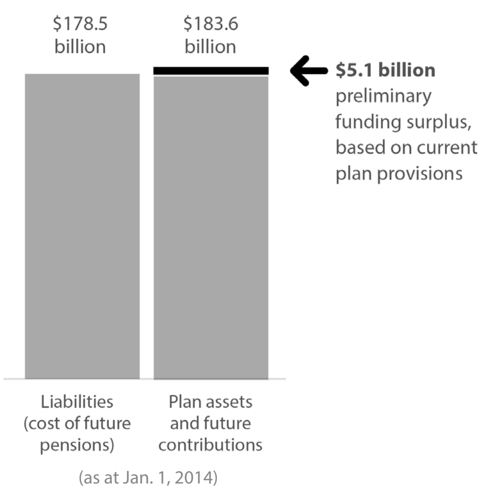
Top Plan Funding Q&As

FUNDING NEWS

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

A: The Ontario Teachers' Pension Plan has a preliminary $5.1 billion surplus as of January 1, 2014. That means the plan has about 3% more than it needs to pay future pensions to all members, based on current plan provisions. Current provisions include reduced levels of inflation protection for pension credit earned after 2009 and increased contribution rates.

PRELIMINARY FUNDING VALUATION



2 **Q: HOW WILL THE 2014 SURPLUS AFFECT MEMBERS?**

A: The Ontario Teachers' Federation (OTF) and the Ontario government, which jointly sponsor the pension plan, will decide what to do with the surplus if they file this funding valuation with the regulators. Members will be notified after a decision is reached.

3 **Q: WILL YOU USE THE SURPLUS FUNDS TO RESTORE BENEFITS THAT HAVE BEEN REDUCED IN RECENT YEARS?**

A: OTF and the Ontario government jointly determine contribution rates and benefits. The sponsors could use the surplus funds to increase inflation protection levels on a go-forward basis. Inflation levels were reduced to help address recent funding shortfalls.

Under the sponsors' Funding Management Policy and other pension plan rules, the surplus is not large enough to be used for other benefit improvements.

4 **Q: HOW DID THE 2014 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.

Read more about the funding valuation in the 2013 Annual Report to Members.

Top Plan Funding Q&As - continued

5 **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 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 working and retired 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. Today, a typical teacher retires at 59 and can expect to collect a pension for 31 years.

6 **Q: WHAT ARE CURRENT INFLATION PROTECTION LEVELS?**

A: Annual inflation increases for retired Ontario teachers are based on three periods of pension credit:

1. Pension credit earned until the end of 2009 is 100% protected against inflation, meaning this portion of a member's pension keeps pace with increases in the cost of living.

2. Pension credit earned from 2010 to the end of 2013 is conditionally protected against inflation. Increases can range from 50% to 100% of the change in the Consumer Price Index (CPI), depending on the plan's funded status. The current level is set at 50% until the next funding valuation is filed with the regulators.

3. Pension credit earned after 2013 is conditionally protected against inflation. Increases can range from zero to 100% of the CPI change, depending on the plan's funded status. The current level is set at 45%, effective in 2015, until the next funding valuation is filed.

7 **Q: WHAT ARE 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

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

A: Yes. OTF and the Ontario government are committed to the long-term viability of the pension plan. With $140.8 billion in assets, the pension plan has enough money to pay pensions for many years.

Teachers' base pensions are defined by a formula based on years of credited service and average salaries. 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 flexibility to manage funding shortfalls when they arise. *(Continued next page)*

Top Plan Funding Q&As - continued

Flexibility is important because pension plans are required to plan ahead 70 years or more. That's when today's youngest teachers and their survivors could still be collecting their pensions.

9 **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.

10 **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.

FUNDING CHALLENGES

11 **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.

12 **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 Interest 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.*

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

A: Athough 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. However, 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.

Top Plan Funding Q&As - continued

14 **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.

15 **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.

MISCELLANEOUS

16 **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.

17 **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 regulators.

18 **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 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.

19 **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.

Top Plan Funding Q&As - continued

20 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

- **11%** Member Contributions
- **12%** Government/Employer Contributions*
- **35%** Investments - Active Management
- **42%** Investments - Benchmark

*Includes 1% original plan deficit funding.