Top Plan Funding Q&As

2012 SHORTFALL ADDRESSED

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

A: The Ontario Teachers' Federation (OTF) and the Ontario government resolved the pension plan's 2012 preliminary funding shortfall. However, another small preliminary shortfall is projected for 2013 because the cost of future pensions continues to grow faster than plan assets. For this reason, OTF and the government will be studying all factors, including demographic challenges, which contribute to funding shortfalls.

2 **Q: HOW WAS THE 2012 SHORTFALL RESOLVED?**

A: OTF and the government changed the way inflation increases will be calculated after teachers retire. Inflation protection for pension credit earned after 2013 will range from zero to 100% of the cost of living, depending on the plan's funded status. In addition, annual cost-of-living increases for recent retirees have been set a little lower. For more information, see page 3, Changes in Inflation Protection.

3 **Q: WHAT DEMOGRAPHIC CHALLENGES WILL BE STUDIED?**

A: Life expectancy for teachers is higher than the general population and continues to increase. Today, a typical teacher retires at 59 and can expect to collect a pension for 30 years or more. The combined effect of early retirement and increased longevity means members now typically collect pensions for more years than they contribute to the pension plan.

A task force, facilitated by Dr. Harry Arthurs, will study a broad range of issues related to changing demographics and intergenerational risk. Dr. Arthurs, former Dean of Osgoode Hall Law School, chaired the review of Ontario's pension legislation in 2006-2008.

There will also be a survey of working members later this year to identify their preferences for possible changes in benefits should funding shortfalls persist.

4 **Q: WHY WAS ACTION TAKEN NOW TO RESOLVE THE SHORTFALL? I THOUGHT WE DIDN'T HAVE TO DO ANYTHING UNTIL 2014.**

A: OTF and the government jointly decided to file the plan's 2012 funding valuation two years earlier than required by the pension regulator. An earlier filing was determined to be in the best interests of members and taxpayers because the pension plan's funding status was projected to deteriorate due to continued low interest rates and demographic factors. An earlier filing avoids potentially more dramatic changes that likely would be necessary if the valuation were filed later. No other action is required to address future shortfalls until 2015, although the sponsors could once again choose to file earlier than required.

5 **Q: WHY DID OTF AND THE GOVERNMENT CHANGE THE INFLATION PROVISION? WHAT OTHER OPTIONS WERE CONSIDERED?**

A: To address a projected shortfall, OTF and the government can:

- Increase contribution rates
- Reduce inflation protection for pension credit earned after 2009
- Reduce other pension benefits members will earn in future years
- Use a combination of these options

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Contribution rate increases beyond those scheduled for next year were not considered because the government is unable to match further rate increases due to efforts to reduce the provincial deficit.

Other benefit changes may be considered if needed in future (see question 3).

That left one option: further reducing inflation protection for future pension credit earned after 2009.

6 **Q: WHY SHOULD YOUNGER TEACHERS PAY MORE AND GET LESS?**

A: Only contribution rates and future benefits can be changed to keep the pension plan fully funded. Pension benefits already earned are protected under current Ontario law.

7 **Q: WHY COULDN'T THE PENSION PLAN JUST CHANGE THE DISCOUNT RATE TO RESOLVE THE SHORTFALL?**

A: The discount rate assumption 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.

The pension plan board increased the discount rate assumption used in the filed valuation because funding risk was reduced with the change in the inflation provision. The new rate was supported by an independent review of the discount rate used in the pension plan's preliminary 2012 valuation if inflation protection were made fully conditional on the plan's funded status.

8 **Q: WHY CAN'T THE PENSION FUND JUST EARN MORE MONEY SO WE DON'T HAVE FUNDING PROBLEMS?**

A: The pension plan has experienced funding problems despite leading investment performance. A study of pension funds around the world showed the Teachers' plan had the highest 10-year average total investment return to the end of 2010. The study was conducted by CEM Benchmarking Inc., a leading authority on pension fund performance. Since 1990, the pension plan has achieved an annualized investment return of 10%. Because the Teachers' plan is mature, it is not prudent to take more investment risk to try to boost returns.

9 **Q: I'M UNHAPPY ABOUT THE INFLATION CHANGE. WHAT CAN I DO? WHO SHOULD I TALK TO?**

A: OTF and the Ontario government are responsible for plan funding decisions and for determining the plan's contribution rates and benefits. You can contact your affiliate pension representative or OTF directly for more information or to express your views.

PENSION SECURITY

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

A: Yes, OTF and the Ontario government are committed to the long-term viability of the pension plan. With $117.1 billion in assets, the pension plan has enough money to pay pensions for many years. But pension plans are required to look ahead 70 years or more. That's when today's newest teachers and their survivors could still be collecting their pensions.

