Top 10 Funding Q&As

1 **Q: HOW HEALTHY IS THE TEACHERS' PENSION PLAN?**

A: The Ontario Teachers' Pension Plan reported a preliminary $17.1 billion funding shortfall as at Jan. 1, 2010. At that date, the Plan had 89% of the estimated funds required to meet its future pension obligations.

2 **Q: WHY DOES THE PLAN HAVE A SHORTFALL?**

A: The cost of future pensions is growing faster than plan assets, despite strong investment returns in 2009.

Low interest rates are a problem for pension plans like the Teachers' plan. Most of the 2010 preliminary short fall was due to further declines in long-term real (after inflation) interest rates. Interest rates are used to estimate the cost of future pensions. When interest rates fall, pension costs rise because more money needs to be set aside to earn the value of pensions that will be paid in the future. Real interest rates declined to 1.5 per cent at the end of 2009 from 2.1 per cent at the start of the year, adding $15.2 billion to the projected cost of future pensions.

The pension fund's 2008 investment loss also contributed to the 2010 shortfall because the Teachers' plan, like most pension plans, spreads investment gains or losses over five years to reduce volatility. This practice of evening out investment fluctuations is known as smoothing. Due to smoothing, a portion of the 2008 loss is being absorbed each year until 2012.

3 **Q: HOW WILL THE SHORTFALL BE RESOLVED?**

A: To address a funding shortfall, the Ontario Teachers' Federation (OTF) and the Ontario government, which jointly sponsor the Teachers' pension plan, could:

- increase contribution rates;
- invoke conditional inflation protection on pension credit earned after 2009;
- reduce benefits members will earn in future years; or
- adopt a combination of these options.

4 **Q: WHEN WILL THE SHORTFALL BE RESOLVED?**

A: If a shortfall persists, the OTF and the Ontario government must eliminate it before the next funding valuation is filed with the provincial pension regulator. The next required filing is due in 2012, although the OTF and government can choose to file earlier.

5 **Q: IS MY PENSION SAFE?**

A: Current Ontario legislation protects the value of pension benefits already earned by working and retired members. Only contribution rates and pension benefits to be earned in future years can be adjusted during a teacher's career in response to funding shortfalls.

6 **Q: SHOULD I CHANGE MY RETIREMENT PLANS BECAUSE OF THE SHORTFALL?**

A: It's unnecessary to delay or advance retirement plans because of the shortfall or concerns about possible future benefit changes. Teachers' pensions are defined by a formula based on years of pension credit and average earnings. Basic pensions do not depend on the size of the pension fund or the funding status of the plan when you retire.

7 **Q: WILL THE SHORTFALL DISAPPEAR WHEN THE ECONOMY IMPROVES OR INTEREST RATES RISE?**

A: An increase in long-term real interest rates will help the plan's funding status because it will decrease the estimated cost of future pensions. However, it's risky to assume it will solve the problem because markets and interest rates are unpredictable and sometimes volatile. The plan's funding status is affected by several other factors, including the impact of smoothing 2008 investment losses until 2012.

Top 10 Funding Q&As – continued

8 **Q: WHY DO WE CONTINUE TO HAVE FUNDING SHORTFALLS?**

A: Pension costs have been growing faster than plan assets for several years. There are many reasons for that. Low long-term real interest rates are a prime factor. Also, teachers are living and collecting pensions for longer periods.

When a shortfall arises, the plan has difficulty absorbing it because of the low ratio of working teachers to pensioners. There are only 1.5 working teachers for every retiree. As a result, a declining proportion of the plan's membership carries increased responsibility for meeting the plan's funding requirements.

Plan maturity – the low teacher-to-pensioner ratio – puts increased pressure on the pension plan to generate higher returns. But higher returns are difficult to achieve because the pension plan has a low risk tolerance due to its maturity. It must insulate itself from potential loss because of the low ratio of working-to-retired teachers and the desire for stable contribution rates. Since the plan has to take less risk, future long-term investment returns are projected to be modest.

9 **Q: HOW DOES THE PENSION PLAN DETERMINE WHETHER IT HAS ENOUGH MONEY?**

A: The pension plan's board hires an independent actuary to conduct an annual funding valuation. The valuation determines the plan's financial health by comparing plan assets (such as stocks and bonds, as well as future contributions) to liabilities (the projected cost of future pensions).

The valuation shows whether there's a surplus of funds, a shortfall of funds or the right amount of funds to cover the projected cost of future pensions. Each valuation looks ahead more than 70 years to determine the pension plan's ability to pay benefits to all current members and their survivors.

To determine how much money is required to pay pensions, the actuary makes assumptions about the future inflation rate, future return on invested assets, future salary increases, age at retirement, life expectancy and other factors.

10 **Q: WHO IS RESPONSIBLE FOR ENSURING THE PLAN CAN PAY PENSIONS?**

A: The OTF and the Ontario government are responsible for ensuring the Teachers' plan is fully funded. The OTF represents plan members and the Ontario government represents employers, such as school boards. The OTF and the government negotiate the use of surplus funds and, when there is a funding shortfall, they both share responsibility for eliminating it.