September 6, 2016

Solvency Funding Review
Pension Initiatives Unit, Pension Policy Branch
Ministry of Finance
7 Queen's Park Crescent
5th Floor, Frost Building South
Toronto, ON M7A 1Y7

To whom it may concern:

Please find enclosed the response of MROO (Municipal Retirees Organization Ontario) to the Ministry's review of solvency funding regulations for Ontario defined-benefit pension plans and to the July 2016 discussion paper.

MROO appreciates the opportunity to participate in this consultation. We would appreciate the opportunity to be consulted on any changes to policy or regulation that may result.

Sincerely,

William J. Harford

William Harford, President

4094 TOMKEN ROAD, MISSISSAUGA ON L4W 1J5 | OFFICE: 905-602-6682 TOLL FREE: 1-800-595-4497 FAX: 905-602-6710

REVIEW OF ONTARIO'S SOLVENCY FUNDING FRAMEWORK

FOR

DEFINED BENEFIT PENSION PLANS

RESPONSE FROM

MROO (Municipal Retirees Organization Ontario)

1. Distinguishing OMERS from other pension plans

To preface our submission, MROO draws an important distinction between OMERS and those pension plans to which solvency funding rules apply. (This same distinction applies to other large, independently-managed, jointly-sponsored, multi-employer plans such as Teachers, HOOPP, or CAAT).

MROO is the association of OMERS pension recipients and a staunch supporter of the OMERS decision-making structure. What distinguishes the OMERS structure is not only its size but its model for maximum risk-sharing.

- Its Boards are equally divided between employer representatives and plan member representatives, including one representative of retiree organizations
- It combines nearly 1000 employers of varying sizes, so that no individual employer makes decisions for the Plan. Similarly, there is no practical chance that a significant number of its nearly 1000 employers will become insolvent and no practical chance that it will be wound up.
- Its size offers both unique investment opportunities and efficiency
- Its arm's-length independent management offers exceptional transparency to members and the opportunity for long-range investment vision

Our submission seeks to minimize impacts on OMERS of any regulatory changes which may emerge from this review, and to distinguish OMERS from the Single-Employer Pension Plans to which solvency funding quite properly applies. At the same time, risk-sharing is the key feature of OMERS that should be extended as far as feasible throughout the realm of Ontario DB pension plans. Fundamentally, the objective underlying our submission is the protection of promised pension benefits in all DB plans.

2. Avoiding Impact on OMERS

In our experience, OMERS has reached out transparently to its members and stakeholder organizations, including retiree groups , has invested prudently, and has managed its post-2008 actuarial deficit responsibly. As noted above, its structure justifies its current exemption from solvency funding requirements. .

Several of the options put forward in the discussion paper would change the rules for going-concern pension plan funding. **OMERS should be exempted** from any changes in going-concern funding rules.

For example, while we see the value in the concept of a mandatory reserve (Provision for Adverse Deviation), OMERS has demonstrated that it does not need a mandatory regulation. OMERS in fact has an explicit policy which governs the circumstances which must pertain before it will consider actions which might reduce the plan's funded status. That policy was thoroughly thrashed out at length between the employer and employee representatives on the OMERS Sponsors Corporation Board of Directors.

OMERS members would be undesirably and unnecessarily affected by a shortening of the required funding deficit amortization period. MROO receives regular feedback from the retiree representative that we have nominated to the Sponsors Board. We are satisfied that the amortization of its deficit is never lost from OMERS' view, but that the Board has carefully taken into account the impacts among generations of contributors as well as on municipal taxpayers.

OMERS has transparently explained to its stakeholders its rationale for the discount rate in its actuarial calculations. Not only must its internal and external actuaries by satisfied but furthermore, as we understand it, OMERS must justify its discount rate to FSCO with each triennial filing. Again, we recognize the potential value of such a regulation for most DB plans. In the case of OMERS, however, a mandatory discount rate cap is unnecessary and undesirable.

As explained later in this submission, the imperative to maximize risk-sharing among SEPP DB pension Plans cries out for a substantial expansion of the Pension Benefits Guarantee Fund. However, given its size and structure, OMERS is already a model of risk-sharing. Accordingly, it is exempt for good reason from membership in the Pension Benefits Guarantee Fund and should remain so. OMERS Plan members can never expect to benefit from the PBGF; it would simply add cost to OMERS for no benefit whatsoever.

2. Jointly-sponsored and Multi-employer Pension Plans

The still-authoritative Ontario Expert Commission on Pensions emphasized that the most effective way to preserve and expand DB pension plans, reduce pension plan costs, and protect pension benefits is to expand both Jointly-sponsored and Multi-employer plans, with professional arms-length management. OMERS is an obvious case in point. Subsequently, the Ontario Government has adopted this direction with respect to DB plans in the broader public sector.

