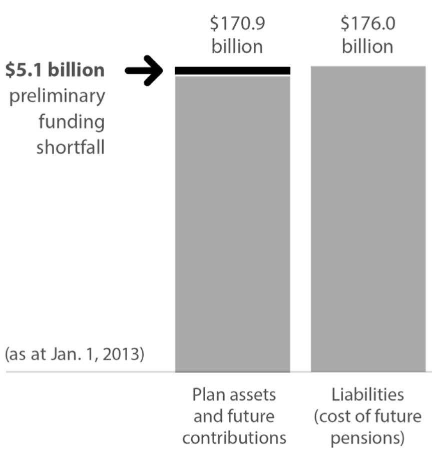
Top Plan Funding Q&As

FUNDING NEWS

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

A: The Ontario Teachers' Pension Plan was 97% funded on Jan. 1, 2013. That means the plan was projected to have 97% of the funds required to meet its long-term pension obligations. A preliminary funding valuation showed a $5.1 billion gap between projected assets and projected liabilities (the cost of future pensions) at the beginning of 2013. The shortfall is projected despite a 13% return on plan investments in 2012 and recent plan changes that eliminated a shortfall last year.



2 Q: HOW WILL THE 2013 SHORTFALL AFFECT MEMBERS?

A: At this point, there is no impact on members. The Ontario Teachers' Federation (OTF) and the Ontario government, which jointly sponsor the pension plan, do not need to resolve any shortfall until they file a funding valuation with the provincial pension regulator. A funding valuation is an assessment of the pension plan's long-term financial status. The next funding valuation is due no later than 2016 and will reflect the plan's status at the date of filing.

3 Q: I THOUGHT WE JUST FIXED THE SHORTFALL?

A: OTF and the government resolved the pension plan's 2012 funding shortfall by changing the plan's inflation protection. However, plan liabilities continued to grow faster than plan assets, resulting in another shortfall in 2013. The latest shortfall arose despite a 13% return on plan investments in 2012.

In preparation for possible future change, a task force will study a broad range of issues related to changing member demographics and intergenerational risk. Among the issues to be studied is the imbalance between working and retired years. Today, a typical teacher retires at 59 and can expect to collect a pension for 31 years. The combined effect of early retirement and increased longevity means members usually collect pensions for more years than they contribute to the pension plan.

The task force is facilitated by Harry Arthurs and includes representatives of OTF, the Ontario government and pension plan management. Dr. Arthurs is the former Dean of Osgoode Hall Law School and chaired the review of Ontario's pension legislation in 2006-2008.

Members also will be surveyed during 2014 to identify their preferences for possible changes in benefits should funding shortfalls persist.

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4 **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 increase in the cost of living, depending on the plan's funded status. In addition, OTF and the government set the level of inflation protection for retirees at:

- 50% of the increase in the cost of living for pension credit earned in 2010–2013, beginning in 2014; and
- 45% of the increase in the cost of living for pension credit earned after 2013, beginning in 2015.

Inflation protection for pension credit earned before 2010 remains unchanged at 100% of the increase in the cost of living.

For more information on how the 2012 shortfall was resolved, read:

- February 2013 Funding Update for Pensioners – Change in inflation protection has small impact on recent retirees
- February 2013 Funding Update for Teachers – Agreement reached to keep Teachers' plan on sound financial footing

PENSION SECURITY

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

A: Yes, OTF and the Ontario government are committed to the long-term viability of the pension plan. With $129.5 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 youngest teachers and their survivors could still be collecting their pensions.

Teachers' base pensions have not changed; they are still defined by a formula based on years of credited service and average earnings. However, after members retire, annual inflation increases for pension credit earned after 2009 are conditional on the funded status of the pension plan. This gives OTF and the government increased flexibility to manage funding shortfalls when they arise.

6 **Q: 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. Only pension benefits not yet earned can be adjusted during a teacher's career.

7 **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 changes to benefits in the future. 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 Ontario's Pension Benefits Act.

FUNDING CHALLENGES

8 **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. These factors result in recurring shortfalls.

Top Plan Funding Q&As - continued

9 **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

10 **Q: WHY CAN'T THE PENSION PLAN JUST EARN MORE MONEY?**

A: The pension plan is already earning double-digit returns and its investment performance ranked the highest of 300 pension plans from around the world, according to CEM Benchmarking Inc. Despite this leading investment performance, plan liabilities (the cost of future pension benefits) continue to grow faster than plan assets.

11 **Q: WOULD A HIGHER DISCOUNT RATE RESOLVE RECURRING FUNDING PROBLEMS?**

A: A higher discount rate is not going to change factors, such as increased life expectancy, that are increasing pension costs.

The discount rate, also known as the future rate of return 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.

Choosing a prudent assumption is critical. If the rate of return assumption is too low, today's teachers will pay more than required to their future pension. If the assumption is too high, future generations will bear the burden of funding shortfalls. Assumptions are carefully selected, within a range of reasonableness, based on detailed mathematical models.

The rate of return assumption has been reviewed by independent third parties who found the rate was 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.

MISCELLANEOUS

12 **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 earnings. The plan is not set up to take additional contributions from members to top up their benefits.

Top Plan Funding Q&As - continued

MISCELLANEOUS

13 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 will depend on the plan's funded status at the time a funding valuation is filed with the provincial pension regulator.

For more information, please see the response to question 4.

14 Q: WHERE CAN I GET MORE INFORMATION?

A: For more information:

- Access resources at www.FundingYourPension.com
- Visit the plan funding section of www.otpp.com (under the Corporate tab)
- Talk to your affiliate pension representative