OMERS Sustainability

Action Required to Ensure Sustainability

AMO Annual Conference, Windsor, August 15, 2016

Prepared by Aon Hewitt

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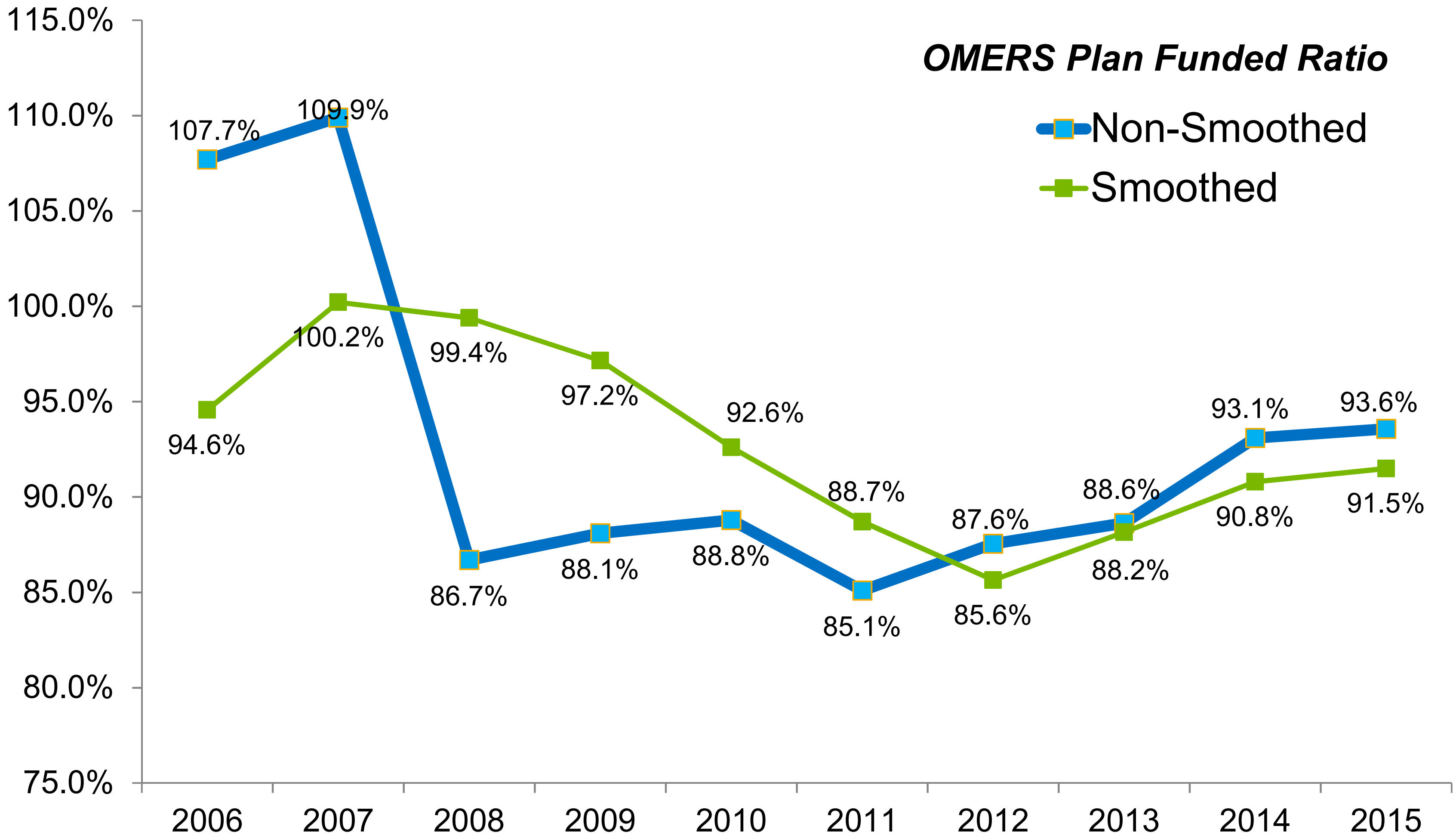
OMERS Funded Status



Funded Status Improving – But Challenges Ahead

- Low Interest Rates, Lower Growth Expectations
- Increasing Longevity
- Aging Population/Plan Maturity

