

Management Position Paper

Valuation of OTPP and OPSEUPP pension assets for the 2015/16 Public Accounts

Management continues to believe that, despite measurement uncertainty, the reported assets resulting from the application of PS 3250 to OTPP and OPSEUPP have value reflecting management's expected future benefits.

PS 3250 provides the guidance on accounting for joint benefit pension plans and acknowledges that an asset can result from the application of PS 3250. Paragraphs .50 to .59 of PS 3250 provide guidance on assessing whether a pension asset is impaired, thereby explicitly acknowledging that an asset can result from the application of the standard.

The Auditor General has noted that the Province does not have the unilateral legal right to use the pension assets because its ability to reduce future minimum contributions or withdraw any pension plan surplus is subject to agreement with the respective pension plans' joint sponsors. In addition the Auditor General has noted that as at March 31, 2016, there were no such agreements in place.

Management does not agree with either of these interpretations of PS 3250:

- a) A unilateral legal right to use the assets is required to recognize an asset or,
- b) In the absence of a unilateral legal right to use the assets, the Province must have an agreement with the joint sponsor to reduce future minimum contributions or withdraw any pension plan surplus.

Management has not asserted that any amount of the two assets is supported by the ability to withdraw pension plan surplus but has communicated that the valuation results previously undertaken and shared with the OAG are based on an assumption that the value of the assets would be gained through future contribution reductions. Paragraph .59 speaks only to the withdrawal of surplus and while it does note that "The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal" as noted, the value of the asset reported by the Province does not reflect an intention to obtain benefits through surplus withdrawals but rather through reductions in future contributions. Management's view is that the guidance in paragraph .59 is specific to the withdrawal of funds from a plan and does not apply to the use of contribution reductions to support the pension assets.

With respect to the requirement to have an irrevocable agreement in place with the joint sponsor as at **year-end**, it is management's view that this is not a requirement of the standard. The standard requires that management take into consideration "uncertainties as to a government's legal right to use a plan's accounting surplus." (3250.52). The standard does not require that there be no uncertainty in order to recognize an asset. This interpretation would not be consistent with the balance of the framework developed to account for defined benefit pension plans. Pension plans, by their nature, include significant estimates -- whether they be related to the value of assets held by the plan that are not publicly traded (e.g. investments in private companies and real assets) or in the present value of the projected benefit obligation that is based on a series of economic assumptions related to inflation,

Commented [NP1]: Isn't this the point of 'Expected FUTURE benefit'?

Management position regarding the valuation of OTPP and OPSEUPP pension assets

salary escalation, mortality and the rate of return that the assets in the plan will earn over the period that benefit payments are paid to pensioners. Any change in these assumptions will have an impact on the accounting surplus, so to apply a test requiring no uncertainty to the recognition of an asset is inconsistent with the accounting for pension plans as a whole. Further the term used to describe the cap in the asset ceiling test is “**expected future benefit**”. Expected does not equate to certainty.

Commented [NP2]: Expected – uncertainty; future – no agreement in place at year end

We acknowledge that the existence of a jointly sponsored plan is not explicitly contemplated in the paragraphs .50 to .59 that deal with the evaluation of whether a pension asset is impaired and believe that this intersection of the guidance should be further clarified in the project that PSAB has on its current agenda with respect to PS 3250 and PS 3255.

In the meantime, we continue to believe that we have appropriately interpreted PSAB that an asset exists and that the valuation of the asset is informed by management’s best estimates which reflect expectations of the most likely outcome.

In connection with valuing the asset, we believe uncertainties should be evaluated taking into consideration the following:

- The contractual agreements between the sponsors that provide for the sharing of risks and benefits
- The contractual obligation under the Partners’ Agreement that the Province and the OTF negotiate both the benefits and the contributions and set Schedule 1 every three years where under a failure to agree might lead to mediation or arbitration, but not an assumption of the ‘status quo’.
- The specific framework within the FMP for OTPP that contemplates specific funding zones and when contribution reductions will be discussed by the sponsors
- The historical actions of the parties which reflect a history of working together to resolve both funding deficits and to use funding surpluses. As discussed most recently in 2014, 2015 and 2016 with respect to OTPP the sponsors agreed to restore indexation, which resulted in a decrease in the amount of future contributions that the Province would have otherwise had to pay to the plan in the amount of \$7.8 Billion (\$4.3 for the 2016 change, \$1.9B for the 2015 change, and \$1.6B for the 2014 change)
- The requirement with respect to OTPP for the sponsors to meet at least every three years to negotiate changes to the plan (section 10 of the Partners’ Agreement)
- Other regulatory requirements, such as provisions in the Income Tax Act that limit the accumulation of surplus in a plan which **mandates distribution** of surplus when met.

