Top Plan Funding Q&As

FUNDING NEWS

1 Q: WHAT IS THE PENSION PLAN'S FUNDED STATUS?

A: The Ontario Teachers' Pension Plan has sufficient assets to meet its future pension obligations to all members, according to a 2014 funding valuation. The valuation shows the pension plan is fully funded based on partially restored inflation protection levels and current contribution rates.

A funding valuation assesses a pension plan's current long-term financial health looking out more than 70 years, when today's youngest members and their survivors could still be collecting pensions.

2 Q: I THOUGHT THE PENSION PLAN HAD A FUNDING SURPLUS?

A: The pension plan had a preliminary $5.1 billion funding surplus as of Jan. 1, 2014. The pension plan sponsors - the Ontario Teachers' Federation (OTF) and the Ontario government - have agreed to use the surplus to partially restore reduced levels of inflation protection for recent retirees.

3 Q: HOW WILL THE SURPLUS BE USED?

A: The surplus will be used to partially restore cost-of-living increases affecting the portion of retirees' pensions earned after 2009. Inflation protection levels were reduced for post-2009 pension credit to deal with recent funding shortfalls.

4 Q: HOW WILL THE SURPLUS DECISION AFFECT ME?

A: Only members who retired after 2009 are directly affected. These members are receiving lower levels of inflation protection as a result of recent funding shortfalls.

Have a look at the chart below to see how the surplus decision affects you.

Member Group	How the spending of the surplus affects you
If you retired before 2010	• No effect. • You continue to receive an annual pension increase equal to 100% of the annual increase in the Consumer Price Index (CPI).
If you retired after 2009	• There are two changes that will increase your gross annual pension, beginning in 2015. See the next Q&A for details.
If you are retiring this year	• In January 2015, you will receive a pension increase equal to 60% of the annual CPI increase for the portion of your pension earned after 2009, plus 100% for the portion of your pension earned before 2010. • Your first pension increase will be prorated to reflect the time you were on pension in 2014.
If you are still working	• No effect. • Inflation increases are determined after you retire.

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5 **Q: HOW WILL THE PARTIAL RESTORATION OF INFLATION PROTECTION AFFECT TEACHERS WHO RETIRED AFTER 2009?**

A: If you retired after 2009, you will see two increases in your pension, beginning in January 2015.

1. Restoration of inflation increases
Your pension will be restored to the level it would have been at if full inflation protection had been provided each year since you retired. This will result in an annual pension increase of up to $50, depending on your personal circumstances.

For example, if Maria's gross annual pension is $49,950, but would have been $50,000 with full inflation increases, she will receive a $50 boost in her pension, beginning in January 2015. That means her gross annual pension will be restored to $50,000. There is no retroactive payment associated with the increase.

2. Increase in inflation level
On top of the restoration of forgone inflation increases, you will receive an annual pension increase, as usual. In 2015, the increase will equal 60% of the annual increase in the Consumer Price Index (CPI) for the portion of your pension earned after 2009, up from the current level of 50%. You will continue to receive 100% inflation protection for the portion of your pension earned before 2010.

The new 60% inflation level will remain in effect at least until the next funding valuation is filed with the regulators.

Continuing with the earlier example, Maria's $50,000 pension would increase by $488 in 2015 if inflation is 1% this year. Most of this increase would be based on the pension credit she earned before 2010.

6 **Q: WHY IS THE SURPLUS BEING USED TO RESTORE INFLATION PROTECTION?**

A: Inflation protection for pension credit earned after 2009 is used as a lever to help manage fluctuations in the plan's funding status, facilitating stability in contribution rates and other pension benefits. When the pension plan has a funding shortfall, smaller cost-of-living increases can help to bring the plan back into balance. When there is a funding surplus, inflation levels may be partially or fully restored.

7 **Q: HOW LONG WILL THE NEW INFLATION LEVEL REMAIN IN EFFECT?**

A: The new 60% level of inflation protection will remain in effect at least until the next funding valuation is filed with the regulators.

8 **Q: WHAT ARE THE CURRENT AND NEW LEVELS OF INFLATION PROTECTION?**

A: Here's an overview of the inflation levels that affect teachers who retired after 2009.

Annual cost-of-living increases

Pension credit	Allowable levels	Current levels	New levels in 2015
Earned before 2010	100%	100%	100%
Earned during 2010-2013	50% to 100%	50%	60%
Earned after 2013	0% to 100%	50%	60%*

**Originally scheduled to be reduced to 45% in 2015, based on the 2012 funding valuation.*

Keep in mind that inflation increases only come into play after a teacher retires. Teachers who retired before 2010 receive 100% inflation protection, while those who retired after 2009 receive conditional inflation protection on pension credit earned after 2009.

