Primary Plan Funding **Policy**

ACTUARIAL SERVICES

Anne Soh
asoh@omers.com

Effective
August 18, 2016

OVERALL PRINCIPLES

Funding is a joint responsibility of the OMERS Administration Corporation (OAC) and the Sponsors Corporation (SC). This Policy sets out funding objectives and identifies risk factors and risk management mechanisms to deliver on the pension promise.

The Policy also sets out the protocols for the preparation of actuarial valuations, any related calculations and projections and for selecting and monitoring actuarial assumptions and methods.

This Policy applies to the funding of the OMERS Primary Pension Plan (Primary Plan).

Next scheduled date for review:	August, 2019
Frequency of review:	3 years

Historical Context

The Primary Plan was established to create efficiencies in providing defined benefit pensions at a reasonable cost that would otherwise not be affordable by individual municipalities. This is made possible through:

- collaboration between OAC and the SC in managing the three funding levers – contributions, benefits and investments
- pooling of funding, costs and risks across a large number of employers and members, and
- pooled and economical access to professional staff and technology in respect of pension administration and investment services

The funding of the Primary Plan takes into account this historical context and:

- OAC's fiduciary responsibilities
- OAC's investment principles for the Primary Plan as captured in its *Statement of Investment Policies and Procedures* (SIP&P), and
- SC's *Statement of Plan Design Objectives and Strategy* (SPDOS) of the Primary Plan

Funding Responsibilities

The Primary Plan is required to be funded by equal member and employer contributions, in combination with investment earnings on the Primary Plan Fund.

Funding is a joint responsibility of OAC and the SC.

OAC's responsibilities under the *OMERS Act, 2006* include:

- asset allocation and investment management
- establishing a funding policy
- appointing the external actuary
- providing for the actuarial valuation

- determining the actuarial assumptions and methods based on the recommendations of its external actuary, and
- providing reasonable technical support to the SC, including estimates of the impact of any proposed plan changes

In addition, under the Memorandum of Understanding between OAC and the SC, OAC is responsible for approving the annual actuarial valuation prepared by its external actuary.

The SC's responsibilities under the *OMERS Act, 2006* include:

- determining the design for benefits
- setting contribution rates
- establishing or changing a reserve to stabilize contribution rates, and
- making decisions about filing actuarial valuation reports more frequently than required under the PBA

SPDOS provides the approach to allocate contributions, such as between groups with different normal retirement ages and below and above the Year's Maximum Pensionable Earnings.

Funding Objectives

OAC's principal funding objective, as part of its fiduciary responsibilities as administrator, is to ensure that funding requirements under applicable legislation and the Primary Plan provisions are satisfied and that the Primary Plan is sustainable over the long run to fulfill its obligation to pay benefits today and into the future.

The SC's principal funding objective is to ensure the continuing health and long-term viability of the Primary Plan. The SC's funding objective takes into consideration the fact that the Primary Plan is jointly sponsored, the interests of stakeholders and the appropriate balance between competing funding objectives, particularly with respect to concepts such as equity, sustainability, security of benefits and affordability.

Recognizing the long-term nature of the obligations and the fact that the PBA permits OAC to exempt the Primary Plan from funding solvency deficiencies, benefit security is achieved by funding on a going concern basis.

Over the long term, the funding target is to maintain a going concern funded ratio, determined in accordance with the actuarial protocols in this Policy, of 100 per cent. Under SPDOS, the SC has targeted a reserve of up to 10 per cent when the Primary Plan is not in deficit.

