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Ontario Teachers' Federation
Fédération des enseignantes et des enseignants de l'Ontario

Communiqué

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Pension Update
Proposal for Addressing our funding deficit

As you know, the Ontario Teachers' Pension Plan is facing a funding deficit. The contribution increases we implemented for 2007, 2008 and 2009 will eliminate the $6.1 billion deficit identified in the last Plan valuation in 2005. However, the Plan's preliminary valuation on January 1, 2008 showed a new deficit of $12.7 billion. We must take action now to reverse this deficit and protect the future pensions of all active members.

If the Partners used contributions alone to eliminate the deficit, rates would rise to more than 16% of gross salary.

For the average teacher earning $54,000, the contribution rate would mean an additional $2,833 starting in January 2009 for at least the next three years. This would mean a total of almost $8,500 in additional contributions.

The Ontario Teachers' Federation (OTF), in co-operation with the Government of Ontario and the Plan management, has thoroughly investigated all possible solutions and selected what we believe is the best option for Ontario teachers and the Province under the circumstances.

The proposal is to change the way post-retirement cost-of-living increases are determined—only on pension benefits earned after 2009. The change will affect you only after you retire.

There will be no new contribution increases for teachers at this time, other than the 0.8% increase previously scheduled for 2009. The Ontario Government will continue to match the contributions paid by Plan members and will increase its contributions, when necessary, to mirror the cost of reduced cost-of-living increases.

It is our shared goal to ensure all members' pensions are protected, with the lowest contribution rates and strongest benefits possible. Ideally, we would have preferred not to make any changes to the Plan. However, our analysis of the 2007 expert panel review and your input from the 2007 member survey have guided us to the best possible solution for ensuring the long-term viability of the Plan. This problem-solving exercise relied on the creativity and flexibility of both the Plan sponsors and the Ontario Teachers' Pension Plan Board.

Please read on for more specific details about this change and the rationale behind it.

Answering your questions

Is my pension secure?

There is no concern about the security of your pension.

Why is this happening now?

The Pension Benefits Act requires us to file a valuation with the Financial Services Commission of Ontario (FSCO) every three years to show the funding status of the Plan and, if there is a funding deficit, to show how we plan to eliminate it. The last filing was in 2005.

Why is there another funding deficit?

To answer simply, it's because of declining long-term interest rates and teachers living longer than ever. While the first part of this answer sounds dismal and the second part pretty good, the reality is that both have an adverse effect on long-term Pension Plan funding. All pension plans in Canada and across North America are now facing these same challenges.

In this difficult economic climate, it's getting harder to achieve the double-digit investment returns the Plan had in previous years. At the same time, teachers can now expect to be retired for more years than they work. Now that we are living longer, the Plan needs to ensure all working teachers receive their earned pension amounts by changing its assumptions about longevity.

The Teachers' Plan is very mature, which means the ratio of working teachers to retirees is declining. In the past, the Plan could afford to invest more aggressively (and thus reap higher returns) because it could always rely on contributions from active teachers to cover any short-term investment losses associated with this type of investing. Today, the Plan has to be more conservative in its investment approach, which means lower investment returns and less money going back into the Plan.

How is the calculation of cost-of-living increases changing?

The changes to the cost-of-living calculation will only affect pension earned after January 1, 2010 in the years when we have a funding deficit. If there is no funding deficit, retired members will continue to receive 100% of the annual cost-of-living increase. If there is a shortfall, retired members will be guaranteed 100% of the cost–of-living increase earned before 2010 and 50% of the cost-of-living increase earned after 2009. How much of the remainder is paid will depend on the funding status of the Plan.