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9 **Q: WHY ISN'T THE SURPLUS BEING SAVED FOR A RAINY DAY OR USED TO LOWER CONTRIBUTION RATES?**

A: OTF and the government have a policy to guide decisions on the use of surplus funds. Their first priority is to restore reduced levels of inflation protection. After inflation protection levels have been restored, OTF and the government may consider other changes.

10 **Q: HOW DID THE SURPLUS COME ABOUT?**

A: A 10.9% return on investments in 2013 and higher interest rates are the primary reasons for the surplus.

The positive return on pension fund investments helped boost assets, while higher interest rates lowered future pension costs.

Future pension costs were also reduced by the sponsors' decision in 2013 to set inflation protection at reduced levels for pension credit earned after 2009.

11 **Q: DOES THIS MEAN THE PLAN'S FUNDING SHORTFALLS ARE OVER?**

A: The pension plan still faces challenges. These include increasing longevity, longer periods of retirement, low interest rates and a volatile investing environment that is not expected to produce the same high investment returns achieved in the past.

OTF, the Ontario government and pension plan management are studying issues related to the cost of providing pensions to all generations of teachers.

Among the issues they are studying is the imbalance between contributing and retired years. A typical teacher retires at 59. The combined effect of early retirement and increased longevity means a typical member contributes to the plan for 26 years and collects a pension for 31 years.

12 **Q: WHAT ARE THE CURRENT CONTRIBUTION RATES?**

A: A two-tiered formula is used to calculate member contributions to the Teachers' pension plan.

In 2014, members contribute:

- 11.5% of their annual salary up to the Canada Pension Plan (CPP) pensionable earnings limit, plus
- 13.1% of any salary above the CPP limit.

The CPP pensionable earnings limit, which changes annually, is $52,500 in 2014. Member contributions to the Teachers' plan are matched by the Ontario government and participating private employers on behalf of all members.

PENSION SECURITY

13 **Q: IS MY PENSION SECURE?**

A: Yes, OTF and the Ontario government are committed to the long-term viability of the pension plan.

14 **Q: IF THERE IS A FUNDING SHORTFALL IN THE FUTURE, CAN MY BENEFITS BE REDUCED?**

A: Yes, but not retroactively. Ontario's Pension Benefits Act protects the value of pension benefits already earned by working and retired members.

15 **Q: SHOULD I RETIRE NOW, WHILE THE PLAN IS IN A STRONG FINANCIAL POSITION?**

A: Choosing a retirement date is a personal decision. Can you afford to retire now? Are you ready to stop working? These are among the many questions you should explore.

It's unnecessary to advance or delay your retirement plans because of the pension plan's funded status. Teachers' pensions provide a guaranteed stream of income defined by a formula based on years of credited service and average salary.

Top Plan Funding Q&As - continued

FUNDING CHALLENGES

16 **Q: WHY WERE THERE RECURRING FUNDING SHORTFALLS IN THE RECENT PAST?**

A: In the past decade, plan liabilities (the cost of future pensions) grew faster than plan assets, despite strong investment returns. Increased life expectancy, longer retirements and low long-term interest rates caused future pension costs to rise faster than the growth in plan assets.

These factors resulted in recurring shortfalls between 2005 and 2013 that the sponsors (OTF and the government) addressed through contribution changes and the move to conditional inflation protection.

17 **Q: HOW DO INTEREST RATES AFFECT PENSION COSTS?**

A: Interest rates are used as a starting point to estimate the cost of future pensions because they predict future economic growth. When long-term interest rates fall, as they did in recent years, pension costs rise. That's because more money needs to be set aside now to earn the investment returns needed to pay pensions in the future.

Low interest rates are great for borrowing, but not for saving. When long-term interest rates drop, the plan needs to set aside more money to reach its goal.

Have a look at the chart to see the impact of interest rates on the cost of providing a typical teacher's pension.

ASSETS REQUIRED FOR A TYPICAL $48,000 PENSION STARTING AT AGE 59*

Real Rate	Amount Required
1.0%	$1.2 million
1.5%	$1.1 million
2.0%	$1.0 million
3.0%	$900,000
4.0%	$795,000
5.0%	$705,000

** Based on an unreduced pension with a normal form of 50% joint and survivor pension and 10-year pension guarantee.*

18 **Q: CAN WE EXPECT INTEREST RATES TO CONTINUE HAVING A POSITIVE EFFECT ON THE PLAN?**

A: Although interest rates are increasing, they are expected to remain low by historical standards for some time. When long-term interest rates rise, as they did in 2013, it helps to reduce future pension costs. The Teachers' pension plan uses a three-year average interest rate as a starting point to determine the discount rate, a key actuarial assumption. A three-year rate instead of a rate at a single point in time helps to smooth out volatility. However, using this three-year average means there will be a lag between the rise in interest rates and the positive effect of higher rates on future pension costs.