Commented [NP3]: Since the PA overrides the FMP, insert wording above.

Commented [NP4]: Though I heard this confirmed today by Len

As previously provided to you, actuarial reports were completed to assess the requirement for a valuation allowance. The results of those reports are summarized here:

Plan	Asset recorded by Province (in billions)	Asset ceiling computed (in billions) and assumption	Number of years contributions could be made without resulting in a valuation
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Management position regarding the valuation of OTPP and OPSEUPP pension assets

		re: years of contributions	allowance
OTPP	\$ 10.1	\$ 29.3 (based on 11 years of contributions)	33
OPSEU	\$ 0.5	\$ 2.8 (based on 17 years of contributions)	35

The number of years that contributions are assumed in determining the asset ceiling are those that are required to be made “regardless of any surplus” (3250.56(a)). Under the Partners’ Agreement, the parties are mandated to negotiate benefits and contributions every three years as a minimum and if agreement is not reached, it is reasonable to expect that a change in contributions might occur rather than the ‘status quo’ being retained. In addition, we have considered the impact of the provision in the Income Tax Act that limits the amount of surplus that can be held in a plan. Based on a preliminary analysis, assuming no changes to management’s assumptions and contribution levels, we believe that the OTPP Plan will be required to begin using its surplus through a reduction in contributions in between 10 and 15 years into the future. Taking this timing into account, the pension asset ceiling is in actually excess of the pension asset recognized (pension asset ceiling of between \$19.9 Billion and \$22.3 Billion), therefore, indicating that no valuation allowance is required. We would be happy to share this analysis with you.

We have also requested that additional modelling be prepared on the assumption that 50% of the surplus is used for benefit improvements and the balance is used for contribution reductions and will share that analysis and its impact on the valuation allowance once complete.

We acknowledge that the estimate of the valuation allowance, and in fact pension plan accounting as a whole, is subject to measurement uncertainty. As previously noted, accounting for pension plans involves significant estimates in all aspects of the accounting whether that be in valuation of non-traded assets, estimation of the economic assumptions used to value current service cost and the projected benefit obligation or the valuation allowance. One of the key assumptions impacting the measurement of the pension asset is the discount rate which reflects management’s best estimate of rate of return. The rate used by the government is permissible under PSAB and consistent with rates followed by other senior Canadian governments. Historical results since the inception of the plans corroborate the reasonableness of the rates used by management and the continued appropriateness for purposes of determining pension expense and pension assets on the Province’s books.

PS 2130 provides guidance on dealing with measurement uncertainty through additional disclosure in the financial statements, which we believe would be a useful addition to the current year financial statements.

PS 2130 also provides guidance on how to deal with measurement uncertainty and includes the following guidance:

Commented [NP5]: New references included in the MLR this year w.r.t. assumptions. Not sure how we get support for the 100% or the 50% model? I suppose that 50% might be more conservative and easier to sign off on?

.12 The estimation of the amount of an item to be accrued or disclosed in financial statements may be based on information that provides a range of amounts. When a particular amount within such a range appears to be a better estimate than any other, that amount would be used. When uncertainty exists, estimates used would attempt to ensure that assets, revenues and gains are not overstated and that liabilities, expenses and losses are not understated. Estimates of the financial effect are determined using professional judgment, supplemented by experience of similar transactions and, in some cases, reports from independent experts. Estimates include any additional evidence provided by subsequent events occurring after the financial statement date.

.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.

We believe this guidance needs to inform our conclusion on the appropriate valuation of the pension assets.

In conclusion, we continue to believe that the OTPP and OPSEUPP-related pension assets recorded on the books of the Province have value when assessed in accordance with PSAB standards. We recognize that the estimation and judgement used in the assessment of whether a valuation allowance is required is significant. We have sought out actuarial modelling to assess reasonable estimates of value of the assets and continue to work through additional scenarios to assess the impact on the value of the asset.

We welcome the opportunity to have a conversation with the Auditor General with respect to the reasonability of management's assumptions on intended future benefit of the asset (benefits vs. contribution reductions) and associated modelling to undertake to value these assets. In light of the timing and complexity related to this issue, for purposes of the 2015/16 Public Accounts, we are amenable to considering alternatives which would enable a timely tabling of the Public Accounts while preserving the integrity of the Province's overall financial position and results and reflects an agreement to continue to collaborate with the Office of the Auditor General on refining the government's pension benefit valuations on a prospective basis.