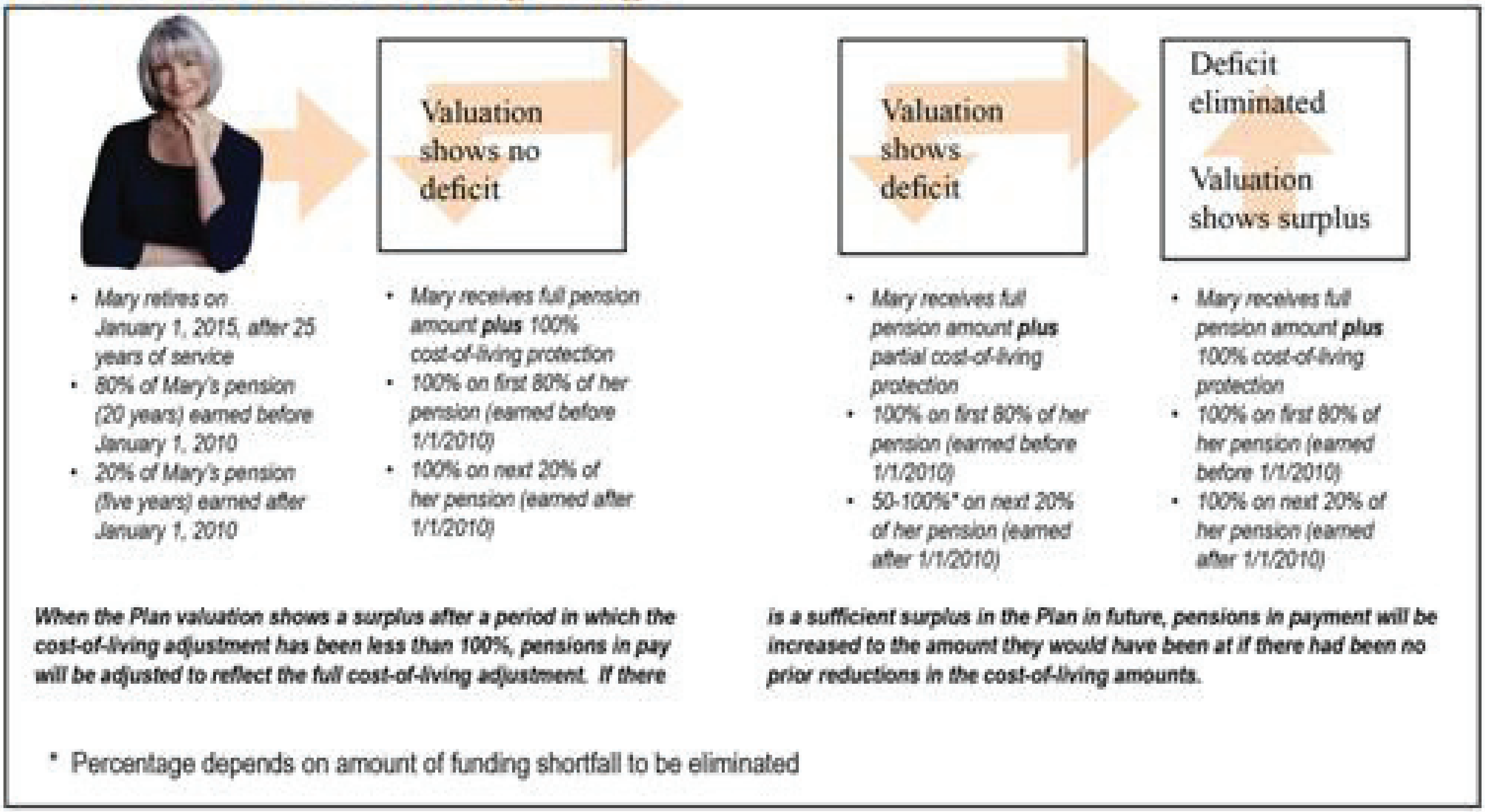
How will it be calculated?

In future, if a Plan valuation indicates a funding deficit, the normal annual cost-of-living increase on a retired member's pension earned for service after January 1, 2010 will be between 50% and 100% depending on the size of the deficit. The reduction will only be as much as necessary to eliminate the funding deficit. It will only remain in effect until a subsequent valuation is performed that indicates there is no longer a funding deficit. These changes will only affect you when you are retired.

What will this mean for me?

During retirement, your pension will not decrease. What may change in the event of a funding deficit is the amount by which your pension is increased each year to account for inflation. This is probably best explained in an example.

Possible Effect of Cost-of-Living Changes



How does this change affect the Plan?

The Partners and the Plan also propose to modify the Funding Management Policy (FMP). The FMP provides some direction in terms of potential surpluses or deficits. As a result of making this change in benefits, the parties have determined that it will be possible to adjust a part of the FMP that affects the projected cost of future benefits. While the amendment in the FMP does not guarantee that there will be no deficits in the future, it reduces the risk of future deficits. In the event there is a future deficit, this amendment will help reduce the size of that deficit.

How much of a risk is this for me?

After looking at several other mature defined benefit plans like ours that have made cost of living protection subject to plan performance, it is almost universal that retired members have received full cost-of-living allowances. This is because of the adjustment that can be made in assumptions about the cost of future pensions. It is the goal to pay full cost-of-living protection as often as possible.

Does this change affect current retirees?

