Pension Surplus and its Availability to OPSEU Pension Plan Sponsors

With net assets of $18.4 billion, OPTrust invests and manages one of Canada's largest pension funds and administers the OPSEU Pension Plan, a defined benefit plan with almost 87,000 members and retirees.

OPTrust is proud of its role as the administrator of a jointly sponsored defined benefit pension plan ("JSPP"). We believe strongly in the value of the risk-sharing model as one of equity and fairness. Our two sponsors, the Government of Ontario (the "government") and Ontario Public Service Employees Union ("OPSEU") share equally in the risk, reward and governance of the Plan.

Background

The Province of Ontario released its financial statements on October 3, 2016. The statement accompanying the release identified concerns by the Auditor General regarding the government's practices related to the accounting treatment of pension assets for the OPSEU Pension Plan and the Ontario Teachers' Pension Plan.

The Auditor General's work improves transparency and the delivery of public services in Ontario. It drives improvements to the administration of Ontario's finances by holding the government accountable in virtually every area of its use of public funds. The discussion around the way risk-sharing is treated in accounting should be consistent with these outcomes.

This paper is meant to inform the debate on this important matter. OPTrust's goal is to ensure the joint risk-sharing within the JSPP model, and specifically the OPSEU Pension Plan, is faithfully reflected in the government's accounting for the Plan. Further, this paper attempts to confirm the facts and circumstances of the plan as they relate to governance and sharing of risks and costs between the two plan sponsors.

OPSEU Pension Plan Governance

OPTrust was established to give plan members and the government an equal voice in the administration of the OPSEU Pension Plan and the management of the assets through joint trusteeship. OPTrust is governed by a 10-member Board of Trustees, five of whom are appointed by OPSEU and five by the government.

While OPTrust is charged with plan administration and investment of plan assets, the Board of Trustees does not have authority to change benefit or contribution levels, or decide on the use of any plan surplus. Those decisions rest with the two plan sponsors – the government and OPSEU.

The OPSEU Pension Plan

The OPSEU Pension Plan was created by legislation, the "*Ontario Public Service Employees' Union Pension Act, 1994,* S.O. 1994, c. 17, s. 143, Sched." (the "OPSEU Pension Act" or "Act"). In explaining this act to the Standing Committee on Estimates - 1994-Nov-01 - Management Board Secretariat, the Hon Brian A. Charlton, Chair, Management Board of Cabinet stated;

> *"We retain full responsibility for that unfunded liability, but all future gains and liabilities against the plan will be jointly shared by the employer -- the government -- and the employees. It's a particularly responsible, if not somewhat frightening, position for any union to move into with a pension plan that size, but they've done it, and done it, in my view, in an extremely professional and responsible way."*
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> *http://www.ontla.on.ca/web/committee-proceedings/committee_transcripts_details.do?locale=en&BillID=&ParlCommID=502&Date=1994-11-01&Business=Management+Board+Secretariat&DocumentID=18243*

This Act overrides the *Pension Benefits Act*, R.S.O 1990, c. P.8, as amended (the PBA) as described in sections 3.2 and 11.2 of the Act which state:

> *3 (2) For greater certainty, in the event of a conflict between this Act and the Pension Benefits Act, this Act prevails.*
>
> *11.(2) The OPSEU Plan shall be deemed to comply with the Pension Benefits Act and the regulations made under that Act so long as it complies with this Act and the Sponsorship Agreement.*

The Plan describes the benefits under the Plan and the use of actuarial gains. Section 6.3, entitled Actuarial Gains and Losses, states as follows in section 6.3 (3) (c) and section 6.4:

> *6.3 (3)(c) thereafter, the remaining gains shall be used equally for the benefit of employers and OPSEU subject to the following:*
>
> *(i) 50% of the gain or such other amount as may be collectively bargained shall be used for the benefit of employers, to be applied against any special payments required to be made by any employers and thereafter to reduce employers' normal costs;*
>
> 6.4 *"Surplus No surplus shall be paid out of the Fund to any employer.*