We recognize the issues of inter-generational equity, melding pension plan design, negotiating with stakeholders, and so on. We trust that the Government has moved as aggressively as it can with mergers and conversions of SEPPs in the broader public sector.

No discussion of viable, transparent, and properly funded plans with reliable benefits is complete without reasserting the value of this approach throughout the economy. The government should aggressively encourage employers, unions, and regulatory bodies to investigate possibilities for the merger and/or conversion of SEPPs, in order to yield large, independently-managed risk-shared plans .

3. Going-Forward Plan Benefits

MROO is a strong believer in Defined Benefit Pension Plans. We do not support reducing the pensions paid in accordance with promises already made and in respect of service already worked.

That said, plan sponsors obviously have options to manage the liabilities that plans incur in the future. For example, the option of Target Benefit pension plans - for going-forward service only! - may fit some funding circumstances while still offering decent retirement income. It is our understanding that Ontario is working on Target Benefit Pension Plan legislation.

The harmonization of benefits earned in the future with the gradual introduction of the enhanced CPP may be another opportunity to manage future DB plan liabilities.

4. Going-Concern Funding Rules

As noted above, we reject the need for any changes to going-concern rules as they apply to OMERS.

Furthermore, it appears to us that going-concern funding rules are increasingly irrelevant to Single Employer DB plans. As noted in the discussion paper, low interest rates and volatile returns on equities are primary factors behind this review. They result in a sustained gap between going-concern funding requirements and the higher solvency funding requirements. The solvency funding requirements are higher because actuaries - who should know - calculate that this level of funding is required to ensure that pensioners receive the pensions (deferred compensation) promised them , regardless of the fate of the company over which they have no control.

Solvency funding requirements were introduced because it was observed that, prior to their introduction, plans that appeared to be "fully funded" were not capable upon windup of meeting their commitments. Pensioners discovered that their "fully funded plan" was actually deficient, and their pensions were reduced. Accordingly, the funding regime was augmented with a funding requirement intended, at least conceptually, to ensure that the plan would be capable of paying its pension obligations, even if the plan were to wind up.

MROO is in favour of ensuring that pensioners receive the pensions (deferred compensation) promised them.

We do not anticipate - nor does the discussion paper - that interest rates will pop back up substantially any time soon. For many years to come, it appears that properly-regulated solvency funding alone will provide the assurance that pensioners deserve, but will yet pose the funding problem that SEPP sponsors wrestle with.

5. Protection of Pension Benefits

The notion of balancing objectives against each other may be read to imply that all objectives are equally worthy, and "balancing" those objectives is a matter of ensuring that each objective is equally met, and equally not met. For instance, the funding framework could be tweaked to enhance "affordability", however that is measured, even if it comes at the cost of reducing benefit security.

However, not all objectives are equally worthy; not all stakeholders are equally vulnerable. A trade-off between retired members, on the one hand, and sponsors or non-plan employees on the other, is not a trade-off of interests among equals.

Retirees are the most vulnerable of the groups whose interests this consultation would "balance". Regulations that assume retirees are on the same footing with sponsors, active members or future members are premised on a falsehood and may well damage the most vulnerable of these stakeholders - retirees.

Ontario's DB plan members, including pensioners, look to the Ontario government to ensure, through legislation and regulations, that the pension commitments that have been made to them will be honoured. Among the objectives of this consultation, pension benefit security must be paramount. Achievement of the other objectives must not come at the expense of benefit security. The objective of this review should be to determine ways in which the prospects of achieving other objectives might be improved, while ensuring that benefit security is enhanced, or at least not imperiled.

Increasing or maintaining pension coverage by impairing benefit security **is not** desirable.

6. Reform of Solvency funding rules

In general , MROO defers to the points raised by the Canadian Federation of Pensioners (CFP) with regard to the options for solvency funding presented in the discussion paper. MROO is a member of the CFP.

It appears that the discussion paper puts forward some ideas which could improve solvency funding rules without jeopardizing benefit security.

- Requiring annual filing of solvency funding status for SEPPs should be a high priority. Both business fortunes and pension fund investment returns can be volatile. A three-year filing schedule can leave both plan members and regulators seriously deluded about the health of some DB plans.
- A three-year rolling average solvency ratio would allow for some legitimate smoothing.
- Requiring written policies will improve pension plan transparency.
- Some limitation on the calculation of commuted values would be well-advised. As noted in the discussion paper, the pension plan has carried a significant funding risk on behalf of its members. A reduction in commuted value to account for a risk premium is fair when an individual chooses to withdraw from plan membership.
- Letters of credit - with the limit possibly enlarged from the current 15% - seem a legitimate option to reduce sponsors' up-front payment without damaging benefit security. A financial institution would issue the LoC only if it were very comfortable with the financial prospects of the sponsor company. Therefore, this option would - properly so - only be available in practice to companies which were in the least danger of wind-up.
- The CFP explains that a reduced percentage of solvency funding to, say, 90% of the solvency liability could be endorsed if - <u>and only if</u> - this change were accompanied by a significant reform and expansion of the Pension Benefits Guarantee Fund.
- Solvency Reserve accounts are an attractive idea in theory. However, in practice, it is likely to be many years before any significant number of DB plan sponsors will have surpluses to draw from rather than deficits to pay down.

