TBS

Office of the Provincial Controller Division

Impact of Change in Calculation of Market-Related Value for Pension Plan Assets

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Purpose

- To provide an overview on the impact of refining the estimates used to calculate the market-related value of pension plan assets (MRVA)

Market-Related Value and Smoothing

- Market-related values are adjusted market values reflecting differences between expected and actual rates of return.
- PSAB allows the differences between market value and market-related value to be deferred and amortized over a period of up to 5 years (smoothing method).
- The experience gains/losses on the smoothed value of pension plan assets will be amortized over the Estimated Average Remaining Service Life (EARSL, between 11 – 13 years across plans)
- Therefore, the timing difference as a result of smoothing will be fully amortized over a 16 – 18 years period.
- Market-related value in the PSAS:
  - *When determining a government's retirement benefit liability and expense, plan assets would be valued at market-related values. Under this method, plan assets are recorded at market value or they are adjusted to market value over a period not to exceed five years. Values adjusted to market closely approximate current economic value in a manner that can minimize short-term fluctuations. Market-related values would be used because they are objective and verifiable. Once a basis of valuation is chosen it would be applied consistently. [PSAB 3250.35]*
  - *For a defined benefit plan, plan assets should be valued at market-related values. [PSAB 3250.37]*

OPCD’s Current Approach

- OPCD has been using the following approach to arrive at a the market-related values for each plan

Plan	Current Approach
Ontario Teachers’ Pension Plan (OTPP)	Province’s economic assumption
Public Service Pension Plan (PSPP)	Plan’s economic assumption
OPSEU Pension Plan (OPSEU)	Plan’s economic assumption
Healthcare of Ontario Pension Plan (HOOPP)	Plan’s economic assumption
Colleges of Applied Arts and Technology Pension Plan (CAATPP)	Plan’s economic assumption

- E&Y indicated that the rate of return used for this calculation should be the Province’s economic assumptions, i.e. the Province’s expected rate of return rather than the Plan providers’ assumptions.

Current Approach vs. E&Y Recommended Approach

Plan	Expected Rate of Return (EROR)			Market-Related Value for 2016 ($M)		
	Current Approach	Recom'd Approach	Change increase/ (decrease)	Current Approach	Recom'd Approach	Change increase/ (decrease)
Ontario Teachers' Pension Plan	6.25%	6.25%	-	169,797	169,797	-
Public Service Pension Plan	N/A*	6.00%	N/A*	23,122	23,661	539
OPSEU Pension Plan	5.75%	6.25%	0.50%	18,415	18,505	90
Healthcare of Ontario Pension Plan	6.27%	5.75%	(0.52%)	66,422	66,228	(194)
Colleges of Applied Arts and Technology Pension Plan	5.70%	6.00%	0.3%	8,902	8,908	6

- A smaller difference in expected rate of return (EROR) will yield a smaller relative difference in the impact on the MRVA calculated under both approaches.

*Under the current approach, the OPB provides the total net realized and unrealized gain/loss on the market value of plan assets which is amortized over four years to arrive at the Province's MRVA.

Fiscal Impact if Change is Implemented for 2016-17 Pension Forecast

- No change to OTPP since the current approach aligns with the recommended approach

- Impact to the PSPP/OPSEU 2017 Budget forecast expenses:

Plan	Approach	Interim 2016-17	Plan 2017-18	Outlook 2018-19	Outlook 2019-20	Outlook* 2020-21
PSPP	Current Approach	518	675	593	579	579
	Recom'd Approach	518	594	543	538	538
	Change Deficit/(Surplus)	**(0)**	**(81)**	**(50)**	**(41)**	**(41)**
OPSEU	Current Approach	131	152	142	157	157
	Recom'd Approach	131	146	138	156	156
	Change Deficit/(Surplus)	**0**	**(6)**	**(4)**	**(1)**	**(1)**
TOTAL	**Change Deficit/(Surplus)**	**0**	**(87)**	**(54)**	**(42)**	**(42)**

**Flat-lined from 2019-20.*

Fiscal Impact if Change is Implemented for 2016-17 Pension Forecast (con't)

- No fiscal impact for HOOPP and CAATPP.
- Changes in expenses due to a change in approach for calculating the MRVA is off-set by the change in valuation allowance for HOOPP and CAATPP.

Plan	Approach	Plan Expense	Interim 2016-17	Plan 2017-18	Outlook 2018-19	Outlook 2019-20	Outlook* 2020-21
HOOPP	Current Approach	Expense	628	439	393	352	352
		Change in VA	0	144	731	845	845
		Total Expense	**628**	**553**	**1,124**	**1,197**	**1,197**
	Recom'd Approach	Expense	628	452	402	359	359
		Change in VA	0	102	722	838	838
		Total Expense	**628**	**554**	**1124**	**1,197**	**1,197**
		Change in Total Expense	**0**	**(1)****	**0**	**0**	**0**

**Flat-lined from 2019-20.*

*** Due to rounding.*

Fiscal Impact if Change is Implemented for 2016-17 Pension Forecast (con't)

- Changes to MRVA in CAATPP are small therefore the expense and the change in valuation allowance are approximately the same under both approaches.

Plan	Approach	Plan Expense	Interim 2016-17	Plan 2017-18	Outlook 2018-19	Outlook 2019-20	Outlook* 2020-21
CAATPP	Current Approach	Expense	188	208	203	185	185
		Change in VA	14	25	43	76	76
		Total Expense	**202**	**233**	**246**	**261**	**261**
	Recom'd Approach	Expense	188	208	203	185	185
		Change in VA	14	25	43	76	76
		Total Expense	**202**	**233**	**246**	**261**	**261**
		Change in Total Expense	**0**	**0**	**0**	**0**	**0**

**Flat-lined from 2019-20.*

Implementation Considerations

- Fiscal impact analysis
  - External advisors completed an analysis on the fiscal impact of the recommended method on a prospective basis (beginning in 2016-17)
  - Prospective application is appropriate for such a change in estimate.

- Implementation considerations for a prospective approach
  - The differences between the approach used by OPCD and the advisor's recommended approach reflect a change in estimate. The net timing differences are immaterial and will be fully amortized over time.
  - A prospective approach is appropriate under PSAS for a change in estimate.
  - The differences will e essentially offset by the valuation allowance for HOOPP and CAATPP which will effectively neutralize the fiscal impact.

Recommendation

- Adopt the recommended method prospectively in calculating the 2016-17 pension forecast which is also appropriate for a change in estimate.

  Rationale:

  - The change will ensure consistency in approach in calculating MRVA and pension expense among the pension plans.

- Other considerations
  - A change in expense (reduction in this case) would possibly invite more questions from the Auditor General on the reason for the change in approach

Questions?