Sections 6.3 and 6.4 of the Plan have an impact on the application of the PSAB Standard PS3250 .055, which states in part:

> *PS3250.055 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. <u>An expected future benefit includes any withdrawable surplus or reduction in future contributions.</u>

Section 6.4 of the Plan is very clear that surplus cannot be removed from the Plan by the employer. Thus the only way the government can have an expected future benefit is by reduction in future contributions. Section 6.3 of the Plan text allows the government to use actuarial gains to reduce employers' normal costs. The use of surplus was also a critical issue in the establishment of this Plan and in the OPSEU Pension Act creating this Plan.

<u>Impact of Surplus on Province's Financial Statements</u>

The Auditor General is correct when she states the government is unable to withdraw surplus from the Plan. Paragraph 6.4 of the Plan Text is clear: surplus cannot be paid to an employer. Still, Paragraph 6.3 of the Plan Text grants 50 per cent of surplus to the employer while restricting the employer's use of surplus to cover special payments and normal cost contributions. Any payment made by government from its share of the surplus reduces the Province's need for future tax and other revenue sources by a corresponding amount. Similarly, the Act requires the government to fund its share of the deficit.

It is further useful to note that no other approvals are needed for the two sponsors to use each of their surplus portions. In particular, there is no requirement to seek regulatory approval to use the surplus to reduce future contributions. The two plan sponsors can, and have in the past, made such decisions.

In the past both sponsors have used surplus to improve benefits for members and reduce contributions to both members and the government. The government used surplus to eliminate the initial unfunded liability in 1999 and then again in 2001. In addition, it reduced its contribution rates in 1994 and 1995. The government also used surplus to improve benefits for members on various occasions after collective bargaining. OPSEU used surplus in 1994, 1999 and 2002 to reduce contribution rates and improve benefits. Deficits were funded by raising contributions in 2008.

Because of these factors, the expected future benefit of the pension assets is greater than nil, and correspondingly the economic value of that surplus should be recorded as the pension asset in the Province's financial statements.

The public sector accounting rules – and accounting rules in general – are intended to and should result in a faithful representation of the economic realities of public pension plans, including their governance, decision-making structure and contractual arrangements, as well as, in the case of JSPPs, the manner in which plan funding and plan risks are in fact shared between the plan's two sponsors.

A central concept behind JSPPs is the sharing of risk between the employer and employees. Any accounting standard used to value the obligations and cost of the Plan must appropriately recognize the existing risk-sharing agreement between the sponsors. The failure to fully recognize risk-sharing in accounting would raise questions about the Plan's governance and possible outcomes. It would also bring into question the appropriateness of "joint defined benefit plan" accounting that has historically been applied, and that is accepted both by the government and the Auditor General. That is because joint defined benefit plan classification requires equitable sharing of costs and risks – if the sharing is not equitable (e.g. the government is responsible for deficits but the plan members benefit from surpluses) then that definition may not be met.

Conclusion

To the extent the plan sponsors are required to fund Plan deficits and are entitled to benefit from Plan surpluses, any interpretation of accounting rules and the resulting accounting must be transparent to stakeholders, including taxpayers, and must treat deficits and surpluses in a uniform manner. Therefore, surpluses and deficits should both be recognized on the Province's balance sheet. Not recognizing a surplus on the balance sheet, when the Plan's documents, legislation, and governance enable the plan sponsors to benefit from such surplus, not only leaves a large amount of assets off the Province's balance sheet but also means that the Province's accounts do not reflect the economic substance of the arrangement and thereby weakens disclosure as well as transparency by giving those that read the Province's financial statements an incorrect perception of how the Plan functions. Similarly, stakeholders would not see an impact should the government decide to spend a surplus in the future because the surplus would not have been included in the Province's financial statements. The public interest is best served by recognizing any accounting surplus of the Plan in the Province's accounts.