On the other hand , several of the alternatives put forward take direct aim at benefit security. Only in exceptional circumstances (perhaps if the PBGF were appropriately expanded) , would any of the following changes be fair or justifiable:

- lengthening the solvency deficiency amortization period
- solvency deficiency consolidation (fresh start calculations)

- incorporating some but not all types of plan benefits liabilities in solvency liability calculations

7. Enhancement of the Pension Benefits Guarantee Fund

Ontario's Mutual Insurance Tradition

In concept, the PBGF borrows from the cherished Ontario tradition of mutual insurance schemes, such as the many farmers' mutual insurance corporations which sprang up and continue to exist around Ontario. Participants pool their risk and stand together in the event of calamity occurring to any of them.

The farmer does not protect himself from the effects of a destructive fire by setting aside enough money to purchase a new barn or equipment. Rather, the farmer - through a mutual insurance scheme - shares the risk of catastrophic fires with a broad base of fellow farmers. Because fires are relatively rare, the collective cost of the insurance to all farmers is smaller than would be the collective cost if each farmer individually tried to set aside amounts sufficient to replace his own barn and equipment..

Similarly, another way to protect SEPP pensioners from the harm of pension plan windups is to share the risk among all pension plan employers/administrators. As long as the incidence of involuntary plan windups is relatively small, the collective cost of insurance premiums to all pension plan administrators should be smaller than the collective cost if each plan administrator had to ensure that the full solvency liability of each plan were covered.

Such a mutual insurance model, together with reforms that will address the shortcomings of the current framework, holds great promise for achieving the objectives of this consultation at the same time as enhancing pension benefit security.

In our view, the option to expand the PBGF would be very much a time-honoured, "made-in-Ontario" part of the solution.

Features of a PBGF expansion

Below would be some important features of an expanded PBGF. For more detail, we refer you to the excellent submission from the Canadian Federation of Pensioners..

- it would guarantee the full amount of the pension that has been committed to each individual, and not limited in the way that the PBGF payouts are currently.
- The premiums to be paid into an enhanced PBGF by participating pension plans should, among other factors, be dependent on the regulated solvency funding

target. The lower the target, the greater will be the risk to the financial viability of a plan on windup, and therefore the greater will be the expected demand on the PBGF.

- An actuarial study is required to determine the appropriate premiums, and to determine the sensitivity of expected premium amounts to the regulated solvency funding target.
- The enhanced PBGF must guarantee the full amount of DB pensions earned by the pension plan stakeholders (active members, pensioners, deferred pensioners, and beneficiaries). The pensions that have been earned must be paid; the commitments that have been made must be honoured.
- All DB pension plans that have the potential to wind up should be required to protect against the potential harm of plan underfunding at the time of wind up. All SEPP DB plans, both large and small, would be covered by the expanded PBGF, and their sponsors would accordingly be accountable for the payment of premiums in respect of that membership.
- The premium structure should be set in a way that incentivizes plan performance and plan governance practices that have the effect of promoting pension benefit security. For example, each plan's premium should reflect the demonstrated solvency funding status of that plan; the greater the solvency funding ratio, the lower the premium charge.
- Similarly, strong governance practices should be rewarded with relatively lower premium amounts.

Provincial support

Current legislation does not require funding of the PBGF by the Government of Ontario, though it does permit it. Ontario has made contributions to the PBGF in the past.

MROO can see a case for provincial funds to help expedite the transition to an enhanced and effective PBGF. Similarly, we can see a case for Provincial funding to accelerate the transition of more SEPPs to Jointly-sponsored plans and/or Multi-Employer Plans.

8. About MROO

The Municipal Retirees Organization Ontario (MROO) was created as a not-for-profit corporation in 1977. We speak on behalf of 150,000 Ontario Municipal Employees Retirement System (OMERS) pensioners and provide services to nearly 20,000 members.

MROO is the largest OMERS retiree organization and the only one with membership open to retirees from all walks of local government life – former union, non-union and management employees of municipalities, police and fire services, libraries, hydro commissions, school boards, health units, and other employers in the OMERS pension plan.

Our board contains elected directors from nine zones across the province. We are an independent, non-partisan organization formed to voice the interests of OMERS retirees to OMERS and governments of all levels, represent our membership in legislative matters that affect retirees, and provide services that benefit our members.

Our advocacy focuses on the OMERS pension plan and retirement income adequacy. MROO offers its members health, dental, life, and home and auto insurance coverage; scholarships for members' relatives; and ongoing communication to our members on retirement issues.

For more information, please visit our website, www.mroo.org.