension plans reflected on the Province's consolidated financial statements (Ontario Public Service Employees Union Pension Plan, Ontario Teachers' Pension Plan, College of Applied Arts and Technology, Health Care of Ontario Pension Plan and Public Service Pension Plan) as well as post-retirement benefits.
        - Conduct related sensitivity and/or scenario analysis as requested by APFR.
        - Participate in discussions and meetings with internal and external stakeholders, as required.

    2. Working with management of the Office of the Provincial Controller, through the Accounting Policy and Financial Reporting Branch (APFR), provide actuarial services related to the following possible areas relating to the Ontario Public Sector Employees Union Pension Plan and Ontario Teachers' Pension Plan:
        - Design and execute various valuation models, as requested by APFR, relating

- to the ceiling test requirements in the CPA Canada public sector accounting handbook (PS3250.050 to PS3250.059).
- Conduct sensitivity and/or scenario analysis as requested by APFR.
- Provide advice to APFR, for accounting purposes, on the ceiling tests and sensitivity analysis.
- Participate in discussions and meetings with internal and external stakeholders, as required.

7. *Ownership and Licences* – Attachment D of the Master Agreement forms a part of this Statement of Work.

8. *Communications and Reporting* - The structure of Ernst & Young's working relationship with OPCD is vital to the success of their engagement. The Project Lead that will handle OPCD work is Uros Karadzic. Ernst & Young's communication strategy will be centred on periodic project update meetings, the frequency of which will be determined by the OPCD and Ernst & Young.

9. *Work Location* - All meetings will be within Greater Toronto Area.

10. *Working Hours* – The Client's normal working hours are 7.25 hours per day, between 8:15 a.m. to 4:30 p.m. Monday to Friday inclusive.

    If required by the Client, the Vendor must provide Services outside of the normal working hours and/or on non-Business days. The Vendor will not be entitled to charge more than the Fixed Price or Per Diem Rate.

11. *Administrative Services and Supplies* – All administrative services and supplies used by the Vendor to complete the Services will be provided to the Client at no additional charge.

12. *Billing and Payment Process* – The Vendor shall provide the Client with quarterly billing statements that outline the per diem charges no later than 10 Business Days after the end of each quarter.

    Billing statements should include all billing information as set out in the Master Agreement.

13. *Names and Roles of Vendor's Personnel:*

Name of Individual	**Level**
Uros Karadzic	Senior Consultant/Project Lead
Shayan Jafrani	Intermediate Consultant/Sr. Analyst
Christina Chan	Consultant/Analyst

Note that participation of Uros Karadzic will commence only upon completion of his engagement with the Pension Asset Expert Advisory Panel.

14. **Invoices** - Invoices for payment of any charges under this Statement of Work shall be sent to:

    Client: Treasury Board Secretariat
    Office of the Provincial Controller Division

Her Majesty the Queen in right of Ontario as represented by The President of the Treasury Board

Per:

Signature: N. Petsche

Name: **Nadine Petsche**

Title: **Director, Accounting Policy and Financial Reporting**

Pursuant to delegated authority.

Per:

Signature:

Name: UROS KARADZIC

Title: PARTNER

I have the authority to bind the Vendor.

Branch: Accounting Policy and Financial Reporting
Representative: Nadine Petsche
Title: Director, Accounting Policy and Financial Reporting
Phone Number: 416 325 8027
Email: Nadine.petsche@ontario.ca

15. *Knowledge Transfer:* The Vendor will work closely with the Client to ensure knowledge transfer to the Client's designated staff, and as necessary with the Auditor General.

16. *Destruction of Information* - The Vendor shall destroy all information contained on any media that was provided by the Client or at the direction of the Client, if requested to do so by the Client, except as required to be retained in accordance with professional standards requirements. The Client may choose to witness this destruction. The Vendor shall provide a certificate of destruction to the Client, if requested to do so by the Client.

17. *Indemnity* – the indemnity set out in the Master Agreement applies to this assignment.

18. *Client Representative and Receipt of Notices*

Client's address for receipt of notices:	**Treasury Board Secretariat**
Client Representative:	**Nadine Petsche**
Telephone number:	**416 325 8027**
E-mail:	**Nadine.petsche@ontario.ca**

19. *Vendor Representative and Receipt of Notices*

Uros Karadzic, Partner
Ernst & Yojng LLP
Ernst & Young Tower
P O Box 251
222 Bay Street
Toronto ON M5K 1J7

IN WITNESS WHEREOF the parties hereto have executed this Statement of Work as of the date first above written.

Statement of Work_EY_2017.pdf

Treasury Board Secretariat

Office of the Treasury Board
Office of the Provincial Controller Division
Accounting Policy & Financial Reporting Branch
Frost Building South, 2nd Floor
7 Queen's Park Crescent
Toronto ON M7A 1Y7
Tel. (416) 325-8027

Secrétariat du Conseil du Trésor

Bureau du Conseil du Trésor
Bureau du contrôleur provincial
Direction de la méthode comptable et des rapports financiers
Édifice Frost Sud, 2e étage
7 Queen's Park Cr.
Toronto ON M7A 1Y7
Téléphone: 416-325-8027

Ontario

December 1, 2017

Ms. Anna Pesme
Ernst & Young LLP
222 Bay Street
Toronto ON
M5K 1J7

Ms. Pesme

RE: RFS-TBS-OTB-OPCD-22

The Ministry is pleased to advise that you are the selected proponent pursuant to the above-noted procurement process.

Enclosed please find two (2) copies of the Agreement for your signature. Please return one copy of the executed Agreement within five (5) business days of receipt of this notice.

Please be advised that this notice of selection letter should not be construed as permission from the Ministry to begin the work detailed in the Agreement. The Ministry will not be responsible or liable for any expenses related to the Deliverables, and the selected proponent is not to accept work requests prior to the execution of the Agreement by the Ministry. Work may begin pursuant to the Agreement when:

(a) the Agreement signed by both parties is returned to the selected proponent, and

(b) written permission is expressly given to the Supplier by the Ministry Representative to begin work under the Agreement.

If you have any questions concerning this process, please feel free to contact me at 416-325-8027.

Sincerely,

Mark Donaldson
Director, Accounting Policy and Financial Reporting Branch
Office of the Provincial Controller Division

FORM OF STATEMENT OF WORK – OPS ENTITY

Statement of Work for Management Consulting Services

This statement of Work No. **RFS-TBS-OTB-OPCD-22** made in **duplicate and effective December 11, 2017 ending on June 15, 2019.**

Ernst & Young LLP (the "vendor" or "EY") and her Majesty the Queen in right of Ontario as represented by the President of the Treasury Board (the "Client") enter into this Statement of Work pursuant to the Master Agreement for Management Consulting Services made as of June 16, 2014 between the Vendor and Her Majesty the Queen in Right of Ontario as represented by the Minister of Government and Consumer Services (such Master Agreement, as from time to time amended, is referred to as the "Master Agreement").

In consideration of their respective agreements set out below, the parties agree as follows:

1. *Structure* – The terms and conditions of the Master Agreement are hereby incorporated by reference in this Statement of Work to the same effect as if fully set out in this Statement of Work. This document and the Master Agreement together comprise a separate Statement of Work between the Vendor and the Client. All capitalized terms used in this Statement of Work without definition have the meanings ascribed to them in the Master Agreement. In the event of any conflict or inconsistency between any term or provision of this Statement of Work and any term of provision of the Master Agreement, the terms and provisions of the Master Agreement shall govern.

2. *Statement of Work* – The Vendor agrees to provide to the Client, and the Client agrees to acquire from the Vendor, the Services and Deliverables described in this Statement of Work upon and subject to the terms of this Statement of Work.

3. *Maximum Price* - C$75,000.00 does not include HST.

4. *Project Start Date* – December 11, 2017

5. *Project End Date* – June 15, 2019

6. *Scope of Services and Deliverables* – The Services and Deliverables to be provided by the Vendor under this Statement of Work include the following:

   - Working with management of the Office of the Provincial Controller's Accounting Policy and Financial Reporting Branch (APFRB), the provider will provide actuarial/accounting services related to the following possible areas:
     - Review the economic assumptions (i.e. management best estimates) used for the accounting valuations of the pension plans and non-pension benefits reported by the Province.
     - Review the actual and forecast numbers prepared by APFR staffs for the Province's various pension and non-pension benefits, including assessing the reasonableness

and completeness of assumptions used by APFRB staff in the models, including any sensitivity analysis as required.
  - From time to time provide recommendations, if any on improvements in the pension and non-pension benefits accounting models.
  - Perform ceiling test requirements in accordance with PS3250.50 to PS3250.59 for all sole sponsor or joint sponsor pension plans that are in an accrued benefit asset position.
  - Provide advice on any accounting issues related to pension and non-pension benefits, as required.
  - Participate in discussions with internal and external stakeholders, as required.

- The Vendor will participate in meetings as necessary to support the engagement objectives.

7. *Ownership and Licenses* – Attachment D of the Master Agreement forms a part of this Statement of Work.

8. *Communications and Reporting* – The structure of Ernst & Young's working relationship with OPCD is vital to the success of their engagement. The Project Lead that will handle OPCD work is Uros Karadzic. Ernst & Yong's communication strategy will be centered on periodic project update meetings, the frequency of which will be determined by the OPCD and Ernst & Young.

9. *Work Location* – All meetings will be within Greater Toronto.

10. *Working Hours* – The Client's normal working hours are 7.25 hours per day, between 8:30 a.m. to 4:30 p.m. Monday to Friday inclusive.

    If required by the Client, the Vendor must provide Services outside of the normal working hours and/or non-Business days. The Vendor will not be entitled to charge more than the Fixed Price or Per Diem Rate.

11. *Administrative Services and Supplies* – All administrative services and supplies used by the Vendor to complete the Services will be provided to the Client at no additional charge.

12. *Billing and Payment Process* – The Vendor shall provide the Client with quarterly billing statements that outline the per diem charges no later than 10 Business Days after the end of each quarter.

    Billing statements should include all billing information as set out in the Master Agreement.

13. Names of Roles of Vendor's Personnel:

Name of Individual	Level
Uros Karadzic	Senior Consultant/Project Lead
Christina Chan	Intermediate Consultant/Project Analyst

14. *Invoices* – Invoices for payment of any charges under this Statement of Work shall be sent to:

Client: Treasury Board Secretariat
Office of the Provincial Controller
Accounting Policy and Financial Reporting Branch
Mark Donaldson
Director, Accounting and Policy Reporting
Tel: 416 325 8027
E mail: mark.donaldson@ontario.ca

15. *Knowledge Transfer* – The Vendor will work closely with the Client to ensure knowledge transfer to the Client's designated staff, and as necessary with the Auditor General.

16. *Destruction of Information* – The Vendor shall destroy all information contained on any media that was provided by the Client or at the direction of the Client, if requested to do so by the Client, except as required to be retained in accordance with professional standards requirements. The Client may choose to witness this destruction. The Vendor shall provide a certificate of destruction to the Client, if requested to do so by the Client.

17. *Indemnity* – the indemnity set out in the Master Agreement applies to this assignment.

18. *Client Representative and Receipt of Notices*

Client's address for receipt of notices:	Treasury Board Secretariat
Client Representative:	Mark Donaldson
Telephone Number:	416 325 8027
E-mail:	mark.donaldson@ontario.ca

19. *Vendor Representative and Receipt of Notices*

Uros Karadzic, Partner
Ernst & Young LLP
Ernst & Young Tower
P O Box 251
222 Bay Street
Toronto ON M5K 1J7

IN WITNESS WHEREOF the parties hereto have executed this Statement of Work as of the date first above written.

Her Majesty the Queen in right of Ontario as represented by the President of the Treasury Board

Per:

Signature:

Name: Mark Donaldson

Title: Director, Accounting Policy and Financial Reporting

Pursuant to delegated authority

Per:

Signature:

Name: UROS KARADZIC

Title: PARTNER

I have the authority to bind the Vendor

Statement of Work_PwC_2014.pdf

(2)

Statement of Work for Management Consulting Services

This Statement of Work no. **OPCD-17- made in duplicate and effective.**

PricewaterhouseCoopers LLP (the "Vendor") and Her Majesty the Queen in right of Ontario as represented by the President of Treasury Board (the "Client") enter into this Statement of Work pursuant to the Master Agreement for Management Consulting Services made as of June 16, 2014 between the Vendor and Her Majesty the Queen in Right of Ontario as represented by the Minister of Government and Consumer Services (such Master Agreement, as from time to time amended, is referred to as the "Master Agreement").

In consideration of their respective agreements set out below, the parties agree as follows:

1. *Structure* - The terms and conditions of the Master Agreement are hereby incorporated by reference in this Statement of Work to the same effect as if fully set out in this Statement of Work. This document and the Master Agreement together comprise a separate Statement of Work between the Vendor and the Client. All capitalized terms used in this Statement of Work without definition have the meanings ascribed to them in the Master Agreement. In the event of any conflict or inconsistency between any term or provision of this Statement of Work and any term or provision of the Master Agreement, the terms and provisions of the Master Agreement shall govern.

2. *Statement of Work* - The Vendor agrees to provide to the Client, and the Client agrees to acquire from the Vendor, the Services and Deliverables described in this Statement of Work upon and subject to the terms of this Statement of Work.