Funding Risks

The principal funding risk is the inability to provide benefits at a reasonable cost with minimal volatility in contribution rates. This risk (in times of deficits and rising costs) and reward (in times of surpluses) is borne by the different stakeholder groups in different manners:

Stakeholder Group	Risk	Reward
Active members	Contribution increase and/or benefit reduction	Contribution decrease and/or benefit restoration or improvement
Employers	Contribution increase	Contribution decrease
Pensioners, deferred vested members and beneficiaries	None	Benefit restoration or improvement

Funding risk results primarily from the following:

- uncertainty and volatility in global economies and investable markets
- plan maturity, which occurs when the membership and liabilities are increasingly attributable to participants nearing retirement age and/or participants in retirement
- unfavourable actual experience from:
  - investment returns, inflationary increases, contributory earnings increases, improvements in life expectancy and other demographic experience, and member spousal status different from actuarial assumptions, both in the short and long term, and
  - adverse behaviours by employers and members, such as exercising a plan feature at the expense of all other employers and members
- legislative, regulatory and political uncertainties

Funding Risk Management

Funding risks are managed through a coordinated process involving a variety of protocols:

- **Actuarial** – periodic actuarial analysis provides information about the funded status and the minimum legislated funding requirements over various time horizons and under various economic and demographic scenarios
- **Contribution and Benefit** – contributions and benefit design are varied to manage the emerging funded status and control the emerging funding risks

- **Investment** – investment strategies and policies are designed to achieve a return that reflects both an acceptable amount of risk as well as a return sufficient to meet the Plan's long term financial obligations
- **Other** – these include:
    - when appropriate, the filing of actuarial valuation reports with the regulators more frequently than required under the PBA to achieve contribution and benefit stability during the period covered by the actuarial valuation
    - the strategic allocation of surplus assets, such as setting reserves, and
    - monitoring, influencing and responding to the legislative, regulatory and political landscapes

Contribution and benefit protocols, voluntary filings of actuarial reports and the setting of reserves are addressed under SPDOS, while investment protocols are addressed under the SIP&P. The balance of this Policy addresses actuarial protocols.

Actuarial Protocols

Actuarial assessments shall be conducted with the following basic principles:

- compliance with all relevant legislation and professional standards and requirements, and
- long-term viability of the funding objectives shall not be compromised for short-term objectives

Actuarial assessments comprise primarily the following:

- annual actuarial valuation
- annual actuarial projections
- periodic review of actuarial assumptions and methods and work performed by the external actuary, and
- actuarial analysis of proposed plan changes

Annual Actuarial Valuation

An actuarial valuation shall be performed as at December 31 each year.

- the actuarial valuation shall be performed on a going concern basis and should be performed on a solvency and a wind-up basis, if required under the PBA
- the going concern actuarial valuation shall be performed using the projected unit credit actuarial cost method. The reported value of the net assets should reflect annual investment gains or losses smoothed over a five-year period
- both demographic and economic assumptions used for the going concern actuarial valuation should be set based on relevant emerging experience of the Primary Plan and should reflect expectations of the broader economic environment. Other than the real discount rate assumption, actuarial assumptions represent the best estimate of the most likely outcomes of future events
- the methodology to determine the real discount rate assumption, set as at July 1 prior to the valuation date, should:
    - i. reflect the expected long-term investment return of the Primary Plan's target strategic asset mix
    - ii. include a margin for conservatism of at least 50 basis points, with the resulting real discount rate not exceeding 4.25 per cent, and
    - iii. include a strategic margin to manage the volatility of the funded status. For a particular valuation, the strategic margin is:
        - built using 50 per cent of positive plan experience, without causing an increase in contribution rates and/or a reduction in benefits with the objective of returning to full funding by 2025
        - built-up in 5 basis point increments, subject to a maximum of 15 basis points in any one year and no more than 50 basis points overall, and
        - released in a year, up to the total accumulated strategic margin, when negative plan experience would otherwise cause an increase in contribution rates and/or a reduction in benefits
- the margin for conservatism and the strategic margin are subject to an overall level of reasonability determined by the OAC Board
- the real discount rate assumption shall be determined annually in accordance with the discount rate methodology following a consultative process between OAC and SC

