UPP3

Backgrounder #1
for Labour Leaders

This backgrounder has been produced by the labour side of the University Pensions Project to introduce some of the key issues driving current pension discussions at Guelph, Queen's and U of T, and why a jointly sponsored pension plan (JSPP) is being explored. You will receive additional backgrounders in the coming weeks and months.

Current status of university pension plans

Under the defined benefit (DB) pension plan framework now in place at most Ontario universities, you receive a lifetime pension based on a formula tied to earnings and service. Your pension is paid from the pension fund, which is made up of employer and employee contributions, and investment earnings on these contributions. Employee contributions are set out in the plan text and may be modified through collective bargaining. The employer must make all necessary contributions to cover plan deficits to meet Ontario's funding requirements, and in good times, it controls any surplus.

Many pension plans in the Ontario university sector currently have significant funding shortfalls—in most cases initially triggered by the 2008 financial crisis. To pay down their shortfalls, each university administration makes large additional annual payments along with their regular pension contributions into their own plan or plans. Moreover, in the absence of major changes to their plans or to current provincial funding requirements (see page 2), or both, university administrations face hundreds of millions of dollars in additional shortfall payments. These payments have serious repercussions for operating budgets and are increasing pressure for concessions from employees, such as increasing contributions, reducing future pension benefits, or a combination of these. Indirect costs affecting negotiations could be job cuts, lower wage increases, and other austerity measures.

TWO SIDES OF A PENSION PLAN

Assets in pension fund	Liabilities
Contributions and investment earnings	Cost of pensions owed to active, inactive and retired members

Estimated cost of $30,000 annual pension paid for life with a 10-year guarantee, starting at age 65

10 years ago: **$444,000**

VS

Today: **$576,000**

Increase due to longer life expectancy (+80K) and low interest rates (+52K)

How we got here

Three factors contributing to the current pension funding challenges are:

1. low interest rates;
2. improvements in life expectancy, which translate into longer pension payouts (and costlier pensions); and
3. volatile investment markets, which are making it more difficult to achieve reasonable and predictable investment returns.

These challenges are compounded by current provincial funding requirements, which determine how the financial health of the plan is measured and what additional contributions must be made in the event of a shortfall.

Provincial funding requirements

Pension plans are required to file a formal valuation with the Ontario pension regulator at least once every three years. This valuation tests a plan's health based on two scenarios:

1. **going concern**, which assumes the plan will continue to operate as expected for many years to come; and
2. **solvency**, which assumes the plan ends on the date of the valuation, and is designed to protect plan members in the case of employer bankruptcy.

Most plans currently have both going concern and solvency shortfalls. In particular, most plans have experienced a significant deterioration in their solvency position. This is largely because the solvency valuation is required to use point-in-time interest rates to determine the money needed to provide pensions owed to members. When interest rates drop, more money is required to provide these pensions—and vice versa. Even minor changes in interest rates can have a dramatic impact on solvency funding results.

A drop in interest rates of

1%

increases solvency funding obligations by about

15-20%

In recognition of the dramatic impact current low interest rates have had on Ontario university plans' solvency results, the province has granted temporary solvency relief for universities that eliminates, or substantially reduces, any payments to address their solvency shortfall. The province has also been working toward developing a more permanent approach to pension funding. Information released on May 19, 2017 suggests that notwithstanding this new approach, university DB plans will likely continue to face funding challenges. Please refer to UPP3 Backgrounder #4.

SOLVENCY VALUATION | **GOING CONCERN VALUATION**

Valuation date

Solvency valuation

- Tests plan's health assuming the university shuts down on the valuation date
- Compares market value of fund on date of valuation to current value of pensions earned by members
- Can exclude certain benefits (such as indexing)
- Tied to current interest rates and prescribed assumptions
- Additional deficits paid off over 5 years (under current regulations)

Going concern valuation

- Measures plan's health assuming it continues to operate long past the valuation date
- Compares value of fund on date of valuation to value of benefits earned as of valuation date
- Uses reasonable long-term assumptions based on information available at valuation date including:
  - When members will retire
  - Future investment returns
- Deficits paid off over 15 years (under current regulations)

Valuations must currently be filed with the pension regulator at least every three years.