3. *Maximum Price:* C$ 65,000.00, not including HST. The Maximum Price reflects: (1) the Fixed Price of $40,000.00 (which includes a total of 25 consultant work days); plus (2) the amount for any consultant work days exceeding 25, which additional consultant work days will be charged on a Per Diem basis at a rate of $1,600 per day per consultant

4. *Project Start Date:* December 5, 2016

5. *Project End Date:* July 30, 2017 *Scope of Services and Deliverables* - The Services and Deliverables to be provided by the Vendor under this Statement of Work include the following:

   Background

   During the 2015/16 Public Accounts audit, the Auditor General raised questions regarding the Province's historical accounting treatment for pension assets for jointly sponsored pension plans. The Office of the Provincial Controller and the Auditor General did not reach agreement on the appropriate interpretation of public sector accounting standards (PSAS) for purposes of the 2015/16 audit. A Panel has been put in place to assess the interpretation of PSAS standards in relation to the Province's joint defined benefit plans. The results of the Panel are expected to be received by the end of the calendar year and will be considered as part of the upcoming Budget process.

   The Panel will need to consider various aspects of the pension agreements and relationships, as well as applicable references of PSAS in conducting its assessment. In addition, the Panel may require interviews or supplementary information to further their understanding of the issue. Given the complexity of the undertaking and the short time frame over which the Panel is expected to complete its analysis, the services of a consultant have been requested by the Chair of the Panel. The Chair has requested that the consultant should be well versed in the applicable PSAS standards and knowledgeable on relevant aspects of the Ontario Teachers' Pension Plan to most effectively support the Panel in documenting its position and recommendations.

Description of Services and Deliverables

Reporting directly to the Pension Asset Expert Advisory Panel ("Panel"), the consultant(s) assigned to this engagement will provide support to the Panel through assistance in synthesizing and documenting the Panel's discussion/position on the pension asset accounting issue raised during the 2015/16 Public Accounts, including assistance in documenting the Panel's recommendations. The engagement may also include working with TBS Communications in providing input to the development of a summary document which would be made publicly available. The individual(s) may also be requested to support the Panel in discussions with other parties, including external stakeholders in documenting input as part of the Panel's process.

The performance of the Services does not constitute an engagement to provide audit, compilation, review or attest services in accordance with professional standards issued by the Chartered Professional Accountants of Canada ("CPA Canada") and, therefore, PwC will not express an opinion or any other form of assurance with respect to any matters. All recommendations and final conclusions reached in connection with this engagement will be the responsibility of the Panel. PwC will not perform any management functions, make management decisions, or perform in a capacity equivalent to that of an employee of the Client or member of the Panel.

Contingency Plan – The Vendor's proposed contingency plan in the case that unforeseen circumstances arise during the engagement timeline is as follows:

- Should scheduling issues arise, the Vendor will work with the Client to coordinate alternate solutions (calls, status updates, etc.).
- In the case that resources change on the part of either the Vendor or the Client (and/or relevant stakeholders)
    - In the former case, the Vendor will work with the Client to identify a suitable replacement in an expedited manner
    - In the latter case, the Vendor will escalate the issue to the Client representative in an attempt to identify a suitable Client/stakeholder replacement.

The Vendor will work with the Panel and potentially other stakeholders to facilitate the Panel's work over the planned period ending July 30, 2017.

Fixed Price and Additional Work Days (Per Diem Rate)
The Fixed Price identified in Section 3 (Maximum Price) above includes a total of 25 consultant work days. The Vendor shall notify the Client when the number of consultant working days exceeds 20 consultant days. In the event the Client or the Panel requests more than 25 consultant work days, the Client shall notify the Vendor and any additional work days requested will be charged on a Per Diem Rate basis at a rate of $1,600.00 per work day per consultant.

6. *Ownership and Licences* - **Attachment E** of the Master Agreement forms a part of this Statement of Work.

Without limiting the generality of the foregoing, everything produced or prepared by the Vendor under this Statement of Work for or on behalf of the Panel or the Client is OPS Confidential Information and shall be owned by the Client. The Vendor agrees that it shall not prohibit, prevent or delay the use (including any modification, translation or reproduction) or disclosure of anything prepared by the Vendor under this Statement of Work for or on behalf of the Panel or the Client, including the requirement to provide advance notice or to pay additional fees. For certainty, the Vendor agrees that everything produced or prepared by the Vendor may be made available to third parties (including to the Auditor General of Ontario, other advisors of the Panel or Client, or to the public). The Client and the Panel may, at its option, but is not required to, refer to the Vendor and any of the Vendor's personnel when making anything produced or prepared by the Vendor available to any third party. References to the Vendor and any of the Vendor's personnel will appropriately reflect the nature of the services provided by the Vendor and any of the Vendor's personnel pursuant to Section 5 above.

7. *Communications and Reporting* - The structure of the Vendor's working relationship with the Panel is vital to the success of their engagement. The Vendor's main point of contact will be Michael Hawtin who is the engagement leader. Lucy Durocher will be the individual consultant assigned to assist the Panel. Lucy Durocher may be assisted by other of the Vendor's staff throughout the engagement.

8. *Work Location* - All meetings will be within Greater Toronto Area.

9. *Working Hours* – The Client's normal working hours are 7.25 hours per day, between 8:15 a.m. to 4:30 p.m. Monday to Friday inclusive.

   If required by the Client, the Vendor must provide Services outside of the normal working hours and/or on non-Business days. The Vendor will not be entitled to charge more than the Fixed Price or Per Diem Rate

10. *Administrative Services and Supplies* – All administrative services and supplies used by the Vendor to complete the Services will be provided to the Client at no additional charge.

11. *Billing and Payment Process* –

   "The Vendor shall provide billing statements periodically through the term of the assignment, which billing statements should include a detailed breakdown of the consultant days worked during the period covered by the billing statement with a short description of the nature of the work performed.

   In the event the Client requests additional consultant working days exceeding the number included in the Fixed Price, the Vendor shall provide the Client with timely billing statements that include a detailed breakdown of the additional consultant work days worked, as communicated by the Vendor to the Director of Accounting Policy and Financial Reporting, Office of the Provincial Controller Division.

   Billing statements should include all billing information as set out in the Master Agreement.

12. *Names and Roles of Vendor's Personnel:*

Individual's Legal Name	Individual's Role and Experience Level	Service Category
Michael Hawtin	Project Manager/Lead, Level 2	
Lucy Durocher	Strategic Advisor, Level 2	
Mandy Tam	Strategic Advisor, Level 1	

13. **Billing Statements** – Billing statements for payment of any charges under this Statement of Work shall be sent to:

Client:	Treasury Board Secretariat, Office of the Provincial Controller Division
Branch:	Accounting Policy and Financial Reporting
Representative:	Nadine Petsche
Title:	Director, Accounting Policy and Financial Reporting
Phone number:	416-325-8027
Email:	Nadine.petsche@ontario.ca

14. *Knowledge Transfer:* The Vendor will work closely with the Client to ensure knowledge transfer to the Clients designated staff, and as necessary with the Auditor General.

15. *Destruction of Information* - The Vendor shall destroy all information contained on any media that was provided by the Client or at the direction of the Client, if requested to do so by the Client, except as required to be retained in accordance with professional standards requirements. The Client may choose to witness this destruction. The Vendor shall provide a certificate of destruction to the Client, if requested to do so by the Client.

16. *Indemnity* – The Client agrees to indemnify and hold the Vendor and their personnel harmless from and against any and all third party claims, losses, liabilities and damages arising from or relating to the services or deliverables under this Agreement, except to the extent finally determined to have resulted from the Vendor's gross negligence or intentional misconduct relating to such services and/or deliverables. Additionally, the indemnity set out in the Master Agreement applies to this Assignment.

17. *Client Representative and Receipt of Notices*

Client's address for receipt of notices:	**Treasury Board Secretariat**
Client Representative:	**Nadine Petsche**
Telephone number:	**416-325-8027**
E-mail:	**Nadine.petsche@ontario.ca**

18. *Vendor Representative and Receipt of Notices*

Vendor's address for receipt of notices:	**PricewaterhouseCoopers LLP.**
Vendor Representative:	**Michael Hawtin**
Telephone number:	**416 815 5003**
E-mail:	**Michael.hawtin@ca.pwc.com**

IN WITNESS WHEREOF the parties hereto have executed this Statement of Work as of the date first above written.

Her Majesty the Queen in right of Ontario, as represented by the President of Treasury Board

Per:

Signature: N. Petsche

Name: Nadine Petsche

Title: Director, Accounting Policy + Financial Reporting

Pursuant to delegated authority.

PRICEWATERHOUSECOOPERS LLP

Per:

Signature: MH

Name: Michael Hawton

Title: Partner

I have the authority to bind the Vendor.

Statement of Work_PwC_2016.pdf

Statement of Work for Management Consulting Services

This Statement of Work no. **OPCD-PWC-01** is made in duplicate and effective September 16, 2016.

PricewaterhouseCoopers LLP (the "Vendor" or "PwC") and Her Majesty the Queen in right of Ontario as represented by the President of the Treasury Board (the "Client" or the "Province") enter into this Statement of Work pursuant to the Master Agreement for Management Consulting Services made as of March 22, 2016 between the Vendor and Her Majesty the Queen in Right of Ontario as represented by the Minister of Government and Consumer Services (such Master Agreement, as from time to time amended, is referred to as the "Master Agreement").

In consideration of their respective agreements set out below, the parties agree as follows:

1. *Structure* - The terms and conditions of the Master Agreement are hereby incorporated by reference in this Statement of Work to the same effect as if fully set out in this Statement of Work. This document and the Master Agreement together comprise a separate Statement of Work between the Vendor and the Client. All capitalized terms used in this Statement of Work without definition have the meanings ascribed to them in the Master Agreement. In the event of any conflict or inconsistency between any term or provision of this Statement of Work and any term or provision of the Master Agreement, the terms and provisions of the Master Agreement shall govern.

2. *Statement of Work* - The Vendor agrees to provide to the Client, and the Client agrees to acquire from the Vendor, the Services and Deliverables described in this Statement of Work upon and subject to the terms of this Statement of Work.

3. *Maximum Price:* C$100,000.00, excluding HST.

4. *Project Start Date:* September 16, 2016.

5. *Project End Date:* December 31, 2016.

6. *Scope of Services and Deliverables* - The Services and Deliverables to be provided by the Vendor under this Statement of Work include the following:

   The Vendor shall provide accounting advice (the "accounting advisory services") regarding the acceptability of the Province's accounting treatment and measurement of pension assets for jointly-sponsored pension plans on the consolidated financial statements of the Province prepared under Public Sector Accounting Standards. The accounting advice may include:

   - Review of background information, position papers developed by the Client or third parties that have been engaged by the Client to draft accounting positions on accounting for the recognition and measurement of pension assets for jointly-sponsored pension plans, and other supporting information.
   - Provide written or oral comments on draft position papers as provided by the Client with respect to the application of Canadian Public Sector Accounting Standards.
   - Participation in discussions with internal and external stakeholders and other parties as directed by the Client.

   During the course of this project, the Client will provide to PwC a written statement of all relevant facts and assumptions, and a description of the circumstances and the nature of any relevant disagreements with the Client's auditor. If an accounting opinion is to be provided, the Client's auditor will confirm to us in writing that the information the Client has provided to PwC is complete and consistent with their knowledge of the facts and circumstances of the specific transaction.

If requested to by the Client during the course of the project, the Vendor shall provide an accounting opinion (the "accounting opinion"), prepared in accordance with Section 7600, *Reports on the application of accounting principles* of the CPA Canada Handbook – Assurance ("Section 7600"), regarding the appropriateness of the Province's accounting treatment and measurement of pension assets for jointly-sponsored pension plans on the consolidated financial statements of the Province prepared under Public Sector Accounting Standards.

Vendor may be required to participate in meetings with the Client and other stakeholders, and to support the Client with respect to the Vendor's accounting advice or accounting opinion (if applicable), including discussions with the Office of the Auditor General.

The Client agrees that any accounting advisory services are solely for the information and use of the Client. Subject to the obligations in Article 27 (Privacy) of the Master Agreement and as required by law by the Client's independent auditors, the Client agrees that any written work product of PwC will not be made available to any other persons or entities. An accounting opinion prepared in accordance with Section 7600 will, in compliance with Canadian GAAS, include restriction of use language identifying the parties to whom use is restricted and a statement that the report is not intended to be and should not be used by anyone other than the specified parties or for any other purposes. However the Client may provide access to PwC's observations and an accounting opinion prepared under Section 7600 (if applicable) to the Client's independent auditors solely for their informational purposes. Except as provided for in the preceding sentence, the Client agrees to seek and obtain the Vendor's written consent before including our accounting opinion (if applicable) or referring to the Vendor in any document disclosed to third parties, including disclosure of a summary of the accounting opinion or publication of the opinion in documentation that may be accessible to or intended for the public. The Vendor may, in their own discretion, waive the requirement to obtain written consent. The Client agrees that prior to or as part of providing their independent auditors with any written work product of PwC, including an accounting opinion prepared under Section 7600, the Client will notify its independent auditors that it is PwC's desire to be notified of, and to consent to, the disclosure of any PwC written work product or reference to any PWC work product in any materials to be disclosed to third parties. PwC agrees that the Client's obligation is only to notify its independent auditors of PwC's desire to be notified about, and to consent to, disclosure, and that the Client is not making any representation or warranty that its independent auditors will notify PwC or seek PwC's consent.

