MEPCO
Municipal Employer Pension Centre of Ontario

The Looming Potential for Significantly Higher OMERS Costs

Update March 29, 2010

Overview

The December 31, 2009 OMERS Plan valuation indicates that the $0.3 billion plan deficit of 2008 has increased to $1.5 billion. This increase could require a total contribution rate increase of 1.2% (0.6% per side) bringing total contribution rate to 16.6% if the 2009 valuation is filed. Investment losses during the 2008/09 period will result in a loss of $6.4 billion that must be accounted for over the next three years. Without changes to the plan or an exemption from solvency requirements, the 15.4% combined contribution rate that employers and employees currently pay could grow to more than 22% by 2013. The time to discuss managing these impacts is now.

Understanding the Funding Challenges

Normal Costs: Plan maturity, the ratio of a declining number of employees to an increasing number of retirees will continue to have a growing impact on normal costs. With benefit payments rising faster than contributions, these costs are expected to increase from 15.09% of contributory earnings to more than 15.60% by 2016/2017.

Investment Returns: Lowered investment returns continue to impact the Plan. The OMERS Plan depends significantly more on these returns than on contribution rates for viability (70% versus 30% respectively). The $6.4 billion loss in 2008 will cause the valuations of the Plan to suffer for the next three years. Given current benefits, the Plan would require in excess of a 15% return in each of the next three years to avoid contribution rate increases.

Solvency Funding Requirements: If there is no legislative relief from the Ontario Government's solvency funding requirement, the Plan deficit is projected to increase by more than $3 billion. This factor alone would necessitate a combined contribution rate increase of 1%.

Impacts of Bill 236: The *Pension Benefits Amendment Act, 2009*, contains provisions on grow-in benefits, transfers of assets, phased retirement and other matters. While much work needs to be done to evaluate the impacts of all of these provisions, they are likely to result in increased funding pressures and costs for both Plan members and employers, including a grow-in impact provision impact of up to $1 billion.

Actuarial Assumptions: Any changes to actuarial assumptions, including demographic assumptions such as retirement rates, or economic assumptions such as interest rates, will affect liabilities and therefore contribution rates.

Collectively, these pressures could see the combined contribution rate increase by up to 7.5% (3.75% per side) in 2013[1] if no further changes to contributions or benefits are made before then. This is due to:

- A 1.75% per side contribution rate increase to address the deferred $6.4 billion in investment losses and the increase in normal costs;
- An increase of up to 0.5% per side if there is no relief from solvency requirements; and,
- A possible increase of 1 to 1.5% per side relating to changes in actuarial assumptions.

Inaction is not an option, so the question is *what is an appropriate approach to managing these pressures?*

[1] This reflects the assumption that the 2011 Plan valuation would be filed in 2012 with increases effective in 2013.

Impacts of Increased Contribution Rates

The specific impacts of rising contribution rates will vary greatly between municipalities, depending on the number of OMERS employees in each and the types of benefits they receive.

Based on data and assumptions from the OMERS actuarial valuation report of 2008, it was estimated by Aon Consulting, MEPCO's actuarial advisors, that a contribution increase of just 1% per side could result in a total cost increase of approximately $134 million for all OMERS employer groups. The share for municipal employers, who represent 38% of the employers group, could be approximately $51 million annually. Based on this calculation, the 7.5% contribution rate expected to occur by 2013 (3.75% per side) could cost municipal employers $190 million each year.

What could that mean for your municipality? If a regional municipality has a $340 million budget for salaries in 2013, a 3.75% per side contribution rate increase could result in $12.75 million in additional OMERS contributions. In a lower tier municipality with a $70 million salary budget, this could lead to an additional $2.6 million in OMERS contributions.

These contribution rate increases add to municipal costs without providing any additional value to services to property taxpayers.

Solvency Requirements

MEPCO, AMO and other OMERS Sponsors are calling on the government to remove the solvency valuation requirement for the OMERS Plan. This practical step would immediately improve the health of the Plan, particularly given that it is projected to have a solvency deficit in excess of $3 billion.

Given that OMERS is a public sector plan with joint sponsorship, the risks and approach for solvency are different from private sector plans. The Province was wise to exempt supplemental plans for police, fire and paramedics from solvency rules through Bill 206 and the other OMERS Plans should be brought in line. MEPCO and AMO continue to press this point with the Province in the interests of municipal employers.

Strategic Questions

As the municipal employer sponsor representative, there needs to be a long term funding strategy which effectively considers all the factors influencing Plan health. MEPCO is considering what that could entail. More specifically it is considering such questions as:

1) What level of total contribution to the OMERS Plan is sustainable and affordable for both employers and employees, now and over time?

2) How can impacts be managed in terms of contribution rates and benefits?

3) Is a cap on contributions or benefit reductions appropriate in the current pension environment and what impacts might such techniques bring?

4) How can necessary contribution rate increases be managed so as not to create a plan surplus in the long run?

Providing Your Input

We welcome your reflections on these questions to strengthen the quality of MEPCO's work and advice to OMERS municipal sector representatives.

Comments can be submitted to bmcleod@amo.on.ca. More information and related presentations are available on the MEPCO website (www.mepco.ca)