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11 Q: CAN MY BENEFITS BE REDUCED?

A: Yes, but not retroactively. Current Ontario legislation protects the value of pension benefits already earned by working and retired members. Only pension benefits not yet earned can be adjusted during a teacher's career.

12 Q: COULD THE GOVERNMENT CHANGE THE LEGISLATION THAT PROTECTS THE BENEFITS I'VE ALREADY EARNED?

A: The government can change legislation, but we cannot speculate on whether that will occur.

13 Q: SHOULD I RETIRE NOW BEFORE MORE CHANGES ARE MADE?

A: It's unnecessary to delay or advance retirement plans because of concerns about possible future benefit changes. Teachers' base pensions are defined by a formula based on years of credited service and average earnings. Also, keep in mind that the value of pension benefits already earned cannot be reduced retroactively under current pension law.

CHANGES IN INFLATION PROTECTION

14 Q: WHAT IS CHANGING?

A: Inflation increases for the portion of your pension earned after 2013 could range from zero to 100% of the change in the cost of living, depending on how much the plan can afford to pay. Inflation protection after you retire is now based on three periods of pension credit, as shown in the chart below:

15 Q: WHAT WILL THE INFLATION INCREASE BE FOR RETIREES?

A: As part of the 2012 shortfall agreement, OTF and the government set the following levels of inflation protection:

- Beginning in 2014, retirees will receive 50% of the increase in the Consumer Price Index (CPI) for the portion of their pension that was earned in 2010–2013 (down from 60%); and
- Beginning in 2015, retirees will receive 45% of the increase in the CPI for the portion of their pension that was earned after 2013.

When a working teacher retires, the level of inflation protection may be different than what is noted above – it will all depend on how much the plan can afford to pay at that time.

Inflation increases for pension credit earned before 2010 remain unchanged at 100% of the change in the CPI.

16 Q: WHERE CAN I GET MORE INFORMATION ON THE INFLATION CHANGE?

A: More information and examples are available in the news section of www.FundingYourPension.com and in the plan funding section of www.otpp.com (located under the Corporate tab). Look for a PDF document on the 2012 shortfall agreement. There is one for pensioners and one for working teachers.

PENSION CREDIT	INFLATION PROTECTION*	WHAT IT MEANS AFTER YOU RETIRE
Earned before 2010	100%	This portion of your pension will keep pace with increases in the cost of living.
Earned during 2010-2013	50% to 100%	Increases for this portion of your pension will range from 50% to 100% of the annual increase in the cost of living, depending on the plan's funded status.
Earned after 2013	0% to 100%	Increases for this portion of your pension will range from zero to 100% of the annual increase in the cost of living, depending on the plan's funded status.

*Inflation protection is based on changes in the cost of living, as measured by changes in Statistics Canada's Consumer Price Index (CPI)

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FUNDING CHALLENGES

17 **Q: WHY DO WE HAVE RECURRING FUNDING SHORTFALLS?**

A: Plan liabilities (the cost of future pensions) are growing faster than plan assets. This trend continues despite strong investment returns and recent plan changes.

Increased life expectancy, longer retirements and low long-term interest rates are increasing future pension costs faster than the expected growth in plan assets, resulting in recurring funding shortfalls.

18 **Q: WHY ARE LOW INTEREST RATES AFFECTING 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 have in recent years, pension costs rise because more money needs to be set aside now to earn the value of pensions that will be paid in the future.

Low interest rates are great for borrowing, but not for saving. Imagine you are saving for a down payment for a house or car by a specific date. If your savings earn less each year because interest rates are low, you will have to put aside more money to reach your goal on time. It's the same with pensions. When long-term interest rates drop, the plan needs to set aside more money to reach its goal.

ASSETS REQUIRED FOR A $40,000 PENSION

Real Interest Rate	Amount Required
1.0%	$985,000
1.5%	$915,000
2.0%	$850,000
3.0%	$740,000
4.0%	$655,000
5.0%	$580,000

19 **Q: HOW ARE DEMOGRAPHICS CONTRIBUTING TO RECURRING SHORTFALLS?**

A: Longer life spans and longer retirements are pushing up pension costs. In 1970, a typical teacher could expect to collect a pension for about 20 years. A typical teacher retiring today can expect to collect a pension for about 30 years, four years longer than she contributes to the pension plan. Plus, a pension may be paid to a survivor.

20 **Q: DO OTHER PENSION PLANS HAVE FUNDING CHALLENGES?**

A: Aging populations and low interest rates have put unprecedented demands on pension plans all over the world. Many organizations have closed their defined benefit plans, shifting the risk of retirement security to their employees. To survive, defined benefit plans will need to adapt to new economic and demographic realities.