Acknowledgements and agreements

The Client acknowledges and agrees to the following:

a. The performance of the accounting advisory services does not constitute an engagement to provide audit, compilation, review or attest services in accordance with professional standards issued by the Chartered Professional Accountants of Canada ("CPA Canada") and, therefore, PwC will not express an opinion or any other form of assurance with respect to the accounting advisory services.
b. The accounting advisory services and accounting opinion (if applicable) to be provided do not include the delivery of any verbal or written advice on the application of accounting principles to a hypothetical transaction.
c. This engagement cannot be relied on to disclose internal control deficiencies, errors or fraud, should they exist.

d. PwC has no responsibility for updating the accounting advisory services or accounting opinion or for performing any additional services, except as agreed to in writing with the Client.
e. The Client's purpose for engaging PwC to perform the accounting advisory services is to supplement management's own technical accounting resources in performing accounting analysis and to assist management in making its determination as to the application of accounting principles and not to obtain an opinion from PwC as to such application, unless an accounting opinion is requested by the Client.
f. The Client shall be solely responsible for, among other things: (a) making all management decisions and performing all management functions; (b) designating one or more individuals who possess suitable skill, knowledge and/or experience, preferably within senior management to oversee the accounting advisory services (c) evaluating the adequacy and results of the accounting advisory services; (d) accepting responsibility for the results of the accounting advisory services; and (e) establishing and maintaining internal controls, including, without limitation, monitoring ongoing activities.
g. All management decisions and final conclusions reached in connection with the accounting advisory services will be the responsibility of the Client. PwC will not perform any management functions, make management decisions, or perform in a capacity equivalent to that of an employee of the Client.
h. PwC has no responsibility related to the Client's accounting or disclosure conclusions, whether or not such conclusions of the Client are related to the accounting advisory services and PwC has no responsibility for any disagreements between the Client and its independent auditor related to the Client's accounting.
i. The Client will be solely responsible for all decisions regarding the accounting treatment of any item or transaction and acknowledges that the accounting advisory services do not include the recording of any amounts in the Client's books or records. All amounts derived from the performance of the accounting advisory services will be reviewed and approved by, and will be the responsibility of, the Client's management.
j. The nature, scope and design of the accounting advisory services and the accounting opinion are solely the responsibility of the Client. PwC will rely, without independent verification, on the facts, information and assumptions provided by the Client. PwC will make no representation nor provide any assurance with respect to the adequacy of the services for the Client's purposes. Furthermore, PwC has no responsibility to advise the Client of other procedures that might be performed.
k. The Client will be solely responsible for providing accurate and complete information requested by PwC. PwC has no responsibility for the accuracy or completeness of the information provided by or on behalf of the client.
l. PwC's accounting and technical assistance will be based on the existing public sector generally accepted accounting principles. Should those generally accepted accounting principles be amended, superseded or revised in any manner, PwC's advice might change. PwC has no responsibility to inform the Client of any changes in generally accepted accounting principles that may occur after the completion of the engagement or any other oral or written work product prepared hereunder that would impact PwC's advice on the appropriate application of generally accepted accounting principles or to update its recommendations or any other oral or written work produce to take any such changes into account.
m. This engagement does not create a relationship between PwC and any person or party other than the Client. This engagement is not intended for the express of implied benefit of any third party.

n. The Client will identify an appropriate individual to serve as the project manager, including overseeing the accounting advisory services.

7. *Ownership and Licences* - **Attachment D** of the Master Agreement forms a part of this Statement of Work.

8. *Communications and Reporting* - The structure of Vendor's working relationship with OPCD is vital to the success of their engagement. Vendor's main point of contact will be Lucy Durocher who is the engagement leader.

9. *Work Location* - All meetings will be within the Greater Toronto Area.

10. *Working Hours* – The Client's normal working hours are 7.25 hours per day, between 8:15 a.m. to 4:30 p.m. Monday to Friday inclusive. If required by the Client, the Vendor must provide Services outside of the normal working hours and/or on non-Business days. The Vendor will not be entitled to charge more than the Per Diem Rate.

11. *Administrative Services and Supplies* – All administrative services and supplies used by the Vendor to complete the Services will be provided to the Client at no additional charge.

12. *Charges On Per Diem Rate Basis*– The Vendor and the Client agree that Work performed under this Statement of Work will be charged on a Per Diem Rate basis. The Per Diem Rate will vary, based on the nature of the final deliverable, as follows:

Nature of final deliverable	Per Diem Rate	Service Category	Estimated hours	Per Diem Rate
Accounting Advisory	General Consultant, Level 2	Service Category 2	20-25	$390/hour
Accounting Opinion	General Consultant, Level 2	Service Category 2	30-35	$990/hour

13. *Billing and Payment Process* – The Vendor shall invoice the Client in accordance with the requirements of the Master Agreement. Billing statements should include all billing information as set out in the Master Agreement.

13. *Names and Roles of Vendor's Personnel:*

Individual's Legal Name	Individual's Role and Experience Level	Service Category	Per Diem Rate
Lucy Durocher	General Consultant, Level 2	Service Category 2	See "charges on a per diem rate basis"
Martin Boucher	General Consultant, Level 2	Service Category 2	See "charges on a per diem rate basis"
Sean Cable (or alternative as agreed to by the Client)	Quality reviewer, Level 2	Service Category 2	See "charges on a per diem rate basis"
Michael Walke	Quality reviewer, Level 2	Service Category 2	See "charges on a per diem rate basis"

14. **Invoices** - Invoices for payment of any charges under this Statement of Work shall be sent to:

Client.	Treasury Board Secretariat, Office of the Provincial Controller Division
Branch.	Accounting Policy and Financial Reporting

Representative:	Nadine Petsche
Title:	Director, Accounting Policy and Financial Reporting
Phone number:	416-325-8027
Email:	Nadine.petsche@ontario.ca

15. *Knowledge Transfer:* The Vendor will work closely with the Client to ensure knowledge transfer to the Clients designated staff, and as necessary with the Auditor General.

16. *Destruction of Information* - The Vendor shall destroy all Confidential information contained on any media that was provided by the Client or at the direction of the Client, if requested to do so by the Client, except as required to be retained in accordance with professional standards requirements. The Client may choose to witness this destruction. The Vendor shall provide a certificate of destruction to the Client, if requested to do so by the Client.

17. *Client Representative and Receipt of Notices*

Client's address for receipt of notices:	**Treasury Board Secretariat**
Client Representative:	**Nadine Petsche**
Telephone number:	**416-325-8027**
E-mail:	**Nadine.petsche@ontario.ca**

18. *Vendor Representative and Receipt of Notices*

Vendor's address for receipt of notices:	**PricewaterhouseCoopers LLP, PwC Tower, 18 York Street, Suite 2600, Toronto ON M5J 0B2**
Vendor Representative:	**Lucy Durocher**
Telephone number:	**416-869-2311**
E-mail:	**Lucy.durocher@ca.pwc.com**
Backup Vendor Representative:	**Martin Boucher**
Telephone number:	**514-205-5415**
E-mail:	**Martin.boucher@ca.pwc.com**

IN WITNESS WHEREOF the parties hereto have executed this Statement of Work as of the date first above written.

HER MAJESTY THE QUEEN IN RIGHT OF ONTARIO, as represented by The President of the Treasury Board

Per:

Signature: N. Petsche

Name: Nadine Petsche

Title: Director, Accounting Policy & Financial Reporting

Pursuant to delegated authority.

PRICEWATERHOUSECOOPERS LLP

Per:

Signature: PricewaterhouseCoopers LLP

Name: LUCY. DURCCHER

Title: PARTNER

I have the authority to bind the Vendor.

Treasury Board Secretariat 7600 Opinion and OTPP Asset Ceiling Document.pdf

Deloitte LLP
Bay Adelaide East
8 Adelaide Street West
Suite 200
Toronto ON M5H 0A9
Canada

Tel: +14167757183
Fax: +14166016610
www.deloitte.ca

July 26, 2018

Deloitte LLP ("Deloitte") was engaged to provide an opinion ("Deloitte Opinion") on the application of accounting standards by the Ontario Treasury Board Secretariat. Our opinion, which was issued on October 2, 2016 and is attached hereto, was prepared under professional standards for such reports.

The Deloitte Opinion addressed the question of whether it was possible to record a pension asset related to the plan surplus in the Province's financial statements, given that the plan is jointly sponsored. We concluded that, based on the information provided to us by the Province and our professional judgement, that it was permissible under PSAS to record a pension plan asset, even though the Province's ability to benefit from any plan surplus, through future contribution reductions for example, would need to be negotiated with and agreed between the Province and OTF.

It is to be noted that even if a pension asset is recorded, PSAS would also require that consideration should be given to limiting the recorded amount of this pension asset to an amount that would be less than the calculated amount of the pension surplus. The Deloitte Opinion did not express a view on whether any limit to the recorded amount of the asset is needed in the case of the Province's accounting for the pension asset related to OTPP. Therefore, our Opinion did not express a view on the amount of the pension asset that should be recorded in the Province's financial statements as at March 31, 2016 or at any other date.

Furthermore, the Deloitte Opinion references an earlier engagement report dated August 18, 2016 (the "Report") entitled "Asset Ceiling Calculations for the Ontario Teacher's Pension Plan" which was prepared in conjunction with management. The Report is also attached hereto. The Report was used by management as part of their analysis to determine that no valuation allowance was required against their Pension Asset as at March 31, 2016. The Report was prepared solely to assist management in preparing their own analysis. We were not engaged to and the Report did not express an opinion on the amount of or need for any valuation allowance. Reference to the Report in the Deloitte Opinion should in no way be construed to be an opinion on that earlier report.

Deloitte.

Deloitte LLP
Bay Adelaide East
22 Adelaide Street West
Suite 200
Toronto ON M5H 0A9
Canada

Tel: 416-601-6150
Fax: 416-601-6151
www.deloitte.ca

October 2, 2016

Private and confidential

Ms. Karen Hughes
Associate Deputy Minister,
Treasury Board Secretariat,
7 Queen's Park Crescent
Toronto ON M7A 1Y7

Dear Ms. Hughes:

We have been engaged to report on the appropriate application of certain aspects of Canadian public sector accounting standards to the recognition of the accrued benefit asset (also referred to in this report as the Pension Asset or the Asset) related to the Ontario Teachers' Pension Plan (OTPP the Plan) in the Province of Ontario's (also referred to as the Province or the Government of Ontario in this report) accounts as at March 31, 2016. This report is being issued to the Associate Deputy Minister of the Treasury Board Secretariat of the Government of Ontario. Our engagement has been conducted in accordance with Canadian generally accepted standards for such engagements**.**

It should be noted that the responsibility for the proper accounting treatment rests with the preparers of the financial statements, who should consult with their incumbent auditor. Our judgment on the appropriate application of Canadian public sector accounting standards for the specific issue being discussed is based on the facts, circumstances and assumptions provided to us. Should the facts, circumstances or assumptions differ, our conclusion may change.

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.

Statement of facts and assumptions (continued)
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.

Statement of facts and assumptions (continued)

- 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 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 make 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.

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[1] Partners' Agreement, section 110.

Relevant extracts from the Partners' Agreement (continued)
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.

Relevant extracts from the FMP (continued)
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.

Application of accounting principles
Specifically, our report addresses the following questions:

1. Is it necessary for a government to have a legally enforceable right to reduce future contributions in order to recognize a Pension Asset under PS 3250?

2. What is the role of legal uncertainty in assessing the government's expectation of future benefit from a Pension Asset?

Our views in this report are confined to these two questions and do not extend to any earlier reports provided by Deloitte or to any other analysis that may have been presented in draft or in any other manner.

Authoritative literature
In our analysis, we considered the pronouncements and guidance in Section 3250 of the CPA Public Sector Accounting Standards Handbook. What we considered to be the most relevant passages from PS 3250 are reproduced below:

> **The objectives of funding and accounting**
>
> .008 Determining whether a retirement benefit plan should be funded and the amount to be funded each period is a financial management matter. The funding objective is to determine an acceptable policy for financing the estimated ultimate cost of a benefit plan. An actuarial valuation for funding purposes is performed to calculate the contributions required to secure the benefits promised.
>
> .009 The accounting objective is to measure and report the obligation for employee retirement benefits and to attribute the costs of those benefits to the periods in which the related services are rendered. To meet that objective, a method is needed to determine the amount of the obligation for retirement benefits outstanding, which represents the liability at the financial statement date, and the value of the benefits employees earned during the period, which represents the expense of that period. Accordingly, it is necessary to develop accounting estimates of liabilities for retirement benefits and expenses using an actuarial cost method and actuarial assumptions that ensure essential information required for fair presentation of financial condition and results of operations can be reported in government financial statements.

Authoritative literature (continued)

.010 Because the objectives of determining the most appropriate funding policy are not necessarily the same as those of determining the most appropriate accounting method, the liability for accounting purposes may not be the same as the amount due but not yet funded at the financial statement date according to the funding plan. In addition, the retirement benefit expense of the period for accounting purposes may not be the same as the contribution computed in the period for funding purposes.

Actuarial assumptions

.042 Actuarial assumptions should be based on the government's best estimates of expected long-term experience and short-term forecasts. [SEPT. 2001]

Joint defined benefit plans

.079 Governments may participate jointly in defined benefit plans where the government shares the risks and rewards jointly with plan participants, represented by a sponsor or sponsors. Joint defined benefit plans are governed by a formal agreement between the sponsors, which establishes that the sponsors have shared control over the plan. A governing board is generally appointed by the joint sponsors with equal representation and a mutually agreed-upon chair.

.080 A government would consider the characteristics of the plan to determine whether it meets the definition of a joint defined benefit plan. In a joint defined benefit plan, funding contributions are shared mutually between the government and the plan members. The sponsors have control over decisions related to the administration of the plan and the level of benefits and contributions on an ongoing basis based on the terms of the contractual agreement. The sponsors share, on an equitable basis, the significant risks associated with the benefit plan. Risk would not be considered to be equitably shared in an arrangement where the government and the joint sponsors fund the plan equally but where the government retains the full risk of the accrued benefit obligation. If the government retains the residual risks it is unlikely that the plan meets the definition of a joint defined benefit plan.

