Ontario Pension Reform and the University of Toronto Pension Plan: Some Things You Should Know

Report #1 of more to come

June 26, 2012

Note: This report is not the last word or meant to be complete at this stage. We all are pilgrims on this educational path to better understand pension plans and the problems faced by the University of Toronto Pension Plan. All journeys have to have a start.

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On June 20, 2012, the Ontario Government passed Bill 55, the *Strong Action for Ontario Act (Budget Measures), 2012.* Pension reform is a major issue covered in the Act, with particular focus on reform of the broader public sector's pension system. The purpose of this brief is to provide an overview of the Government initiatives and the potential impact these reforms may have on the University of Toronto Pension Plan (UTPP).

What are the main pension reform initiatives that are included in Budget 2012?

Three primary initiatives were announced as part of the Budget:

i. There will be consultations on a possible legislative framework for jointly sponsored public sector pension plans (JSPP);
ii. The Government intends to introduce framework legislation in the fall 2012 legislative session to pool investment management of "smaller" public sector pension plans;
iii. The Government also intends to move all single employer public sector pension plans to 50-50 cost sharing within five years, to adjust the solvency relief regulation to encourage this outcome, and to support the conversion of these plans to joint sponsorship under the JSPP model.

What prompted the establishment of these initiatives?

On February 15, 2012, the Commission on the Reform of Ontario's Public Services released what is commonly referred to as the Drummond Report. One of the emphases of the Drummond Report was compensation in the public sector. The report highlighted the level of pension-related expenses and the projected growth of such expenses the Government will face in the coming years. In an attempt to cap these expenses, it recommended a number of initiatives, including:

- When faced with future funding shortfalls, the Government should focus on reducing future benefit levels;
- Where negotiation is unable to resolve pension funding issues, legislation should be adopted to implement change;
- Ancillary benefits such as indexation and early retirement incentives should be reduced and/or employee contributions should be increased;
- Pension plans in the broader public sector, especially in the university and energy sectors, should be consolidated both with respect to administration and investment pooling;

Budget 2012 has embraced many of the Drummond Report recommendations with the primary objective of capping Government liabilities associated with BPS pension benefit provision.

What is the status of the proposal to pool pension plan investments and what impact might this have on the UTPP?

Consultation on the pooling of pension fund investments has already commenced. Bill Morneau, a senior pension industry actuary has been appointed as a special Pension Investment Advisor.

The Advisor has invited submissions on the pooling of investments, including asking: whether participation should be voluntary or mandatory; what governance structure should be implemented; how pooling should be integrated with Plan administrator fiduciary responsibilities; how transition should be handled including the costs of transition; how plan design, asset allocation models and the size of a plan should affect participation; whether defined contribution plans should participate in pooling; how pooling might reflect the different benefit and demographic profiles associated with different pension plans; and whether other BPS funds should also be included. In background materials, the Government has suggested that up to 70 BPS funds could be wrapped into the pooling initiative.

The Advisor has indicated that he intends to proceed extremely quickly, aiming for a report to the Government by September. Unlike other similar processes, this process involves only a single Advisor, without co-advisors to assist him. Further there is very limited opportunity for input from the public or stakeholders beyond the invitation for submissions and the convening of selective private meetings to review options.

While the University of Toronto is the largest player in the university pension plan field, the asset base of its pension plan is significantly less than that of many existing plans, including sector wide and jointly sponsored plans such as OMERS, HOOPP and the Teachers Plan. One of the key objectives in pooling assets is to provide access to investment vehicles that are not available to smaller funds and that can increase investment performance.

We anticipate legislation will be introduced in the fall as stated by the Government; that it is unlikely that there will be significant opposition from employers; and that the possibility of mandatory participation for plans such as UTPP is significant.

Of the questions posed in the consultation, key areas of concern are whether the investment pool will allow participating pension plans to maintain their own investment strategy and asset mix, whether there will be an opportunity to participate in the governance of the investment pool and whether there will be asset-liability matching on a plan by plan basis. Models from other provinces have varied in scope – some pooling assets and liabilities, others focusing only on the asset side; some providing for mandatory participation, others allowing for an opt-out.

We are waiting to see what is recommended by Morneau and the content of the follow-up draft legislation. We have been in communication with the Administration about concerns specific to the UTPP, and have also been working with OCUFA, which is planning a submission on behalf of Ontario faculty associations in general.

Will the goal of 50/50 cost sharing and JSPP conversion affect UTPP?

Although the Budget materials do not indicate that 50/50 cost sharing will be legislated, the sword held by the Government is solvency relief. Phase II of the current University solvency relief model links achievement of savings targets to the granting of solvency relief. There is a significant risk that the criteria for the granting of solvency relief may be modified so that relief will only be granted if a plan moves to 50/50 cost sharing. A natural follow-on or condition to an agreement to share risks 50/50 is the full sharing of the administration and governance of the plan. A follow-on effect is that the UTPP would then be exposed to whatever other changes that are being proposed by the Government with respect to JSPPs, set out immediately below.

What changes are being contemplated for Jointly Sponsored Pension Plans (JSPPs)?

The Budget sets out the Ontario government's objective of moving to a 50-50 funding model between employers and employees for all JSPPs. The Budget also proposes consultations that are intended to create a legislative framework including the following parameters in times of plan deficit:

- reduction of future benefits or ancillary benefits would be mandatory prior to an increase in employer contributions;
- accrued benefits would not be impacted by benefit reductions (current retirees would not be affected);
- limits on reductions before contribution increases are considered will be available in "exceptional circumstances"; and
- a third-party dispute resolution process will be invoked where sponsors cannot agree on benefit reductions.

A final parameter is that the framework will be reviewed after Ontario's budget is balanced.

Clearly, there is linkage between the 50/50 cost share initiative and the reforms to the JSPP framework. If UTPP were to move to a JSPP model, it would then face the possibility of benefit reductions prior to any employer contribution increase.

In addition, a key issue in any discussion of conversion is to carve out legacy funding obligations. In other words, if joint cost sharing is to be considered, it should only be undertaken on a go forward basis. It follows logically that any contemplated reduction in future benefits should be linked to the employer contribution requirement in respect of service on after a change to a JSPP, and not with respect to benefit accruals that occurred prior to the change.

The Government is hoping that there will be negotiated settlements in the public sector that embody cost sharing and joint governance. It is hoping to avoid having to legislate on the issue, but instead to provide the incentive to negotiate through modifications to the solvency relief measures.

What can UTFA do now?

UTFA will be reviewing the recommendations of the Morneau Report concerning the investment pooling issue, and it is expected this will be completed in early Fall, likely with legislation to follow. Issues such as 50/50 cost sharing and joint governance, including the possibility of a stand-alone faculty and librarian plan, are all matters for consideration between the Administration and UTFA but will undoubtedly be significantly influenced by any changes in solvency relief requirements that may be issued by the Government. At this stage, UTFA is now engaged in the process of considering how best to educate our membership around these issues and options, and to develop proposals (with advice from expert advisors) aimed at securing the interests of UTFA members in this very uncertain pension environment.