No. If you are retired and already receiving your pension, your benefits and cost-of-living protection will not change, because your benefits are protected by legislation.

Why was this solution selected?

As the Plan sponsors, the OTF and the Ontario Government have only two possible ways to balance the funding of the Plan—increase contributions or change benefits (or a combination of the two). To come to the solution, OTF, the Government and the OTPP, worked together to conduct extensive research on the assumptions used to value the Plan, the safeguards put in place by other Canadian pension plans of a similar size and maturity, and the preferences of working members. Based on this due diligence, we determined that further contribution increases would not be a sustainable way to address our funding challenge in the long term and that, of the benefit changes possible, the most palatable option among working members is to change the way post-retirement cost-of-living increases are determined when there is a funding deficit.

The proposed solution is similar to the solutions that have already been put in place for the Hospitals of Ontario Pension Plan and the Colleges of Applied Arts and Technology Pension Plan.

Why couldn't we just increase contributions?

If we relied on contribution increases alone, we would need to raise contributions to more than 16% of gross salary, far beyond what teachers have indicated they would tolerate and beyond the 15% cap that we committed to at the last valuation. Over time, newer teachers would be shouldering the brunt of this and any future deficits through increasingly higher contributions. We did not believe this was an equitable solution.

What other options were possible?

Other possible benefit changes considered were increasing the 85-factor to 90 or decreasing pension benefit levels by 10%. When we asked teachers which benefit change they would be most comfortable with should contribution increases alone be insufficient to address a funding deficit, most chose to make the amount of cost-of-living increases conditional on the health of the Plan—with the understanding that cost-of-living increases would resume in full once the Plan could afford it.

How does the Government pay its share?

If there is a change required to the cost-of-living calculation in future due to a funding deficit, the Government will contribute an extra amount to the Plan —equal to the amount retired members did not receive as cost-of-living increases that year. In this way, the Government will do its part to reduce the deficit so that those affected will return to 100% cost-of-living protection sooner.

Will we still have a contribution increase in 2009?

Yes, but it will be the expected 0.8% increase implemented to eliminate the 2005 funding deficit. There will be no change in contributions in 2010 or 2011.

How did we get here?

In 2005, contribution rates were increased to eliminate a $6.1 billion deficit in the last funding valuation. In that deal, the OTF and the Government also agreed to:

- Cap contributions at 15%.
- If contributions reached the cap of 15%, consider changing benefits.
- Conduct a survey to determine member preferences in case of future deficits.
- Retain an expert panel to examine the actuarial basis used for valuations.

At that time, we told you that the cost of providing pensions was growing faster than Plan assets despite continued strong investment returns. We also warned that we could have a deficit in 2008.

Since the preliminary Plan valuation in January 2008 showed a funding deficit, your representatives and a sub-committee of the OTF Executive have been meeting with the Government and the Plan managers. We analyzed the options and discussed what we would need to do to ensure the filing—due to the FSCO on September 30, 2008—would be balanced.

Once the sub-committee reached agreement on the solution, it reported to the Executive. The OTF Board of Governors was then convened to hear the details.

Why are benefits changing?

It was our greatest hope that we would never have to make the changes to the Plan. However, after carefully reviewing all the options, we believe that changing the way we calculate post-retirement cost-of-living increases, when needed to address a deficit, is the most palatable solution. It will ensure we keep contributions under the 15% cap and is in keeping with members' feedback on the change they would prefer should it become a necessity.

What are the next steps?

We will reconvene the Board of Governors on September 29, 2008 to seek its support of the agreement. The valuation will be filed with the FSCO by the September 30, 2008 deadline. Between now and March 2009, OTF, the Government, and the Plan managers will work out the precise mechanism for calculating cost-of-living increases during funding deficits.

Going forward, a new Partners' Advisory Committee will meet quarterly to share information regarding Plan economics and the actuarial assumptions.

Additionally, a mechanism is being put into place to allow a review of the assumptions used for the OTPP. The setting of assumptions is a critical process. The OTPP Board has a fiduciary responsibility to oversee the management of the Plan, including operations, investment, strategy and the projection of the Plan's liabilities into the future. At times, one or both Partners have questioned whether the assumptions used by the Plan were too conservative. The establishment of an on-going committee to share information about all aspects of the Plan will ensure your teacher representatives and your Government partner are well informed and we will have additional opportunities to share our views and provide input to the Plan through this process.

We will continue to keep you informed as details are finalized. If you have any questions, please contact OTF's Director of Pension & Economic Affairs or your Affiliate pension officer.