.081 *When a government participates in a joint defined benefit plan, the government's risk is limited to its portion of the plan. The government should account for its portion of the plan in accordance with the standards for defined benefit plans*. [SEPT. 2001]

.082 A government may convert an existing defined benefit plan for which it is the sole sponsor to a joint defined benefit plan where the risks and benefits are shared. When converting to a joint plan, a government would consider whether there are any special accounting issues that arise, including whether the predecessor plan has been settled or partially settled and/or curtailed or partially curtailed. In assessing such issues a government would have regard to its specific circumstances and the terms of the joint defined benefit plan.

Disclosure

.083 The notes and schedules integral to the financial statements would disclose the methods and judgments applied in accounting for accrued benefit obligations and expenses. Full disclosure is particularly important for retirement obligations because the measurements depend heavily upon judgments rather than objective evidence.

Limit on the carrying amount of an accrued benefit asset

.050 *An accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance. When a defined benefit plan gives rise to an accrued benefit asset, a government should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. A change in valuation allowance should be recognized in the statement of operations for the period in which the change occurs.* [SEPT. 2001]

.051 A government with a defined benefit plan may have an accrued benefit asset for accounting purposes. An accrued benefit asset arises when the government's total contributions to the plan, including interest earned thereon, are greater than the retirement benefit expense recognized since the start of the plan. Contributions reflect the funding objectives of the plan. The benefit expense reflects the accounting objectives and may differ for a number of reasons, including the fact that actuarial gains and losses are deferred and amortized in future periods.

.052 A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions. The accrued benefit asset may become impaired when there is a plan surplus for accounting purposes that the government is not entitled to benefit from fully. For example, there may be a regulatory moratorium on pension surplus withdrawals or uncertainties as to a government's legal right to use a plan's accounting surplus.

.053 To determine the extent to which an accrued benefit asset may be impaired, the government first determines the adjusted benefit asset . The adjusted benefit asset is the accrued benefit asset less net unamortized actuarial losses (determined on a basis using market value of assets).

.054 The adjusted benefit asset is then compared to the expected future benefit . When the expected future benefit exceeds the adjusted benefit asset, the accrued benefit asset is not impaired and, accordingly, no valuation allowance is required. The chart included as Appendix A to this Section is intended to set out the relationship between the various defined terms.

.055 The objective of the standard in paragraph PS 3250.050 is to limit a government's accrued benefit asset to the amount it can realize in the future. The expected future benefit is a calculated amount representing the benefit a government expects to realize from a plan surplus. An expected future benefit includes any withdrawable surplus or reduction in future contributions.

.056 A government determines its expected future benefit as the sum of:

a) the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and

b) the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

Limit on the carrying amount of an accrued benefit asset (continued)

.057 A government's expected future accruals for service for the current number of active employees are determined on a basis consistent with that used to determine its accrued benefit obligation. These expected future accruals for service, less required employee contributions and minimum contributions the government is required to make regardless of any surplus, are then discounted back to the current period to determine the present value. The interest rate used to calculate this present value is the expected rate of return on plan assets used to determine the benefit expense in the period.

.058 When administration expenses are paid by the plan and included in the normal cost calculation, a best estimate of the future administration expense is included in the expected future accruals for service. When administration expenses are paid by the plan and not included in the normal cost calculation, the rate of return on plan assets is adjusted to reflect the deduction of the administrative expenses.

.059 A key factor in determining a government's expected future benefit from a defined benefit plan with a plan surplus for accounting purposes is the ability of the government to withdraw assets from the plan. The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal. It excludes any withdrawable plan surplus a government is currently required, or intends, to allocate to employees. A government may not anticipate obtaining a legally enforceable right to withdraw a portion of a plan surplus to which it is not currently entitled, whether on the basis of precedent or otherwise. Accordingly, when withdrawal of plan surplus requires the approval of employees or an appropriate regulatory authority or a court of law, a government excludes any amount subject to this restriction from its expected future benefit until such approval has been obtained. A change in the allocation of surplus between a government and its employees is incorporated into the calculation of the expected future benefit only when it has been agreed to and, when required, approved by the appropriate regulatory authorities.

We also considered the following definitions as set out in the glossary of PS 3250:

- An **accrued benefit asset** is the amount of any asset recognized on a government's statement of financial position in respect of employee retirement benefits before deducting any valuation allowance that may be required. It is the sum of the government's accumulated cash contributions less the sum of the current and prior years' benefit expenses (before any change in the valuation allowance).
- The **expected future benefit** is a calculated amount representing the benefit a government expects to realize from a plan surplus. An expected future benefit includes any withdrawable surplus or reduction in future contributions. A government determines its expected future benefit as the sum of:
  (a) the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and
  (b) the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

Limit on the carrying amount of an accrued benefit asset (continued)

- A **joint defined benefit plan** is a contractual arrangement between the government and another sponsor or sponsors representing plan participants that has all of the following characteristics:
  (a) the sponsors co-operate toward achieving the significant clearly defined common goal of providing retirement benefits in exchange for services rendered by the employees;
  (b) funding contributions are shared mutually between the government and the plan members, represented by the non-government sponsor;
  (c) the sponsors share control of decisions related to the administration of the retirement benefit plan and to the level of benefits and contributions on an ongoing basis; and
  (d) the significant risks associated with the retirement benefit plan are shared on an equitable basis between the government and the plan members, represented by the non-government sponsor.

The contractual arrangement establishes that the sponsors have shared control over the retirement benefit plan, and ensures that neither party is in a position to control the plan unilaterally. Nevertheless, overall, there must be an equitable relationship between the funding by the government of the retirement benefit plan, the extent of control it is able to exercise over the plan and the risks and benefits that accrue to the government from the plan.

CONSIDERATION OF QUESTION 1

Application of PS 3250 to Joint Defined Benefit Plans
A joint defined benefit plan is a unique sort of retirement benefit plan where the sponsors have shared control over the plan. As a result, no one party can, by itself, control decisions around funding, benefits and other matters; funding contributions, risks and benefits are to be shared mutually between the sponsors. We would note that paragraph .081 of PS 3250 clearly states that a government should account for its portion of the plan in accordance with the standards for defined benefit plans. As a result, the Province of Ontario accounts for its proportionate share of OTPP and has historically recorded its share as 50% of the plan.

The Province of Ontario’s Public Accounts have included a Pension Asset related to OTPP since fiscal 2001/2002. We have been informed that this situation has arisen because, to this point in time, the government’s share of the total contributions to the Plan plus the actual investment returns on the Plan’s assets have exceeded the government’s share of the accumulated retirement benefit expense. The accounting for the accrued benefit obligation results from a complex process involving significant assumptions and actuarial calculations covering a very long time frame as is required by S 3250. S 3250.51 includes an explicit acknowledgement that the accounting position and funding position can be quite different, as follows: “Contributions reflect the funding objectives of the Plan. The benefit expense reflects the accounting objectives and may differ for a number of reasons.”

The assumptions used in the calculation of the accrued benefit obligation are required to be the “government’s best estimate of expected long-term experience and short-term forecasts” (3250.42) and each key assumption must be based on the government’s best estimate of those future events that have an effect on the accrued benefit obligation (3250.41). This approach is designed to recognize the long-term nature of the retirement promises with appropriate consideration of, but not undue influence of, experience expected in the short-term. 3250.57 requires that the future service cost calculation included in the calculation of the valuation allowance be determined on a consistent basis with that used to determine the accrued benefit obligation itself. The Province of Ontario has determined the discount rate to be used in valuing the pension obligation related to OTPP by referencing the expected rate of return on Plan Assets, which is one of the acceptable references suggested on PS 3250.44. We express no view on the actual rates that were chosen.

Application of the limit on the carrying amount of an accrued benefit asset
PS 3250.50 requires that an accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance. When a defined benefit plan gives rise to an accrued benefit asset, a government should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. This comparison between the adjusted benefit asset and the expected future benefit informs whether a valuation allowance is required and if so, how much of a valuation allowance should be recorded. (It should be noted that "accrued benefit asset" and "adjusted benefit asset" are defined terms used in S. 3250. As at March 31, 2016, in this particular case, management has represented to us that these two amounts are the same.)

PS 3250.52 contemplates that there are two ways in which a government can benefit from an accrued benefit asset. A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions. As such, an expected future benefit would include the ability to either withdraw plan assets from the plan or reduce future contributions.

PS3250.52 also goes on to consider that an accrued benefit asset may become impaired when there is a plan surplus that the government is not entitled to benefit from fully. The paragraphs in the standard that follow determine how a government would go about considering the extent of any impairment, which would give rise to a valuation allowance. In order to make this determination, the government is required to consider the "expected future benefit", which would effectively create a ceiling for the asset. Here the guidance diverges between benefit expected to be realized through future reductions in contributions and those to be realized through withdrawal of surplus.

Specifically with respect to withdrawal of surplus, PS 3250.59 is very clear that expected future benefit can only be asserted where the government has a current legally enforceable right to withdraw assets from the Plan. We considered whether this guidance should be applied to cases where the expected future benefit related to the Pension Asset is expected to be realized through reduced contributions and concluded that the guidance does not apply in this situation; while PS 3250.59 does introduce the concept of a legally enforceable right, it does so solely in the context of a government's future withdrawal of a Plan surplus, and not in the context of a government's reduction of future contributions. We believe it reasonable to conclude that if the standard setters had intended legal enforceability to be the test, they would have included that notion throughout the guidance, instead of only raising it in the context of a withdrawal of surplus. In the situation at hand, the Province is not asserting an expected future benefit based on surplus withdrawal. Instead the Province's position is that the future benefit is expected to be realized through future contribution reductions. Therefore, we do not believe that 3250.59 applies in this case.

Additionally, in forming our view on the application of PS 3250 to Joint Defined Benefit Plans, we noted that there is specific guidance (PS 3250.81) that requires the Government to account for a portion of the Plan in accordance with the standards for defined benefit plans.

For the reasons stated above, we are of the view for Question 1, that legal enforceability of a government's right to access a pension plan surplus through future contribution reductions is not necessary to justify recognition of a Pension Asset. We believe that the guidance in PS 3250 is the primary source of GAAP on this topic and, since it is clear, there is no need to look at any other potential sources of GAAP.

CONSIDERATION OF QUESTION 2

Since we have concluded that legal enforceability is not a necessary requirement to support a government's right to access a pension plan surplus through future contribution reductions, we further considered what role legal considerations should play in the measurement of the Pension Asset. We note that PS 3250.52 requires one to consider "uncertainties as to a government's legal right to use a plan's accounting surplus." Our interpretation of this guidance is that it presents a lower threshold than legal enforceability. Specifically, the amount of Pension Asset that gets recorded needs to be subject to considerations around any legal uncertainties. This consideration will involve significant professional judgment. However, it is our view that uncertainty does not need to be reduced to zero in order to recognize a Pension Asset.

PS 3250.53 to .58 lay out a mathematical calculation that determines the adjusted benefit asset and the expected future benefit, and tests whether a government can expect to recover its accrued benefit asset through a withdrawal of surplus or through the reduction of future contributions. The stated objective of this exercise, as set out in PS3250.055, is to limit the amount of the government's accrued benefit asset to the amount "it can realize in the future." The expected future benefit is further described as "a calculated amount representing the benefit a government expects to realize from a plan surplus", where realization includes a reduction in future contributions. A valuation allowance is recorded against the Pension Asset to limit the asset value, if necessary, based on this analysis.

PS 3250.55 indicates that the expected future benefit is a calculation that represents the benefit a government expects to realize from a plan surplus. This calculation is further described in PS 3250.56(a), which sets out that the government's calculation of expected future benefit would be the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus. Note that in the case at hand, the calculations are done on a 50% basis since the starting point, per PS 3250.81 and as set out in the fact summary above, is that the government accounts for its portion of the Plan. For this same reason, employee contributions are also excluded in this case since they would represent the teachers' portion of the Plan.

PS 3250.55 indicates that the expected future benefit is a calculation that represents the benefit a government expects to realize from a plan surplus. The expected future benefit would operate as a ceiling on the Pension Asset value to be recorded in the accounts. For example, if the Pension Asset were $150, but the expected future benefit calculated as described above were $100, a valuation allowance of $50 would be recorded against the Pension Asset and the asset recorded in the government's financial statements would be reduced to $100.

There are two parts to the calculation of expected future benefit. The first part of the calculation is the sum of the present value of the expected future accruals for service for the current number of active employees. This amount is required to be calculated using consistent assumptions as those used for the calculation of the accrued benefit obligation itself. The second part of the calculation is the present value of required employee contributions and minimum required contributions by the government itself, regardless of any surplus. The main area for judgment in the above calculation is in the determination of future minimum contributions required to be made by the government regardless of any surplus. There is no further guidance in S 3250 as to how this calculation should be performed and what restrictions or parameters should be factored into this calculation.

Determining the number of years of contributions to include should involve consideration of legal uncertainty as set out in PS 3250.52. With respect to this uncertainty, we would observe that there are a number of considerations that may be relevant. As part of this analysis, we reviewed Osler's legal letter of September 20, 2016. That letter makes a number of observations about the Plan agreements and governing documents that we will not reiterate here. Osler's do note that legal enforceability does not exist. However, as noted above we do not believe that legal enforceability is required in this case.