Challenges –Low Interest Rates and Low Growth

- Low Interest Rates, Lower Growth Expectations

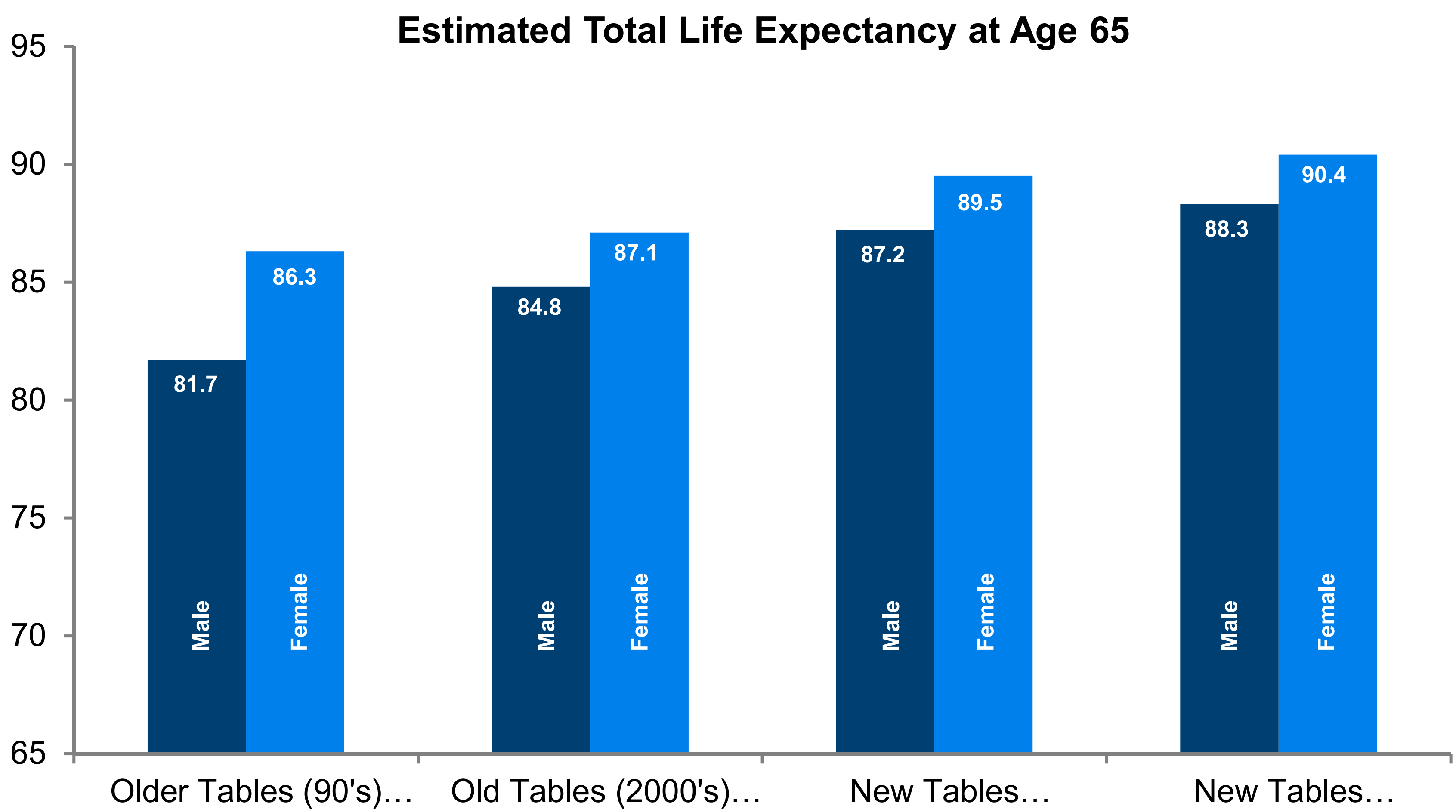
> ***"The returns of the past 30 years were lifted by an extraordinary beneficial confluence of economic and business factors. Consequently, investors may need to adjust their expectations downward."***
>
> *(McKinsey May 2016 Report, "Diminishing Returns: Why Investors May Need to Lower Their Expectations")*

- Steep decline in interest rates since 1980 boosted returns. Cannot fall much more from here.
- Aging population also lowers growth expectations. Economic growth likely to be slower.

