AON memo to MOF re limit on accrued benefit asset.pdf

# Memorandum

To: Alex Killoch/Rob Pomykacz, Ministry of Finance

From: Allan Shapira, Aon Hewitt

Date: August 2, 2016

Re: Ontario Teachers' Pension Plan – Limit on Accrued Benefit Asset

This memo will address the limit on the accrued benefit asset held on the Ontario Government's financial statements in respect of the Ontario Teachers' Pension Plan ("OTPP").

We are addressing this issue in our role as the actuary to the Ontario Government in its role as a sponsor of the OTPP. We note, however, that we do not prepare any of the accounting information for the OTPP for purposes of the Ontario Government's financial statements, which is prepared under Section PS 3250 of the Public Sector Accounting Standards.

Based on the information provided to us, there is currently an accrued benefit asset on the Government's financial statements in respect of the OTPP. Under PS 3250.050, the intent is to limit a government's accrued benefit asset to the amount it can realize in the future. Under PS 3250.050; "A government may benefit from an accrued benefit asset by either withdrawing surplus or taking a contribution holiday or receiving a refund of contributions. The accrued benefit may become impaired when there is a plan surplus for accounting purposes that the government is not entitled to benefit from fully."

The protocol for the use of surplus under the OTPP is detailed in the Funding Management Policy ("FMP") adopted by the Ontario Government and Ontario Teachers Federation as sponsors of the OTPP. The sharing of any surplus would be on a 50/50 basis between the Government and members, consistent with the funding of the OTPP.

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.
- 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.

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 contributions by the Minister will be adjusted to offset any surplus distribution or changes in benefits that are reflected in the liabilities.

Our interpretation of paragraph PS 3250.056 is the calculation of the expected future benefit on an open group basis. Based on the 50% methodology used to calculate the Government's obligations and pension expense under PS 3250, the expected future benefit would be calculated as 50% of the present value of future accruals for service. Based on the information provided to us, the total annual service accrual as of January 1, 2016 is $2,899 million, calculated using a discount rate of 6.25% and an ultimate salary increase assumption of 3% in the salary grid plus experience-related increases. Using the 6.25% discount rate and a 3% salary increase assumption (i.e. without the experience-related salary increases), the expected future benefit would be $44,600 million. We also requested the OTPP actuary to calculate this expected future benefit on a closed group basis for context and this resulted in an expected future benefit of $19,400 million. For further context, the present value of a decrease in the Government's contribution rate by 1% of salary calculated on an open group basis would be $4,300 million.