Future reductions in contributions will need to be negotiated and agreed between both sponsors, who are required under the Plan governing documents to bargain in good faith. There are a number of factors to consider and it is possible for reasonable professionals to arrive at different conclusions, even when confronted with the same set of facts and circumstances. These considerations will be highly judgmental.

With respect to these judgments, we offer the following observations. We express no opinion on the completeness of this list of observations or the relative importance of each of these points.

- Plan documents and design contemplates the shared nature of the Plan.
- Section 10 of the Partners agreement require that the partners meet every 3 years to discuss changes to the Plan.
- As described to us by management, there was a long history of sharing surpluses through various mechanisms during the 1990's when funding surpluses were more common. The FMP also contemplates a sharing of surpluses.
- As described to us by management, in addition to the history of surplus utilization noted in the facts and assumptions, it is worth noting that the actions taken around inflation indexation and subsequent restoration of those benefits are a recent example of the sharing philosophy governing operation of the OTPP. Starting in 2011 in response to a deficit situation, it was determined that indexation would be reduced for teachers retiring after 2009. Consistent with the 50/50 approach inherent in the Plan operation, the government agreed to make payments (often referred to as "share the pain" payments) into the Plan that would effectively match the value of benefits foregone by teachers. In 2014, 2015 and 2016, surpluses were used to restore some of the lost indexation. This decision results in a decrease in the Province's "share the pain" payments.
- The FMP explicitly considers the possibility of contribution reductions at different funding levels, although both sponsors need to agree. The OTPP's investment performance has consistently outperformed expectations. If this situation continues the funding surplus can be expected to continue to grow. Modelling could be performed to help estimate when the different funding zones will be reached and probability of contribution reductions may be increased.
- We also note that Canada Revenue Agency establishes limits for pension surpluses. When these limits are breached, steps need to be taken to reduce the surplus. In such a situation, contribution reductions would be one way to reduce the surplus that would need to be negotiated by the parties within their overall framework for negotiation. Again, modelling could be done to develop expectations as to when these CRA limits could be expected to be reached.
- Contributions are generally borne equally by the Province and the teachers. It may be reasonable to presume that teachers will also want to see contribution reductions at some point. Admittedly, increases in benefits could also use any surplus; however, it may be reasonable to expect that the interests of taxpayers and teachers will need to be weighed in the "good faith" bargaining process such that unequal weighting towards increases in benefits may be unlikely.

- In determining the range of possible outcomes, it is noted that measurement uncertainty may exist (PS 2130.03). This paragraph also notes that many items are measured using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned courses of action. As noted in PS 2130.13, "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."

However, application and weighting of these and other considerations is a highly judgmental exercise and it is possible that there is a range of reasonable conclusions that may result in a range of reasonable estimates for the valuation allowance to be taken against the Pension Asset. We are unable to opine on whether a valuation allowance is needed, and if so, what a reasonable range of estimates would be.

Given the complexities and degree of judgment involved in these matters, appropriate disclosure is a matter of significance as is recognized in 3250.83 which states, in part, *"Full disclosure is particularly important for retirement obligations because the measurements depend heavily upon judgments rather than objective evidence"*. This importance is also highlighted in the context of joint benefit plans in 3250.93 which requires that the unique nature and terms of any joint plans be disclosed.

We would also note that Deloitte prepared a report dated August 18, 2016 entitled "Asset Ceiling Calculations for the Ontario Teacher's Pension Plan" in conjunction with management that was used by management as part of their analysis to determine that no valuation allowance was required against their Pension Asset as at March 31, 2016. That report was prepared solely to assist management in preparing their own analysis. We were not engaged to and did not express an opinion on the amount of or need for any valuation allowance, nor do we express an opinion on this analysis at this point. Reference to the August 18, 2016 report in this report should in no way be construed to be an opinion on that earlier report.

The ultimate responsibility for the decision on the appropriate application of Canadian Public Sector Accounting Standards for the specific transaction described above rests with management as preparers of the financial statements, who should consult with the Auditor General of Ontario. Our judgment on the appropriate application of Canadian Public Sector Accounting Standards for the specific situation described above is based on the facts, circumstances and assumptions provided to us. Should the facts, circumstances or assumptions differ, our conclusion may change.

This report is intended solely for the information and use of Ms. Karen Hughes and management of the Government of Ontario and is not intended to be and should not be used by anyone other than the above party and the Auditor General of Ontario or for any other purpose. For further clarity, this report should not be distributed to anyone outside those named in the previous sentence, nor should it be quoted from outside this group for any purpose. Please contact Kerry Danyluk, National Director of Accounting Services, regarding any questions about the content of this report (416 775-7183 or kdanyluk@deloitte.ca).

Yours truly,

Deloitte LLP.

Chartered Professional Accountants
Licensed Public Accountants

Deloitte.

Analysis of Pension Asset Ceiling Accounting Considerations for the Office of the Provincial Controller Division re: Ontario Teachers' Pension Plan (OTPP)

August 19, 2016

Table of contents

Introduction

In preparation of the Province of Ontario Financial statements, the Office of the Provincial Controller Division (OPCD) has retained Deloitte to provide support in analyzing issues around pension accounting. The present document is prepared in relation to the assessment of the application of public sector accounting standards as related to asset ceiling and valuation allowance to the Ontario Teachers' Pension Plan (OTPP).

The relevant accounting standard referenced in our analysis is public sector accounting standard PS3250 on retirement benefits.

The document will cover the following elements:

- Summary of the situation;
- Overview of the accounting paragraphs that apply to this and the explanation;
- Review of the considerations that go into the asset ceiling test and the Expected Future Benefit (EFB) calculation;
- Review of the employer access to future contribution reduction or surplus withdrawal;
- Summary of findings relating to observations made in discussing the applicability of the asset ceiling test for Ontario's 2015-16 Financial statements.

We are available to discuss the content of this document.

Martin Raymond
Partner, FSA, FCIA

Trevor Gary
Senior Consultant

Section 1 – Summary of the situation

The OPCD in preparation of the Ontario Financial statements for 2015-16 has requested support to assess potential asset ceiling risks in relation to the calculation for the OTPP reported on the Province's consolidated financial statements.

Here are a few facts obtained from discussion / documentation around the OTPP and its accounting:

- The plan is covered by its own legislation, the Teachers' Pension Act
- Most recent funding report was prepared at January 1, 2015 with contributions set for 2015, 2016 and 2017
- The OTPP is a Joint Sponsored Pension Plan (JSPP) as per the Ontario Pension Benefit Act (PBA)
- The plan is accounted for using Joint defined accounting provisions of the standards and the government portion of the plan is determined at 50% of the overall plan, this reflects the 50/50 sharing principle underlying the OTPP (per Teachers' Pension Act par. 5 (1.1) and 10 (1) and page 16 of the funding valuation report – extracts provided in Section 4)
- The total accounting service accrual (service cost) is about $2.9B per year calculated in accordance with PSAB (per the Jan. 26, 2016 Mercer letter to OTPP)
- The recent accounting surplus measure (Dec 31, 2015) for the portion of the government (50% of the total plan) is around $20B, using a market-related value of assets (smoothed assets). The surplus using fair value measure of assets is about $28B (per the excel supporting file for accounting calculations received).

We note that the accounting actuarial values are prepared at Dec 31, 2015 and that an adjustment for March 31, 2016 is performed to obtain the year-end values. The balance sheet asset position for the OTPP can be illustrated as follows: (per the excel supporting file for accounting calculations received)

(all figures in $B)	Total plan	50% Share of the plan
Market related value of assets	157.0	78.5
Value of obligation	116.4	58.2
Surplus (deficit)	40.6	20.3
Unamortized (gains) losses	(18.0)	(9.0)
Adjustment for March 31, 2016	(1.8)	(0.9)
Asset (liability) position	20.8	10.4
Specific Government adjustment		(0.3)
Final asset (liability) position on balance sheet		10.1

This document will cover the following key questions:

- What are the key considerations that go into the asset ceiling determination?
- What is the impact of an asset ceiling for 2015-16, if applicable?
- Is there an asset ceiling impact for OTPP as at March 31, 2016 (that would apply to the $10.1B shown above) and if so how is it calculated?

Below is a list of documents and references used in our analysis.

List of documents
Funding management policy (FMP) of OTPP – agreement between the parties to the plan (provided by OPCD)
Asset ceiling documentation prepared by Allan Shapira (Aon) dated August 2, 2016 (provided by OPCD)
Actuarial valuation report of OTPP as at January 1, 2015 – funding purposes – prepared by Mercer (provided by OPCD)
Accounting standards PS3250 on post-employment benefits
Teachers' Pension Act (found on the internet)
Discussions with OPCD and Allan Shapira (incl. overview of some results used in this document) including a summary note prepared by Nadine Petsche, Director of Accounting Policy and Financial Reporting at OPCD (August 4, 2016)
Excel supporting file for accounting calculations (provided by OPCD)
Supporting document from OTPP to OPCD on accounting results, including the communication from Mercer on valuation results for different assumption basis – both documents dated Jan. 26, 2016 (provided by OPCD)

Section 2 – Relevant PS3250 paragraphs

Below are some extracts from the PS3250 which are relevant for calculating the limit on carrying amount of accrued benefit asset (the asset ceiling test) and the joint defined benefit which are relevant to the analysis and position taken for financial statement preparation. Note that the underlined are from us.

Limit on the carrying amount of an accrued benefit asset

.050 *An accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance. When a defined benefit plan gives rise to an accrued benefit asset, a government should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. A change in valuation allowance should be recognized in the statement of operations for the period in which the change occurs.* [SEPT. 2001]

.051 A government with a defined benefit plan may have an accrued benefit asset for accounting purposes. An accrued benefit asset arises when the government's total contributions to the plan, including interest earned thereon, are greater than the retirement benefit expense recognized since the start of the plan. Contributions reflect the funding objectives of the plan. The benefit expense reflects the accounting objectives and may differ for a number of reasons, including the fact that actuarial gains and losses are deferred and amortized in future periods.

.052 A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions. The accrued benefit asset may become impaired when there is a plan surplus for accounting purposes that the government is not entitled to benefit from fully. For example, there may be a regulatory moratorium on pension surplus withdrawals or uncertainties as to a government's legal right to use a plan's accounting surplus.

.053 To determine the extent to which an accrued benefit asset may be impaired, the government first determines the adjusted benefit asset. The adjusted benefit asset is the accrued benefit asset less net unamortized actuarial losses (determined on a basis using market value of assets).

.054 The adjusted benefit asset is then compared to the expected future benefit. When the expected future benefit exceeds the adjusted benefit asset, the accrued benefit asset is not impaired and, accordingly, no valuation allowance is required. The chart included as Appendix A to this Section is intended to set out the relationship between the various defined terms.

.055 The objective of the standard in paragraph PS 3250.050 is to limit a government's accrued benefit asset to the amount it can realize in the future. The expected future benefit is a calculated amount representing the benefit a government expects to realize from a plan surplus. An expected future benefit includes any withdrawable surplus or reduction in future contributions.

.056 A government determines its expected future benefit as the sum of:

a. the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and
b. the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

.057 A government's expected future accruals for service for the current number of active employees are determined on a basis consistent with that used to determine its accrued benefit obligation. These expected future accruals for service, less required employee contributions and minimum contributions the government is required to make regardless of any surplus, are then discounted back to the current period to determine the present value. The interest rate used to calculate this present value is the expected rate of return on plan assets used to determine the benefit expense in the period.

.058 When administration expenses are paid by the plan and included in the normal cost calculation, a best estimate of the future administration expense is included in the expected future accruals for service. When administration expenses are paid by the plan and not included in the normal cost calculation, the rate of return on plan assets is adjusted to reflect the deduction of the administrative expenses.

.059 A key factor in determining a government's expected future benefit from a defined benefit plan with a plan surplus for accounting purposes is the ability of the government to withdraw assets from the plan. The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal. It excludes any withdrawable plan surplus a government is currently required, or intends, to allocate to employees. A government may not anticipate obtaining a legally enforceable right to withdraw a portion of a plan surplus to which it is not currently entitled, whether on the basis of precedent or otherwise. Accordingly, when withdrawal of plan surplus requires the approval of employees or an appropriate regulatory authority or a court of law, a government excludes any amount subject to this restriction from its expected future benefit until such approval has been obtained. A change in the allocation of surplus between a government and its employees is incorporated into the calculation of the expected future benefit only when it has been agreed to and, when required, approved by the appropriate regulatory authorities.

Joint defined benefit plans

.079 Governments may participate jointly in defined benefit plans where the government shares the risks and rewards jointly with plan participants, represented by a sponsor or sponsors. Joint defined benefit plans are governed by a formal agreement between the sponsors, which establishes that the sponsors have shared control over the plan. A governing board is generally appointed by the joint sponsors with equal representation and a mutually agreed-upon chair.

.080 A government would consider the characteristics of the plan to determine whether it meets the definition of a joint defined benefit plan. In a joint defined benefit plan, funding contributions are shared mutually between the government and the plan members. The sponsors have control over decisions related to the administration of the plan and the level of benefits and contributions on an ongoing basis based on the terms of the contractual agreement. The sponsors share, on an equitable basis, the significant risks associated with the benefit plan. Risk would not be considered to be equitably shared in an arrangement where the government and the joint sponsors fund the plan equally but where the government retains the full risk of the accrued benefit obligation. If the government retains the residual risks it is unlikely that the plan meets the definition of a joint defined benefit plan.