Peer Comparison of Funding Discount Rates

Plan	Current Valuation	Prior Valuation
Ontario Teachers	4.80% (2% +2.8% real)	4.85% (2% +2.85% real)
HOOPP	5.65% (2% + 3.65% real)	5.85% (2.25% + 3.60% real)
OPSEU Trust	5.55% (2% + 3.55% real)	5.85% (2% + 3.85% real)
CAAT	5.70% (2.2% + 3.5% real)	5.80% (2.3% + 3.5% real)
OMERS	6.25% (2% + 4.25% real)	6.50% (2.25% + 4.25% real)

Challenges – Living Longer



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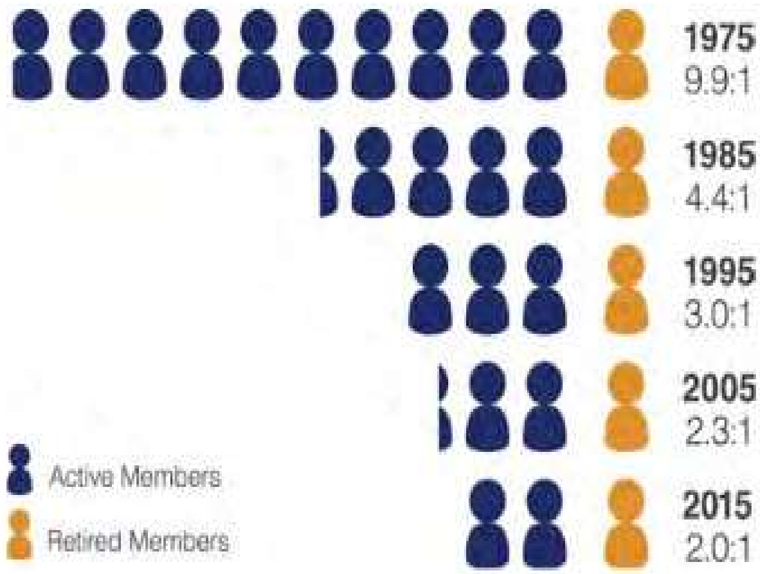
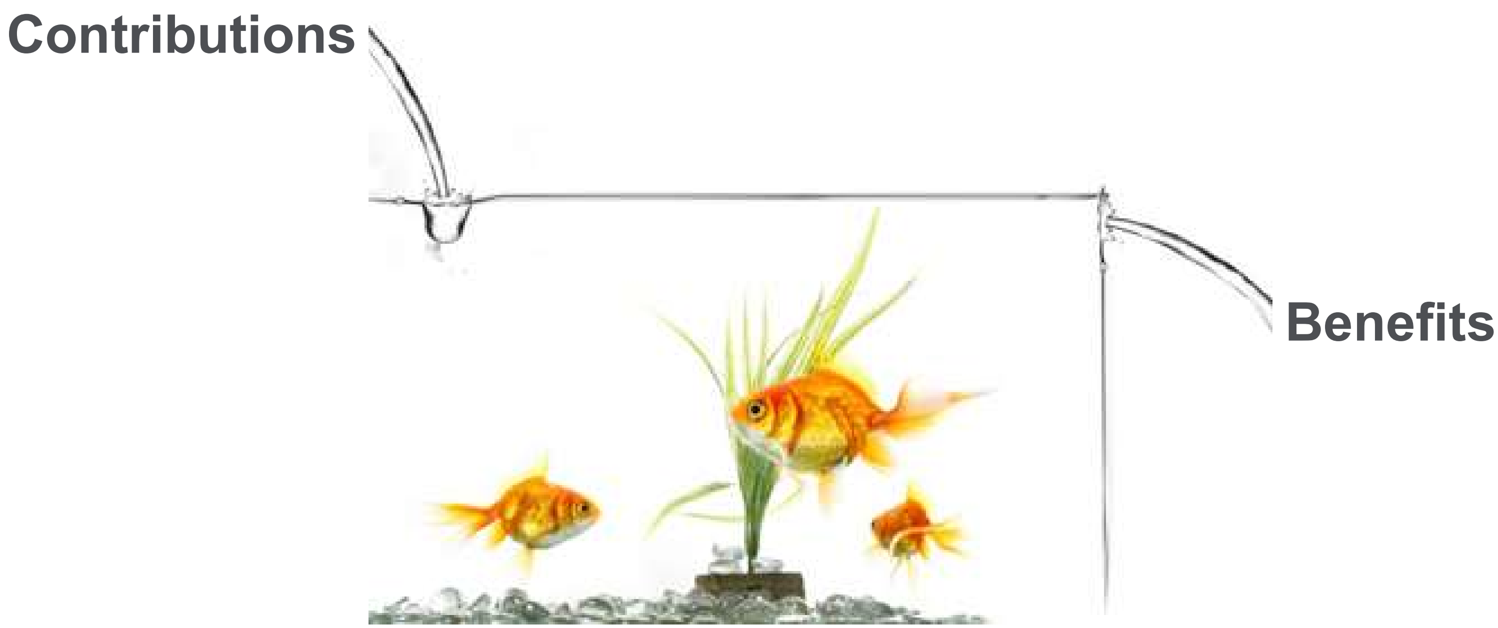
Challenges – Aging Population/Maturing Plans



