August 13, 2012

OMERS Governance Review
c/o Ministry of Municipal Affairs and Housing
Municipal Finance Policy Branch
777 Bay Street, 13th Floor
Toronto, ON M5G 2E5
Attention: Mr. Tony Dean

Re: MEPCO Submissions on the 2012 OMERS Governance Review

Dear Mr. Dean:

This submission is made by the Municipal Employers Pension Centre of Ontario ("MEPCO") in response to the request for comments by you, on behalf of the Ministry of Municipal Affairs and Housing, regarding the governance review of the Ontario Municipal Employees Retirement System ("OMERS Plan") in accordance with the *Ontario Municipal Employees Retirement System Review Act, 2006* (the "OMERS Review Act").

MEPCO is a wholly owned subsidiary of the Association of Municipalities of Ontario, the municipal employers sponsor. It is responsible for research, advice and liaison on matters related to OMERS on behalf of AMO and municipal employers in the OMERS Plan. MEPCO is pleased to be given the opportunity to participate in this consultation process.

We understand that the scope of your Governance Review under the OMERS Review Act is to address and evaluate:

(a) the effectiveness and fairness of the governance model:

(i) in representing the interests of the employers that participate in the OMERS pension plans and the members and former members of the OMERS pension plans,
(ii) in ensuring the efficient governance of OMERS, and
(iii) in ensuring the accountability of OMERS;

(b) the efficiency and effectiveness of decision-making by the Sponsors Corporation, including its use of the supplementary decision-making mechanisms set out in or permitted under the Ontario Municipal Employees Retirement System Act, 2006; and

(c) the effectiveness of the governance model in ensuring the overall fairness and financial stability of OMERS and, in particular, in ensuring that there is no subsidy of a supplemental plan by the primary pension plan.[1]

[1] Section 2(3) of OMERS Review Act.

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The general principle of devolving responsibility for the governance of the OMERS Plan from the government to the sponsors and the consideration of the creation of a supplemental plan for police, fire and paramedic sections are not part of the Governance Review mandate.[2]

Background

The key overriding concern of MEPCO and the constituents it represents in the context of the Governance Review is the long-term sustainability of OMERS, i.e., the ability to provide pension benefits to members (this is the core business of OMERS) over the long-term (the pension promise) at a reasonable cost to employers and members (the objective).

As background to MEPCO's recommendations, a brief broad overview of the Canadian pension governance system and a few key facts surrounding the devolution of OMERS is warranted.

Generally, the Canadian occupation pension plan system is founded on a two party/role governance model. The first party - the "sponsor" - is *inter alia* responsible for establishing the plan, setting its terms, funding the benefits payable from the plan and ultimately terminating the plan. The sponsor is responsible for setting the parameters of the plan – it is ultimately responsible for the ongoing viability and sustainability of a plan. The second party - the "administrator" - is *inter alia* responsible for administering the plan terms and pension funds and investing the plan assets during the life of the plan. In this role, the administrator is held to a fiduciary standard of care, meaning that its actions and decisions must be made in the best interests of the plan's beneficiaries. The sponsor is not subject to the same standard of care, but is entitled to act in its own best interests, subject to an implied duty of good faith.[3]

As you know, a bi-cameral governance model reflecting the separate roles of "sponsor" and "administrator" was adopted when the governance of the OMERS Plan was devolved in 2006. Two separate corporations were established: the OMERS Sponsors Corporation ("SC") was established to act as the "sponsor" of the OMERS Plan and the OMERS Administration Corporation ("OAC") was established to act as the "administrator" of the OMERS Plan. As "sponsor" the SC is responsible for plan design, including benefit changes, contribution rate adjustments, and other funding matters. As "plan administrator" the OAC responsibilities include pension administration, investment of plan assets, and the appointment of auditors.

Under the *Ontario Municipal Employees Retirement System Act, 2006* ("OMERS Act"), the composition and method for choosing the members of the Board of Directors of the SC is determined by the by-laws of the SC and that the composition and method for choosing the members of the Board of Directors of the OAC is also determined by the by-laws of the SC. OMERS is a jointly sponsored pension plan. In accordance with the current SC by-laws, both corporations, the SC and the OAC, have an equal number of employer and member appointed representatives.

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[2] Section 2(4) of the OMERS Review Act.

[3] Roles and responsibilities differ for multi-employer pension plans that are established and maintained by boards of trustees rather than the plan sponsor.

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Appendix A sets out the sponsor entities responsible for appointing the members of the Boards of Directors of the SC and the OAC.

The SC and the OAC recently retained an expert in pension plan governance, Professor Harry Arthurs, to review the overall governance of OMERS. We understand that Professor Arthurs' 2011 Report concluded that the governance of OMERS was generally efficient and effective and he made some recommendations to further enhance efficiency and effectiveness. We also understand that Professor Arthurs concluded that the current bi-cameral model should be retained.

The role and composition of the SC is critical to the OMERS governance framework and was carefully calibrated at the time of devolution. Equal representation of employer and member appointed representatives on the SC was a fundamental principle of the joint governance model in the devolution process and negotiations. Through the SC, employers and member representatives are jointly responsible for plan design and the resulting contributions levels. In other words, this composition gives employers and members with a "say for pay". In relation to OMERS, it is important to remember that "employer interests" are synonymous with the interests of taxpayers and citizens who indirectly contribute to the OMERS Plan through taxes and utility rates. Employer and member representatives are also responsible for appointments to the Boards of Directors of the SC and the OAC. This appointment process is an important feature of a jointly sponsored plan – it provides a linkage and accountability between employers and members and the respective Boards.