.081 *When a government participates in a joint defined benefit plan, the government's risk is limited to its portion of the plan. The government should account for its portion of the plan in accordance with the standards for defined benefit plans.* [SEPT. 2001]

.082 A government may convert an existing defined benefit plan for which it is the sole sponsor to a joint defined benefit plan where the risks and benefits are shared. When converting to a joint plan, a government would consider whether there are any special accounting issues that arise, including whether the predecessor plan has been settled or partially settled and/or curtailed or partially curtailed. In assessing such issues a government would have regard to its specific circumstances and the terms of the joint defined benefit plan.

Section 3 – Asset ceiling test and EFB calculation basis

PS3250.053 refers to the adjusted benefit asset. This is the amount on which the asset ceiling test applies (PS3250.054) by comparing it to the Expected future benefit (EFB). In many cases, we are seeing unamortized losses, and the adjusted benefit asset effectively equals the accounting surplus. However, for the OTPP, as shown in the Section 1, it is unamortized gains which exist rather than losses.

In this situation, if we take the OTPP case, we would have:

- Adjusted benefit asset = accrued benefit asset less unamort. losses = $10.1B - $0.0B = $10.1B
- So the amount to test against EFB would be $10.1B

Further, PS3250.053 refers to market value of assets rather than market-related value of assets that allows for some smoothing of assets gains and losses (which is used under OTPP). Considering that the market value of assets (total plan) is $171.4B at Dec 31, 2015 as per the excel file for accounting calculation and applying the 50% share, we do get $85.7B for the Government share. The difference represents gains on assets not yet reflected in the market-related value of assets and therefore, the unamortized (gains) losses are adjusted accordingly for the test. Making the adjustment for market value measures, we would therefore obtain the following:

(all figures in $B)	50% Share of the plan-market related value	50% Share of the plan market value
Value of assets	78.5	85.7
Value of obligation	58.2	58.2
Surplus (deficit)	20.3	27.5
Unamortized (gains) losses	(9.0)	(16.2)
Adjustment for March 31, 2016	(0.9)	(0.9)
Asset (liability) position	10.4	10.4
Specific Government adjustment	(0.3)	(0.3)
Final Asset (liability) position on balance sheet	10.1	10.1

We note that the end result for the test is still $10.1B adjusted benefit asset on either market-related value or market value. This occurs because the test is showing unamortized gains in both basis. If unamortized losses were present instead, the results of the test would differ.

The above are basic considerations of the asset ceiling test and mostly straight-forward in application. The most challenging part of the asset ceiling test is identifying the basis to value the EFB under PS3250.056. There are various elements to be considered in this calculation that will determine the amount to use. The definition of EFB incorporates key components that need some analysis. The present section deals with these components.

Definition of EFB

.056 A government determines its expected future benefit as the sum of:

a. the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and
b. the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

Key components of the definition are:

- present value calculation
- future service accruals
- current number of active employees
- required employee contributions
- minimum contributions the government is required to make regardless of any surplus
- amount of surplus that can be withdrawn

Current number of employees – Open group notion

Under the definition of the EFB, it is indicated that the present value of future accruals for service is to be based on the current number of active employees. The application of this particular element of the calculation has generally been seen in practice as assuming that the plan would have a perpetuity of future accruals since active employees terminating or retiring would be replaced by new active employees, keeping the number equal to the current population. Unless there is signal or expectation of reduction in population (e.g. if the plan was closed to new entrants or if the employer is going through downsizing), this open group notion has been observed in practice.

Future service accruals - Projection of salary

Under the definition of the EFB, we are performing a present value calculation and therefore this assumes that the underlying components of the calculation are projected into the future (future accruals and contributions). In performing such projection, an increase in salary based on the accounting assumption for salary increase would be applicable.

Present value – discounting effect

Calculation of a present value requires the determination of an interest rate to use. Under PS3250.057, the interest rate used is determined in reference to the expected rate of return on plan assets used to determine the benefit expense.

Future service accruals and required employee contributions - Joint Defined Benefit accounting

Since the OTPP is accounted for based on joint defined benefit provisions of the accounting standards, the asset ceiling test needs to be performed based on the government's portion of the plan (par. PS3250.081). Looking at the EFB definition, it means that the calculation of PS3250.056 a) needs to be adjusted to only reflect the employer share (50% of the total accruals) and to remove any employee contributions that were considered in the calculation (since this relates to the employee portion of the plan).

<u>Observations on PS3250 EFB calculation (in practice)</u>

Deloitte has shared with management that historically there has been in practice a very liberal application of the PS3250 asset ceiling calculation. The EFB has generally been determined as the present value of all future employer service accruals (perpetuity) considering the increase of salary factored into the calculation. This approach is based on View 1 described in the minimum employer contribution required discussion below. One simple way of obtaining that value is based on the following calculation:

- Determine the total accrual for service for one year
- Determine the accrual for service for the employer for one year (i.e. total accrual net of the employee portion)
- Calculate the perpetuity of increasing service cost as follows : accrual of service for employer / (expected return on plan assets – salary increase)
- To illustrate this for OTPP, we did get the following information
  - Total service accrual = $2.9B
  - Employer service accrual (assuming 50% share) = $2.9B / 2 = $1.45B
  - Expected return on plan assets = 6.25% (per the Jan 26, 2016 document and the observed values used in the excel file for accounting calculation)
  - Salary increase = 3% (excluding merit/promotional scale for simplicity - per the Jan 26, 2016 document and the observed values used in the excel file for accounting calculation)
  - Perpetuity = $1.45B / (6.25% - 3%) = $44.6B

<u>Minimum employer contributions required regardless of any surplus – Views for determination in EFB calculation</u>

There has been in recent years more questions around the meaning of the EFB definition and mostly around what the last part of PS3250.056 a) means. The terminology used of “minimum employer contribution required regardless of any surplus” has been discussed and there have been different views on what this represents.

One view (View 1) focus on whether there is a minimum employer contribution under the plan / legislation that is required even if a surplus would be present. For instance, a plan contribution could be defined as always being at least of 5% of salaries. In such circumstances, there would be a contribution requirement to a minimum level for every year even when surplus is present. If no such minimum exists and there is a possibility to get to 0% contribution, for instance in surplus position, then there would be no minimum contribution required “regardless of any surplus”. This view leads to no reduction in the EFB calculation in cases where no minimum % contribution exists in the plan provisions. In the example above, the perpetuity of $44.6B is not reduced and therefore EFB remains at $44.6B.

Another view (View 2) is that minimum required contribution must at least consider the effect of the most recent funding valuation report. This report determines what contribution requirement applies to the current period of the valuation report and until a new report is completed. For instance, if the employer needs to contribute for the next 3 years a certain amount of contribution (service cost and special contribution for deficit), then this represents the minimum required employer contribution regardless of any surplus. As an example, under the most recent funding report of the OTPP (Jan 1, 2015) this amount is about $1.7B per year for 2015, 2016 and 2017 which includes service cost and also special contributions. Contributions from 2018 will be determined based on a new valuation report and therefore are unknown as of now (no minimum required contribution on the valuation date for years beyond 2017). In the example above, the perpetuity of $44.6B is reduced by 2 years of $1.7B (excluding interest for simplicity) for an EFB of $41.2B.

Finally, a more extreme view (View 3) could be to actually prepare detailed future projections of funding valuation results on either a deterministic calculation with identification of the actual year(s) when funding surplus would be present or a stochastic calculation to identify what is the probability of occurrence of funding surplus in future years and the outcome in those cases for contribution reduction/surplus withdrawal. Such an approach would need the inclusion of some many complex assumptions and the preparation of a high volume of calculations. In the example above, the perpetuity of $44.6B would be reduced more than View 1 or View 2 because of possible future years in the projection that lead to required contribution payments.

We have never seen in practice the use of View 3 under PS3250, while View 1 has been largely used historically. On the other hand, we note that View 2 has been recently observed as a possible emerging interpretation of the paragraph 3250.056.

Amount of surplus that can be withdrawn and contribution reduction availability – OTPP plan characteristics

One element of importance (PS3250.052 and PS3250.059) is to identify whether the employer does have access to the surplus based on legislation and plan characteristics. Is there really some way the government can either withdraw surplus from the plan or reduce future contributions through contribution holiday. The OTPP does have its own Legislation (Teachers' Pension Act) and a Funding policy (Funding Management Policy – FMP) agreed between employer / employees to determine whether and how surplus can be used under the plan. The FMP provides insight on this significant element and is dealt with in the next section.

Section 4 – Sharing principle, contribution reduction and surplus withdrawal

Extracts from the Teachers' Pension Act

The following paragraphs of the Teachers' Pension Act are supporting elements for the use of the 50 / 50 sharing of contributions - paragraph 5. (1.1) - and also support the use of the Funding Management Policy agreed between the parties for treatment of the surpluses and deficits – paragraph 10. (1) 3.

Contributions by the Crown

5. (1) The Minister of Finance shall pay from the Consolidated Revenue Fund an amount equal to contributions under the pension plan payable by the Minister of Education. R.S.O. 1990, c. T.1, s. 5 (1); 1993, c. 39, s. 3 (1); 2005, c. 31, Sched. 21, s. 2 (1).

Matching contributions

(1.1) The total amount of the 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. 1991, c. 52, s. 3; 1993, c. 39, s. 3 (1); 2005, c. 31, Sched. 21, s. 2 (2).

Joint management

10. (1) The Minister of Education and the executive of The Ontario Teachers' Federation may enter into an agreement that provides for the following matters:

1. The joint management of the pension plan by the Minister and the executive of the Federation.
2. The composition of the Board, the appointment of the members of the Board and the delineation of the powers and duties of the Board.
3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members.
4. The amendment of the plan, including the amendment of Schedule 1, by agreement between the Minister and the executive of the Federation.
5. The resolution of disputes between the Minister and the executive of the Federation with respect to amendments to the plan.
6. Any other matter to which the Minister and the executive of the Federation agree. 1991, c. 52, s. 6; 1993, c. 39, s. 5; 2005, c. 31, Sched. 21, s. 4 (1).

Extracts from the most recent funding valuation report (Jan. 1, 2015 – page 16)

The extracts show that Government contributions are matching employees, besides a small portion for LT disability cases and also that there might be an additional contribution for what is referred as foregone inflation. These are supporting the assessment of the 50 / 50 sharing nature of the plan.

- The Province or Designated Employers, as the case may be, should generally match active teacher contributions. However, in the case of teachers on LTIP, they should pay 12.0% (6.9% for Designated Employers if disability occurred before January 1, 1991) of the member's pensionable earnings, indexed to inflation in accordance with the Teachers' Pension Act.

- In addition to the above matching contributions, the Province and Designated Employers are also required to make special contributions for any year in which the cumulative cost-of-living adjustment to pensions in respect of service after 2009 is less than 100% of CPI increases (but only to the first 50% of any inflation foregone) since the members' retirement. The amount of such special contributions is equal to the amount by which the pensions or other entitlements received by members for the year are less than the pension amounts they would have received for that year if 100% CPI indexing had been provided for post-2009 service.

Funding Management Policy (FMP)

The FMP is a document agreed between employer / employees that identifies how the plan is to be funded and specifically how it will deal with deficit and surplus situations. We are particularly interested to identify whether in surplus position the government has access to surplus withdrawal or contribution reduction.

The idea of the plan is that the employer contribution will match the employees' contribution. The use of Joint Defined benefit accounting under PS3250 reflects that general principle underlying the nature of the plan by applying a 50/50 share.

The plan also has provisions that make post-retirement indexing for some service period (post-2009) conditional on the plan financial situation. Should the indexing not be provided fully (100% CPI), some portion (or all) of the indexing amount not provided to the retirees (called foregone inflation) will lead to additional employer contribution in that year. This also reflects the 50 / 50 principle of the plan in that on the employee side, a benefit is not fully provided (less than 100% indexing for retirees) and on the employer side an additional contribution is paid. In similar way, if and when benefits would be increased to the employees, the employer would also get a similar benefit in value (contribution reduction and/or surplus withdrawal).

The FMP will have first use of surplus to reduce contributions to the "basic contribution level" which is the 2012 value (10.4% of salary below YMPE and 12.0% above YMPE) and / or increase benefit to restore any foregone inflation. The Partners need to agree on the actions that will be taken. We also note that for the employer, should the contribution rate already be at the basic rate and a surplus is present, surplus withdrawal and / or further contribution reduction is also possible action to be taken.

In discussing with Allan Shapira (Aon), we understand that the FMP has five funding zones:

- The middle zone is the Fully Funded zone under which base benefits and contributions are maintained. In this zone, the plan is adequately funded to provide base benefits (including indexation at 100% of CPI) supported by the base contributions. Given the volatility of market factors and the numerous assumptions in the funding valuation, "fully funded" is considered a range.
- There are two zones below the Fully Funded zone that address the treatment of deficits (through additional contributions and / or reduction of benefits).
- There are two zones above the Fully Funded zone that address the treatment of surpluses. The first zone is the Temporary Plan Improvement 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). If the surplus reaches a

specified level, the next zone, the Permanent Plan Improvement zone, provides for permanent changes to contribution rates and/or benefits.

We also note that surplus distribution is a possible approach to deal with surplus in the FMP as per paragraphs 1.06 and 4.04.

Under the FMP, a surplus distribution or a benefit improvement can only be made if the Partners have entered into a written agreement governing the manner in which employer contributions will be adjusted to offset any surplus distribution or changes in benefits that are reflected in the obligation value through benefit changes.

As illustrated in the latter zones above, the FMP considers that surplus situations and actions taken can be of permanent nature but also temporary nature. We understand that the inclusion of temporary use of the surplus has the effect of having more likelihood of years of surplus usage than if only permanent approach was possible.