- Decline in ratio of actives to retirees
- Large burden on current and future active employees to deal with risk.
- OMERS plan liability is 470% of contributory payroll in 2015
- A 2008-like shock would require
  - 8.1% increase in contributions (combined), or
  - 50% reduction in value of future benefit accruals for actives
- Burden will only increase as plan continues to mature.

Sustainability is in the Eyes of the Stakeholders

- A Sustainable plan is one that can consistently, through both favourable and adverse circumstances, deliver an *appropriate range* of benefits within an *acceptable range* of costs over the long term.



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Sustainability Definition
Used By a Large Public Sector Pension Plan

- Sustainability is the ability to meet the needs of the present without compromising the ability of future generations to meet their own needs
- Sustainability requires that:
  - the base contribution level supports the long-term cost of the promised benefits
  - contributions are flexible within a range considered affordable
  - benefits are flexible within a tolerated range and change in a predictable manner
  - intergenerational transfers are understood and are considered reasonable

Improving OMERS Sustainability

- Funding Management Strategy
  - Sets maximum contribution rate
  - Build a reserve during good periods
- OMERS 2020 Strategy
  - Collaborative: Sponsors Corporation and Administration Corporation
  - Stable and predictable contributions and benefits
    - Address challenges, including plan maturity
  - Investments - Diversification

Additional Flexibility Urgently Needed

- Only two levers currently available to deal with deficits: increase contributions and/or cut future accruals for actives.
- Intergenerational Fairness
- Adjustable benefits such as indexing
- Why look at this now?
  - Hopefully, never needed.
  - But important to have flexibility in place, in case it is needed.

Conditional Indexing Provisions – Peer Plans

Plan	Inflation Protection Provision	Ability to adjust past service obligation in event of shock in 2016
Hospitals of Ontario Pension Plan	Pre-2006 75% to 100% of CPI Post-2005: Conditional Catch-up to 100% of CPI was provided in 2014.	Indexing on 11 years of accrued service (2006-2016) can be adjusted.
Ontario Teachers Pension Plan	Pre-2010 service: 100% of CPI 2010-2013: 50%-100% of CPI Post-2013: Conditional Catch-up to 100% of CPI was provided in 2016.	Indexing on 7 years of accrued service (2010-2016) can be adjusted
Colleges of Applied Arts and Technology	Pre-2007 service: 75% of CPI Post-2006: Conditional Have provided 75% of CPI on all service.	Indexing on 10 years of accrued service (2007-2016) can be adjusted
OMERS	100% of CPI	Currently no ability to adjust accrued benefits

Why Conditional Indexing Is the Key

- Why Conditional Indexing?
  - Least disruptive benefit change. Getting a smaller increase instead of cutting a benefit.
  - Easier to implement in a low inflation environment
  - Easier to administer than other benefit changes
  - Easy to scale/adjust up or down as needed, can be easily restored when plan returns to surplus position
  - Intergenerational Equity: can be applied to retirees (once provision has been in place for many years), not just current active members;
    - only change that directly addresses issue of plan maturity.

- Action is required now!
  - Does not need to be invoked unless needed.
  - Must be put in before it is needed to promote intergeneration equity

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