19 **Q: HOW DOES THE DISCOUNT RATE AFFECT PENSION COSTS?**

A: The discount rate plays a key role in projecting whether the pension plan has enough assets to meet its future pension obligations. A lower discount rate assumption increases the projected cost of pensions, while a higher assumption lowers this cost.

20 **Q: IS THE DISCOUNT RATE REASONABLE?**

A: The discount rate has been independently reviewed by industry experts three times in the last six years. Each time the rate was determined to be within a reasonable range, given the demographic profile of the Teachers' plan. Other pension plans may use different discount rates because their membership characteristics are different.

Changing the discount rate does not change factors such as increased life expectancy, one of the demographic factors that are leading to higher pension costs.

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MISCELLANEOUS

21 **Q: CAN A MEMBER CONTRIBUTE MORE TO THE PENSION PLAN TO "PAY FOR" FULL INFLATION PROTECTION?**

A: No, contributions to the Teachers' plan are based on a percentage of salary. The plan is not set up to take additional contributions from members to top up their benefits.

22 **Q: HOW IS THE LEVEL OF INFLATION PROTECTION DETERMINED?**

A: The two plan sponsors, OTF and the Ontario government, set contribution rates and benefit levels. They jointly determine indexation levels as part of this process. Inflation protection on pension credit earned after 2009 depends on the plan's funded status at the time a funding valuation is filed with the provincial pension regulator.

23 **Q: IF THE PENSION PLAN JUST MADE MORE MONEY OR REDUCED COSTS, WOULD WE BE ABLE TO PUT SHORTFALLS BEHIND US?**

A: The pension plan is already earning double-digit returns and its 10-year investment performance ranked the highest among similar pension plans around the world for three years, according to CEM Benchmarking Inc. However, we do not expect to replicate the high returns earned in previous decades. We are in a volatile, low-return investment environment, so it is not prudent to rely on investment income alone to balance the plan's assets and liabilities.

The pension plan is committed to cost effectiveness and carefully monitors budgets and costs. Managing a successful investment program and providing top-notch member service means certain expenditures are necessary, but the plan is constantly looking for efficiencies to keep costs at a reasonable level.

More information is available in the 2013 Annual Report.

24 **Q: WHY WILL SOME GENERATIONS OF MEMBERS RECEIVE POTENTIALLY LOWER INFLATION INCREASES THAN OTHER GENERATIONS OF MEMBERS?**

A: No generation of teachers has received exactly the same benefits as the one before or after it. Economies and job markets change; interest rates and inflation rates change; and prices for goods and services change. Pension plans also change.

For example, inflation protection was not provided automatically until the mid-1970s, and many older members did not have an opportunity to retire at an 85 factor or receive a 10-year pension guarantee.

Have a look at the infographic, The Evolution of a Teachers' Pension, to see how pension benefits and contribution rates have changed with the times since a pension plan was created for Ontario teachers in 1917.

Keep in mind that Ontario's Pension Benefits Act protects the value of pension benefits already earned by working and retired members.

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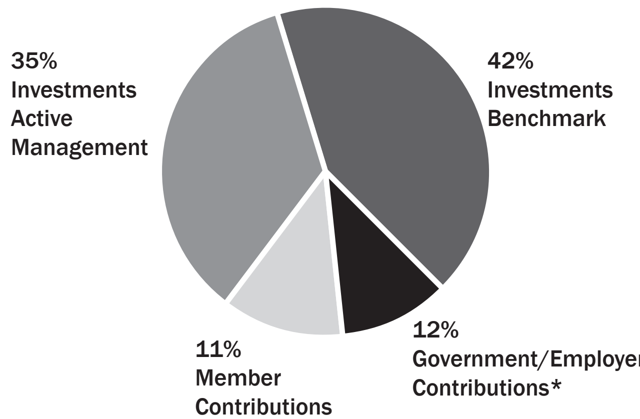
25 **Q: DOES THE GOVERNMENT PAY A HIGHER CONTRIBUTION RATE THAN TEACHERS DO?**

A: The contribution rate is the same for members and the government, as well as other employers that participate in the pension plan, such as private schools. The Ontario government and other employers match total member contributions.

Since 1990, about 77% of the funds used to pay teachers' pensions have come from returns on plan investments.

PENSION FUNDING SOURCES SINCE 1990



**includes 1% original plan deficit funding.*

In addition, the Ontario government and other employers make extra payments to the pension plan equal to the total annual inflation increases that retirees forgo, as a result of conditional inflation protection, to a maximum of 50% missed inflation.