Based on the information received, we note that the accounting obligation calculated for the financial statements, and the accounting surplus resulting from that obligation value, is already including an assumption that 100% CPI is provided. Therefore, the accounting surplus is already based on fully restored benefits and full indexing. Any remaining surplus would therefore be available from the employer side to reduce the contribution level or withdraw surplus.

We also note that the accounting valuation is based on best estimate assumptions and that the surplus amount determined by that calculation represents what is the most likely outcome, considering that assumptions are realized in the future. As such, the amount for the employer portion does represent a realistic potential value to the government in contribution reduction and / or surplus withdrawal. We do not know when the actual event would take place and whether it would be through contribution reduction or surplus withdrawal, but we know that this represents a realistic economic benefit.

Section 3.06 of the FMP does identify the steps of restoration of indexing and also identifies under 3.06 e) the contribution reduction action that can apply. We note again that the accounting obligation measure already includes the 100% CPI indexing and therefore covers the escalated adjustements defined in 3.06.

Section 3.06 *Application of Restoration Basis Excess*: For purposes of clarity, excesses identified pursuant to Section 3.05 shall be applied in the following order, provided that the partners reserve the right to reconsider such application having regard to the contribution rate and benefits then in effect, prevailing economic circumstances and other relevant factors:

(a) *Bring Escalated Adjustments to 50% for Post-2013 Service*: to provide escalated adjustments up to 50% of the CPI adjustment in respect of service accrued after 2013 for the period covered by the valuation, and assumed thereafter at the same rate;

(b) *Bring Escalated Adjustments to 100%*: to provide escalated adjustments up to 100% of the CPI adjustment for the period covered by the valuation, and assumed thereafter at the same rate;

(c) *Restore Escalated Adjustments for Post-2013 Years*: to provide escalated adjustments to increase, to the extent possible, the current accumulated adjustment ratio for each year after 2013, to the current accumulated adjustment ratio for the period from 2010 to 2013, beginning with the first year in which current escalated adjustments were less than 50% of the run-rate escalated adjustments;

(d) *Restore Escalated Adjustments for Post-2009 Years*: to provide escalated adjustments to increase, to the extent possible, the current accumulated adjustment ratio for each year after 2009 to the run-rate accumulated adjustment ratio, beginning with the first year in which current escalated adjustments were less than run-rate escalated adjustments;

(e) *Provide Benefit Increases or Contribution Rate Reductions*: to provide the following:

(i) an increase in benefits, where the present value of current benefits is less than the present value of run-rate benefits,

(ii) a reduction in contribution rates, where the present value of current contributions exceeds the present value of basic contributions, or

(iii) a combination of (i) and (ii).

(Last amended May 27, 2015 – Effective March 6, 2015)

Section 5 – Asset ceiling for OTPP

The factors illustrated in the Section 4 coming from the analysis of the FMP and surplus application are considerations to determine the Government access to the surplus. We have discussed the plan mechanics with OPCD and here are the key factors of the FMP and OTPP plan characteristics that would be considered in support of the Government Expected future benefit coming from surplus withdrawal and contribution reduction:

- The plan nature is defined to be a 50 / 50 share between employees and employer
- Looking at the FMP, this principle applies to bad news and good news, hence for deficit and surplus situations
- The employer can benefit from surplus withdrawal and contribution reduction
- The surplus situations could be dealt with permanent and temporary changes, increasing the likelihood of surplus application
- The accounting valuation currently includes a 100% CPI indexing, hence the resulting accounting surplus to the employer portion has already fully restored benefits considered
- Accounting valuation uses best estimate assumptions and therefore the resulting surplus is considered a realistic value

Based on the Government view on the OTPP and our discussions with OPCD, we understand that the position is that the asset position should not be reduced by any valuation allowance. This position is based on the nature of the sharing principle of the OTPP which allows for the Government to have access to the surplus and hence the Economic benefit. It is unknown when the benefit will materialize and what form it will take but it is of realistic economic value.

That being said, a very important consideration is that the amount determined represents what the accounting defines as the best estimate. The selection of assumptions to prepare the accounting valuation is therefore significant to ensure that the surplus calculated is realistic. Considering the accounting standards requirement to use best estimate assumptions, it is reasonable to consider that those assumptions are selected by the Government as best estimates and therefore the surplus determined is a realistic value of what benefit the Government may realize in the future through surplus withdrawal/contribution reduction.

Should the characteristics of the plan or the FMP parameters change in the future, or if the Government has a different view on the application of the OTPP provisions and the FMP for surpluses, this may affect the Government access to surplus and hence the Government view on asset ceiling test.

Based on the facts coming from the FMP, the plan nature and based on discussions with OPCD, it has been determined that the current view is that any surplus identified to the Government portion would be used to its own benefit and that the Government is not obligated to using any surplus towards increasing benefits to the members (either through historic practice or internal policy). The above analysis provides evidence to support OPCD's position that no valuation allowance is required to the OTPP asset amount reported under PSAB.

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Treasury Board Secretariat 7600 Report FINAL.pdf

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Private and confidential

Ms. Karen Hughes
Associate Deputy Minister,
Treasury Board Secretariat,
7 Queen's Park Crescent
Toronto ON M7A 1Y7

Dear Ms. Hughes:

We have been engaged to report on the appropriate application of certain aspects of Canadian public sector accounting standards to the recognition of the accrued benefit asset (also referred to in this report as the Pension Asset or the Asset) related to the Ontario Teachers' Pension Plan (OTPP the Plan) in the Province of Ontario's (also referred to as the Province or the Government of Ontario in this report) accounts as at March 31, 2016. This report is being issued to the Associate Deputy Minister of the Treasury Board Secretariat of the Government of Ontario. Our engagement has been conducted in accordance with Canadian generally accepted standards for such engagements.

It should be noted that the responsibility for the proper accounting treatment rests with the preparers of the financial statements, who should consult with their incumbent auditor. Our judgment on the appropriate application of Canadian public sector accounting standards for the specific issue being discussed is based on the facts, circumstances and assumptions provided to us. Should the facts, circumstances or assumptions differ, our conclusion may change.

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.

Statement of facts and assumptions (continued)
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.

Statement of facts and assumptions (continued)

- 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 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 make 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.

[1] Partners' Agreement, section 110.

Relevant extracts from the Partners' Agreement (continued)
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.

Relevant extracts from the FMP (continued)
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.

Application of accounting principles
Specifically, our report addresses the following questions:

1. Is it necessary for a government to have a legally enforceable right to reduce future contributions in order to recognize a Pension Asset under PS 3250?

2. What is the role of legal uncertainty in assessing the government's expectation of future benefit from a Pension Asset?

Our views in this report are confined to these two questions and do not extend to any earlier reports provided by Deloitte or to any other analysis that may have been presented in draft or in any other manner.

Authoritative literature
In our analysis, we considered the pronouncements and guidance in Section 3250 of the CPA Public Sector Accounting Standards Handbook. What we considered to be the most relevant passages from PS 3250 are reproduced below:

> **The objectives of funding and accounting**
>
> .008 Determining whether a retirement benefit plan should be funded and the amount to be funded each period is a financial management matter. The funding objective is to determine an acceptable policy for financing the estimated ultimate cost of a benefit plan. An actuarial valuation for funding purposes is performed to calculate the contributions required to secure the benefits promised.
>
> .009 The accounting objective is to measure and report the obligation for employee retirement benefits and to attribute the costs of those benefits to the periods in which the related services are rendered. To meet that objective, a method is needed to determine the amount of the obligation for retirement benefits outstanding, which represents the liability at the financial statement date, and the value of the benefits employees earned during the period, which represents the expense of that period. Accordingly, it is necessary to develop accounting estimates of liabilities for retirement benefits and expenses using an actuarial cost method and actuarial assumptions that ensure essential information required for fair presentation of financial condition and results of operations can be reported in government financial statements.

Authoritative literature (continued)

.010 Because the objectives of determining the most appropriate funding policy are not necessarily the same as those of determining the most appropriate accounting method, the liability for accounting purposes may not be the same as the amount due but not yet funded at the financial statement date according to the funding plan. In addition, the retirement benefit expense of the period for accounting purposes may not be the same as the contribution computed in the period for funding purposes.

Actuarial assumptions

.042 Actuarial assumptions should be based on the government's best estimates of expected long-term experience and short-term forecasts. [SEPT. 2001]

Joint defined benefit plans

.079 Governments may participate jointly in defined benefit plans where the government shares the risks and rewards jointly with plan participants, represented by a sponsor or sponsors. Joint defined benefit plans are governed by a formal agreement between the sponsors, which establishes that the sponsors have shared control over the plan. A governing board is generally appointed by the joint sponsors with equal representation and a mutually agreed-upon chair.

.080 A government would consider the characteristics of the plan to determine whether it meets the definition of a joint defined benefit plan. In a joint defined benefit plan, funding contributions are shared mutually between the government and the plan members. The sponsors have control over decisions related to the administration of the plan and the level of benefits and contributions on an ongoing basis based on the terms of the contractual agreement. The sponsors share, on an equitable basis, the significant risks associated with the benefit plan. Risk would not be considered to be equitably shared in an arrangement where the government and the joint sponsors fund the plan equally but where the government retains the full risk of the accrued benefit obligation. If the government retains the residual risks it is unlikely that the plan meets the definition of a joint defined benefit plan.

.081 *When a government participates in a joint defined benefit plan, the government's risk is limited to its portion of the plan. The government should account for its portion of the plan in accordance with the standards for defined benefit plans*. [SEPT. 2001]

.082 A government may convert an existing defined benefit plan for which it is the sole sponsor to a joint defined benefit plan where the risks and benefits are shared. When converting to a joint plan, a government would consider whether there are any special accounting issues that arise, including whether the predecessor plan has been settled or partially settled and/or curtailed or partially curtailed. In assessing such issues a government would have regard to its specific circumstances and the terms of the joint defined benefit plan.

Disclosure

.083 The notes and schedules integral to the financial statements would disclose the methods and judgments applied in accounting for accrued benefit obligations and expenses. Full disclosure is particularly important for retirement obligations because the measurements depend heavily upon judgments rather than objective evidence.

Limit on the carrying amount of an accrued benefit asset

.050 *An accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance. When a defined benefit plan gives rise to an accrued benefit asset, a government should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. A change in valuation allowance should be recognized in the statement of operations for the period in which the change occurs.* [SEPT. 2001]

.051 A government with a defined benefit plan may have an accrued benefit asset for accounting purposes. An accrued benefit asset arises when the government's total contributions to the plan, including interest earned thereon, are greater than the retirement benefit expense recognized since the start of the plan. Contributions reflect the funding objectives of the plan. The benefit expense reflects the accounting objectives and may differ for a number of reasons, including the fact that actuarial gains and losses are deferred and amortized in future periods.

.052 A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions. The accrued benefit asset may become impaired when there is a plan surplus for accounting purposes that the government is not entitled to benefit from fully. For example, there may be a regulatory moratorium on pension surplus withdrawals or uncertainties as to a government's legal right to use a plan's accounting surplus.

.053 To determine the extent to which an accrued benefit asset may be impaired, the government first determines the adjusted benefit asset . The adjusted benefit asset is the accrued benefit asset less net unamortized actuarial losses (determined on a basis using market value of assets).

.054 The adjusted benefit asset is then compared to the expected future benefit . When the expected future benefit exceeds the adjusted benefit asset, the accrued benefit asset is not impaired and, accordingly, no valuation allowance is required. The chart included as Appendix A to this Section is intended to set out the relationship between the various defined terms.

.055 The objective of the standard in paragraph PS 3250.050 is to limit a government's accrued benefit asset to the amount it can realize in the future. The expected future benefit is a calculated amount representing the benefit a government expects to realize from a plan surplus. An expected future benefit includes any withdrawable surplus or reduction in future contributions.

.056 A government determines its expected future benefit as the sum of:

a) the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and

b) the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

Limit on the carrying amount of an accrued benefit asset (continued)

.057 A government's expected future accruals for service for the current number of active employees are determined on a basis consistent with that used to determine its accrued benefit obligation. These expected future accruals for service, less required employee contributions and minimum contributions the government is required to make regardless of any surplus, are then discounted back to the current period to determine the present value. The interest rate used to calculate this present value is the expected rate of return on plan assets used to determine the benefit expense in the period.

.058 When administration expenses are paid by the plan and included in the normal cost calculation, a best estimate of the future administration expense is included in the expected future accruals for service. When administration expenses are paid by the plan and not included in the normal cost calculation, the rate of return on plan assets is adjusted to reflect the deduction of the administrative expenses.

.059 A key factor in determining a government's expected future benefit from a defined benefit plan with a plan surplus for accounting purposes is the ability of the government to withdraw assets from the plan. The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal. It excludes any withdrawable plan surplus a government is currently required, or intends, to allocate to employees. A government may not anticipate obtaining a legally enforceable right to withdraw a portion of a plan surplus to which it is not currently entitled, whether on the basis of precedent or otherwise. Accordingly, when withdrawal of plan surplus requires the approval of employees or an appropriate regulatory authority or a court of law, a government excludes any amount subject to this restriction from its expected future benefit until such approval has been obtained. A change in the allocation of surplus between a government and its employees is incorporated into the calculation of the expected future benefit only when it has been agreed to and, when required, approved by the appropriate regulatory authorities.