Solvency funding review

It is expected that solvency funding would no longer apply on conversion from a single employer pension plan to a multi-employer JSPP, and the need to fund any solvency shortfalls would be eliminated. Under the current funding regime, all multi-employer JSPPs are exempt from solvency funding. Given the success enjoyed by these plans and their collective lobbying power, the province has made no move to change JSPP funding rules.

We also know that managing the cost of funding and maintaining defined benefit pension plans in the university sector has been on the provincial government's agenda since its 2012 release of the Drummond report on the reform of Ontario's public services and subsequent budget.

The province wants equal sharing of pension costs between employers and employees—which naturally leads plan members to insist on equal participation in plan governance. The province also supports the consolidation of plans to achieve efficiencies of scale.

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Jointly sponsored pension plan (JSPP) option

JSPPs aren't new. Ontario's JSPPs currently make up six of the largest pension plans in the province, including the Ontario Teachers' Pension Plan (OTPP), the Ontario Municipal Employees Retirement System (OMERS) and the Healthcare of Ontario Pension Plan (HOOPP). These plans have a long history, and are internationally respected for their ability to provide secure, high-quality pensions.

JSPPs provide defined benefit pensions. However, whereas university administrations are responsible for governing current plans and ensuring they meet provincial funding requirements, management and labour sponsors in a JSPP share equally in plan governance and plan costs.

Three important drivers of UPP3:

1. *Protect defined benefit pensions, which provide a secure and predictable income at retirement;*
2. *Establish a prudent and stable funding regime; and*
3. *Give employees an equal voice in the management of the plan.*

UNIVERSITY PENSIONS PROJECT

To achieve exemption from solvency funding and the economies of scale desired by the province, stakeholders from the University of Guelph, Queen's University and the University of Toronto are working to design a JSPP option for Ontario's universities. The goal is to provide pension benefits that are at least as good as you have today. Once the design of this JSPP option is concluded, the plan will be open to all Ontario universities that want to join. You should note that under pension law all benefits earned to date will be protected, with the JSPP design covering future benefits only.

HOW THE TRANSITION TO THE NEW PLAN WOULD WORK

Each university would be responsible for funding its current deficit at the time of conversion to the new plan. With these deficit payments, the JSPP would be fully funded on a going concern basis at inception. Future gains and losses would be managed jointly by a sponsor board, with equal representation by employers and employees—and future contributions and benefits would be calculated on the same terms across all participating universities.

For existing employees, your final pension will be a combination of the secured benefits earned under your old plan and those earned under the new JSPP. Retirees would continue to receive their pensions as usual, but payments would be made by the new JSPP.

The decision to convert to the new plan requires a formal consent process (laid out in Regulation 311/15 of the Pension Benefits Act), and ratification by active, inactive, and retired members/beneficiaries.

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The process for moving forward

- UPP3 will work toward finalizing a "term sheet" by June 30th. This document will provide details on the provisions of the JSPP, its governance structure and the transition process.
- Working with stakeholder groups, UPP3 will embark on a broader education and consultation process.
- This will be followed by the necessary internal approval processes, union processes and member ratification processes.

WHAT YOU CAN DO

We encourage you to follow and become active in the discussions. Here's how you can do that:

- **Understand the issues:** In the weeks and months ahead, there will be presentations, question and answer documents, and a website set up as a focal point for all supporting materials.
- **Lend your voice:** Your feedback on the issues will play an important part in how the JSPP option unfolds.
- **Stay up to date:** We'll keep you informed along the way, and send notifications when new information is posted to the website.
- **Attend information sessions:** Your active participation will help promote meaningful discussion.