Annual Actuarial Projections

Projections of the funded status, minimum legislated funding requirements and the likelihood of contribution rate increases/benefit reductions shall be prepared annually. These projections should cover the following elements:

- projections of the going concern actuarial valuation results. Solvency projection results or commentaries should also be included if solvency measures affect the timing of the filing of actuarial valuations, which, in turn, affects minimum contribution requirements under the PBA
- projections should be performed over a time horizon of at least 10 years, recognizing that the credibility of projection results diminish with the length of the projection horizon

- projections should cover different demographic and economic experience scenarios, including stress testing. The scenarios should be broad enough to cover both favourable and unfavourable experiences, with specific focus on existing and potentially new risk factors that would have material implications to the projected funded status and the likelihood of contribution increases/benefit reductions
- projections should also cover the impact of any changes in actuarial assumptions during the projection horizon if these assumptions are under stress. Sources of gains and losses from the annual actuarial valuation should be reviewed to identify potential stresses

Periodic Review of Actuarial Assumptions and Methods and Work Performed by the External Actuary

The actuarial assumptions and methods and work performed by the external actuary should be reviewed periodically as follows:

Actuarial Assumptions and Methods	Minimum Review Frequency
Discount rate assumption	Annually
Long-term inflation assumption	Annually
Discount rate methodology	Every 3 to 5 years *
Actuarial cost method	Every 5 years
Asset smoothing method	Every 5 years
Other assumptions (e.g., demographic, salary increase, etc.)	Evaluated annually, comprehensive experience study every 5 years
Independent assessment of actuarial assumptions and methods and work performed by the external actuary	Every 10 years

* In the event that best estimate projections indicate the Primary Plan could achieve full funding within the next two to three years, a review of the discount rate methodology shall occur at that time.

Actuarial Analysis of Proposed Plan Changes

The funding impact of any changes to the Primary Plan, either considered or proposed by the SC, shall be analyzed by OAC using the actuarial protocols and the results submitted to the SC for its consideration.

Responsibilities

The VP, Actuarial Services and Plan Actuary is responsible for:

- providing direction to the oversight of, and to the coordination of the work performed by, OAC's external actuary
- preparing the annual actuarial projections
- ensuring that the actuarial valuation is filed with regulatory authorities, subject to the SC Board direction, but, in any event, no less frequently than once every three years or as necessary to comply with the law, and
- preparing actuarial analysis

The external actuary is responsible for:

- performing the annual actuarial valuation and providing the independent actuarial opinion and certification for funding and financial statement reporting purposes
- recommending the actuarial assumptions and methods
- providing official cost estimates for plan design changes, and
- conducting special projects such as experience studies and contribution rate studies

Exceptions

The Policy Sponsor may grant non-substantive exceptions to this Policy but shall report such exceptions to the OAC Board in writing.

Responding to Incidents of Non-Compliance

The Policy Manager is accountable for identifying incidents of potential non-compliance under this Policy based on established procedures, and reporting such incidents to the Policy Sponsor.

Monitoring and Reporting

The Policy Manager is responsible for administration of the Policy, including implementing procedures to enable compliance, monitoring and reporting, as well as to coordinate training as required.

Documents related to this Policy

- Memorandum of Understanding – describes the roles of the SC and OAC in the OMERS Plan Funding Process
- SIP&P – sets out how the assets of the Primary Plan are invested by OAC
- SPDOS (includes the Funding Management Strategy) – sets out the SC's methodology for the determination of contribution rates, the design of benefits and the establishment of reserves

ROLES & RESPONSIBILITIES

Policy Approver	OAC Board of Directors	Responsible for approving the Policy
Policy Sponsor	Chief Financial Officer	Ultimately accountable for the Policy, including its development, implementation and administration
Policy Manager and Monitor	VP, Actuarial Services and Plan Actuary	Responsible for the design and operational effectiveness of the day to day administration of the Policy and for the monitoring, compliance and reporting functions of the Policy