We also considered the following definitions as set out in the glossary of PS 3250:

- An **accrued benefit asset** is the amount of any asset recognized on a government's statement of financial position in respect of employee retirement benefits before deducting any valuation allowance that may be required. It is the sum of the government's accumulated cash contributions less the sum of the current and prior years' benefit expenses (before any change in the valuation allowance).
- The **expected future benefit** is a calculated amount representing the benefit a government expects to realize from a plan surplus. An expected future benefit includes any withdrawable surplus or reduction in future contributions. A government determines its expected future benefit as the sum of:
  (a) the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and
  (b) the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

Limit on the carrying amount of an accrued benefit asset (continued)

- A **joint defined benefit plan** is a contractual arrangement between the government and another sponsor or sponsors representing plan participants that has all of the following characteristics:
  (a) the sponsors co-operate toward achieving the significant clearly defined common goal of providing retirement benefits in exchange for services rendered by the employees;
  (b) funding contributions are shared mutually between the government and the plan members, represented by the non-government sponsor;
  (c) the sponsors share control of decisions related to the administration of the retirement benefit plan and to the level of benefits and contributions on an ongoing basis; and
  (d) the significant risks associated with the retirement benefit plan are shared on an equitable basis between the government and the plan members, represented by the non-government sponsor.

The contractual arrangement establishes that the sponsors have shared control over the retirement benefit plan, and ensures that neither party is in a position to control the plan unilaterally. Nevertheless, overall, there must be an equitable relationship between the funding by the government of the retirement benefit plan, the extent of control it is able to exercise over the plan and the risks and benefits that accrue to the government from the plan.

CONSIDERATION OF QUESTION 1

Application of PS 3250 to Joint Defined Benefit Plans
A joint defined benefit plan is a unique sort of retirement benefit plan where the sponsors have shared control over the plan. As a result, no one party can, by itself, control decisions around funding, benefits and other matters; funding contributions, risks and benefits are to be shared mutually between the sponsors. We would note that paragraph .081 of PS 3250 clearly states that a government should account for its portion of the plan in accordance with the standards for defined benefit plans. As a result, the Province of Ontario accounts for its proportionate share of OTPP and has historically recorded its share as 50% of the plan.

The Province of Ontario's Public Accounts have included a Pension Asset related to OTPP since fiscal 2001/2002. We have been informed that this situation has arisen because, to this point in time, the government's share of the total contributions to the Plan plus the actual investment returns on the Plan's assets have exceeded the government's share of the accumulated retirement benefit expense. The accounting for the accrued benefit obligation results from a complex process involving significant assumptions and actuarial calculations covering a very long time frame as is required by S 3250. S 3250.51 includes an explicit acknowledgement that the accounting position and funding position can be quite different, as follows: "Contributions reflect the funding objectives of the Plan. The benefit expense reflects the accounting objectives and may differ for a number of reasons."

The assumptions used in the calculation of the accrued benefit obligation are required to be the "government's best estimate of expected long-term experience and short-term forecasts" (3250.42) and each key assumption must be based on the government's best estimate of those future events that have an effect on the accrued benefit obligation (3250.41). This approach is designed to recognize the long-term nature of the retirement promises with appropriate consideration of, but not undue influence of, experience expected in the short-term. 3250.57 requires that the future service cost calculation included in the calculation of the valuation allowance be determined on a consistent basis with that used to determine the accrued benefit obligation itself. The Province of Ontario has determined the discount rate to be used in valuing the pension obligation related to OTPP by referencing the expected rate of return on Plan Assets, which is one of the acceptable references suggested on PS 3250.44. We express no view on the actual rates that were chosen.

Application of the limit on the carrying amount of an accrued benefit asset
PS 3250.50 requires that an accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance. When a defined benefit plan gives rise to an accrued benefit asset, a government should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. This comparison between the adjusted benefit asset and the expected future benefit informs whether a valuation allowance is required and if so, how much of a valuation allowance should be recorded. (It should be noted that "accrued benefit asset" and "adjusted benefit asset" are defined terms used in S. 3250. As at March 31, 2016, in this particular case, management has represented to us that these two amounts are the same.)

PS 3250.52 contemplates that there are two ways in which a government can benefit from an accrued benefit asset. A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions. As such, an expected future benefit would include the ability to either withdraw plan assets from the plan or reduce future contributions.

PS3250.52 also goes on to consider that an accrued benefit asset may become impaired when there is a plan surplus that the government is not entitled to benefit from fully. The paragraphs in the standard that follow determine how a government would go about considering the extent of any impairment, which would give rise to a valuation allowance. In order to make this determination, the government is required to consider the "expected future benefit", which would effectively create a ceiling for the asset. Here the guidance diverges between benefit expected to be realized through future reductions in contributions and those to be realized through withdrawal of surplus.

Specifically with respect to withdrawal of surplus, PS 3250.59 is very clear that expected future benefit can only be asserted where the government has a current legally enforceable right to withdraw assets from the Plan. We considered whether this guidance should be applied to cases where the expected future benefit related to the Pension Asset is expected to be realized through reduced contributions and concluded that the guidance does not apply in this situation; while PS 3250.59 does introduce the concept of a legally enforceable right, it does so solely in the context of a government's future withdrawal of a Plan surplus, and not in the context of a government's reduction of future contributions. We believe it reasonable to conclude that if the standard setters had intended legal enforceability to be the test, they would have included that notion throughout the guidance, instead of only raising it in the context of a withdrawal of surplus. In the situation at hand, the Province is not asserting an expected future benefit based on surplus withdrawal. Instead the Province's position is that the future benefit is expected to be realized through future contribution reductions. Therefore, we do not believe that 3250.59 applies in this case.

Additionally, in forming our view on the application of PS 3250 to Joint Defined Benefit Plans, we noted that there is specific guidance (PS 3250.81) that requires the Government to account for a portion of the Plan in accordance with the standards for defined benefit plans.

For the reasons stated above, we are of the view for Question 1, that legal enforceability of a government's right to access a pension plan surplus through future contribution reductions is not necessary to justify recognition of a Pension Asset. We believe that the guidance in PS 3250 is the primary source of GAAP on this topic and, since it is clear, there is no need to look at any other potential sources of GAAP.

CONSIDERATION OF QUESTION 2

Since we have concluded that legal enforceability is not a necessary requirement to support a government's right to access a pension plan surplus through future contribution reductions, we further considered what role legal considerations should play in the measurement of the Pension Asset. We note that PS 3250.52 requires one to consider "uncertainties as to a government's legal right to use a plan's accounting surplus." Our interpretation of this guidance is that it presents a lower threshold than legal enforceability. Specifically, the amount of Pension Asset that gets recorded needs to be subject to considerations around any legal uncertainties. This consideration will involve significant professional judgment. However, it is our view that uncertainty does not need to be reduced to zero in order to recognize a Pension Asset.

PS 3250.53 to .58 lay out a mathematical calculation that determines the adjusted benefit asset and the expected future benefit, and tests whether a government can expect to recover its accrued benefit asset through a withdrawal of surplus or through the reduction of future contributions. The stated objective of this exercise, as set out in PS3250.055, is to limit the amount of the government's accrued benefit asset to the amount "it can realize in the future." The expected future benefit is further described as "a calculated amount representing the benefit a government expects to realize from a plan surplus", where realization includes a reduction in future contributions. A valuation allowance is recorded against the Pension Asset to limit the asset value, if necessary, based on this analysis.

PS 3250.55 indicates that the expected future benefit is a calculation that represents the benefit a government expects to realize from a plan surplus. This calculation is further described in PS 3250.56(a), which sets out that the government's calculation of expected future benefit would be the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus. Note that in the case at hand, the calculations are done on a 50% basis since the starting point, per PS 3250.81 and as set out in the fact summary above, is that the government accounts for its portion of the Plan. For this same reason, employee contributions are also excluded in this case since they would represent the teachers' portion of the Plan.

PS 3250.55 indicates that the expected future benefit is a calculation that represents the benefit a government expects to realize from a plan surplus. The expected future benefit would operate as a ceiling on the Pension Asset value to be recorded in the accounts. For example, if the Pension Asset were $150, but the expected future benefit calculated as described above were $100, a valuation allowance of $50 would be recorded against the Pension Asset and the asset recorded in the government's financial statements would be reduced to $100.

There are two parts to the calculation of expected future benefit. The first part of the calculation is the sum of the present value of the expected future accruals for service for the current number of active employees. This amount is required to be calculated using consistent assumptions as those used for the calculation of the accrued benefit obligation itself. The second part of the calculation is the present value of required employee contributions and minimum required contributions by the government itself, regardless of any surplus. The main area for judgment in the above calculation is in the determination of future minimum contributions required to be made by the government regardless of any surplus. There is no further guidance in S 3250 as to how this calculation should be performed and what restrictions or parameters should be factored into this calculation.

Determining the number of years of contributions to include should involve consideration of legal uncertainty as set out in PS 3250.52. With respect to this uncertainty, we would observe that there are a number of considerations that may be relevant. As part of this analysis, we reviewed Osler's legal letter of September 20, 2016. That letter makes a number of observations about the Plan agreements and governing documents that we will not reiterate here. Osler's do note that legal enforceability does not exist. However, as noted above we do not believe that legal enforceability is required in this case.

Future reductions in contributions will need to be negotiated and agreed between both sponsors, who are required under the Plan governing documents to bargain in good faith. There are a number of factors to consider and it is possible for reasonable professionals to arrive at different conclusions, even when confronted with the same set of facts and circumstances. These considerations will be highly judgmental.

With respect to these judgments, we offer the following observations. We express no opinion on the completeness of this list of observations or the relative importance of each of these points.

- Plan documents and design contemplates the shared nature of the Plan.
- Section 10 of the Partners agreement require that the partners meet every 3 years to discuss changes to the Plan.
- As described to us by management, there was a long history of sharing surpluses through various mechanisms during the 1990's when funding surpluses were more common. The FMP also contemplates a sharing of surpluses.
- As described to us by management, in addition to the history of surplus utilization noted in the facts and assumptions, it is worth noting that the actions taken around inflation indexation and subsequent restoration of those benefits are a recent example of the sharing philosophy governing operation of the OTPP. Starting in 2011 in response to a deficit situation, it was determined that indexation would be reduced for teachers retiring after 2009. Consistent with the 50/50 approach inherent in the Plan operation, the government agreed to make payments (often referred to as "share the pain" payments) into the Plan that would effectively match the value of benefits foregone by teachers. In 2014, 2015 and 2016, surpluses were used to restore some of the lost indexation. This decision results in a decrease in the Province's "share the pain" payments.
- The FMP explicitly considers the possibility of contribution reductions at different funding levels, although both sponsors need to agree. The OTPP's investment performance has consistently outperformed expectations. If this situation continues the funding surplus can be expected to continue to grow. Modelling could be performed to help estimate when the different funding zones will be reached and probability of contribution reductions may be increased.
- We also note that Canada Revenue Agency establishes limits for pension surpluses. When these limits are breached, steps need to be taken to reduce the surplus. In such a situation, contribution reductions would be one way to reduce the surplus that would need to be negotiated by the parties within their overall framework for negotiation. Again, modelling could be done to develop expectations as to when these CRA limits could be expected to be reached.
- Contributions are generally borne equally by the Province and the teachers. It may be reasonable to presume that teachers will also want to see contribution reductions at some point. Admittedly, increases in benefits could also use any surplus; however, it may be reasonable to expect that the interests of taxpayers and teachers will need to be weighed in the "good faith" bargaining process such that unequal weighting towards increases in benefits may be unlikely.

- In determining the range of possible outcomes, it is noted that measurement uncertainty may exist (PS 2130.03). This paragraph also notes that many items are measured using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned courses of action. As noted in PS 2130.13, "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."

However, application and weighting of these and other considerations is a highly judgmental exercise and it is possible that there is a range of reasonable conclusions that may result in a range of reasonable estimates for the valuation allowance to be taken against the Pension Asset. We are unable to opine on whether a valuation allowance is needed, and if so, what a reasonable range of estimates would be.

Given the complexities and degree of judgment involved in these matters, appropriate disclosure is a matter of significance as is recognized in 3250.83 which states, in part, *"Full disclosure is particularly important for retirement obligations because the measurements depend heavily upon judgments rather than objective evidence"*. This importance is also highlighted in the context of joint benefit plans in 3250.93 which requires that the unique nature and terms of any joint plans be disclosed.

We would also note that Deloitte prepared a report dated August 18, 2016 entitled "Asset Ceiling Calculations for the Ontario Teacher's Pension Plan" in conjunction with management that was used by management as part of their analysis to determine that no valuation allowance was required against their Pension Asset as at March 31, 2016. That report was prepared solely to assist management in preparing their own analysis. We were not engaged to and did not express an opinion on the amount of or need for any valuation allowance, nor do we express an opinion on this analysis at this point. Reference to the August 18, 2016 report in this report should in no way be construed to be an opinion on that earlier report.

The ultimate responsibility for the decision on the appropriate application of Canadian Public Sector Accounting Standards for the specific transaction described above rests with management as preparers of the financial statements, who should consult with the Auditor General of Ontario. Our judgment on the appropriate application of Canadian Public Sector Accounting Standards for the specific situation described above is based on the facts, circumstances and assumptions provided to us. Should the facts, circumstances or assumptions differ, our conclusion may change.

This report is intended solely for the information and use of Ms. Karen Hughes and management of the Government of Ontario and is not intended to be and should not be used by anyone other than the above party and the Auditor General of Ontario or for any other purpose. For further clarity, this report should not be distributed to anyone outside those named in the previous sentence, nor should it be quoted from outside this group for any purpose. Please contact Kerry Danyluk, National Director of Accounting Services, regarding any questions about the content of this report (416 775-7183 or kdanyluk@deloitte.ca).

Yours truly,

Deloitte LLP.

Chartered Professional Accountants
Licensed Public Accountants