MEPCO's Recommendations

As you would expect, in the current environment a paramount concern for MEPCO's constituents is the employer contribution rates. However, contribution rates are a function of the benefits provided under the OMERS Plan and the actuarial valuation of the OMERS Plan (which takes into account the return earned by the OMERS Plan assets), not the governance framework *per se*.

With respect to the governance framework, MEPCO supports the existing bi-cameral governance model which separates the roles of (1) sponsor and (2) administrator. A properly structured bi-cameral model provides a clear separation between fiduciary and non-fiduciary functions. As outlined below, MEPCO submits that some of the OAC responsibilities require clarification and are more properly categorized as sponsor functions. As a result, some OAC tasks should fall within the SC's accountabilities.

The SC, as "sponsor", is the entity that is ultimately responsible for the ongoing viability and long-term sustainability of OMERS. As such, MEPCO believes that the governance model must preserve the right of the SC to oversee the plan assets and liabilities. To achieve this objective the SC must play a greater role in two activities: the preparation and approval of actuarial valuations and the preparation and approval of the funding policy.

1. **The SC should be responsible for setting actuarial methodologies and assumptions and approving actuarial valuation reports.**

Current Governance Structure

Under the current OMERS Act, the OAC is responsible for: (1) appointing the actuary for the plans, (2) having actuarial valuations of the plans prepared, and (3) determining the actuarial methods and assumptions to be used in the valuation, based on the recommendations of the actuary.[4] The OMERS Act gives the SC the authority to have a valuation filed more frequently than is required under the Ontario *Pension Benefits Act* (the "PBA").[5]

There is a Framework Agreement between the SC and the OAC. It provides that the OAC is required to provide the SC with copies of draft and preliminary actuarial valuations and that the SC may provide commentary on the valuations.[6] However, final decision-making power regarding the acceptance of actuarial valuations rests solely with the OAC; the OAC has no obligation to take the SC's comments into account.

Proposed Change

A plan's funded status, as determined by the actuarial valuation report, directly impacts contribution levels and, in turn, the sustainability of a plan. Accordingly, MEPCO submits that the current governance structure should be revised to provide that the SC, as the plan sponsor corporation, is responsible for: (1) appointing the actuary for the plans; (2) setting the actuarial methodologies and assumptions to be used in a valuation report, based on the advice of the actuary; and (3) approving valuation reports. The OAC would continue to be responsible for: (1) having valuation reports prepared; and (2) filing valuations with the Superintendent of Financial Services (the "Superintendent").

The actuarial valuation report is the tool used to measure the funded status of a defined benefit ("DB") plan. The actuary measures a plan's assets and liabilities on a given date to provide a snapshot of the plan's funded status. Actuarial methodologies and assumptions used to prepare a valuation report are constrained by professional actuarial standards. However, the actuarial professional standards leave some discretion for the setting of methodologies and assumptions to be used in a valuation.

The Ontario PBA provides that the administrator is responsible for filing valuations with the Superintendent.[7] However, the PBA does not prescribe who – the administrator or the sponsor – retains the actuary, provides direction to the actuary regarding the actuarial methodologies and

[4] Sections 17(2), 19 and 35(2)(b) of the OMERS Act.
[5] Section 25(2) of the OMERS Act.
[6] Touchpoint 8 of Framework Agreement.
[7] Section 14(1) of the PBA Regulations

assumptions to be used in a valuation report, and then ultimately approves the valuation report . However, the recently released Guideline No. 7, *Pension Plan Funding Policy Guideline* issued by the Canadian Association of Pension Supervisory Authorities ("CAPSA"), supports MEPCO's position that responsibility for these tasks should be assigned to the SC as sponsor of the OMERS plan.

CAPSA is a national inter-jurisdictional association of pension regulators whose mission is to facilitate an efficient and effective pension regulatory system in Canada. Every policy issued by CAPSA must be approved by each and every Canadian pension regulatory authority. On November 15, 2011, CAPSA released its Guideline No. 7, *Pension Plan Funding Policy Guideline* (copy enclosed). This policy speaks directly to the issue of responsibility for selecting actuarial methods and assumptions. The Guideline states:[8]

> The plan sponsor can provide useful guidance to the plan actuary in selecting actuarial methods and assumptions that are appropriate for the plan sponsor's risk management approach. This guidance can include the going concern actuarial cost method, desired margins or provision for adverse deviations and acceptable asset valuation methods and ranges. The plan administrator would provide information on data, investments, historical experience, etc. to assist the actuary in developing these assumptions. [emphasis added]

Along similar lines, in Professor Arthur's Ontario's Report of the Expert Commission on Pensions released in 2008[9] (the "Expert Commission Report"), it is assumed that the plan sponsor is ultimately responsible for setting the actuarial assumptions and methodologies. More specifically, in the context of discussing the need for transparency in valuations, funding decisions and other operational matters the Expert Commission Report states[10]:

> Key issues [in actuarial discretion in valuations] include the selection of appropriate discount rates and mortality tables. In effect, how the actuary exercises professional discretion with regard to these matters determines the range of choice available to the sponsor in determining how much to contribute to maintain the plan's funding. This situation exposes actuaries to subtle — even overt — pressures to exercise their discretion in a way that produces outcomes agreeable to the sponsor. In the end, of course, the sponsor makes the choice — but it is actuarial discretion that confers legitimacy on that choice. [emphasis added]

It is MEPCO's view that the OMERS Act which now provides that the OAC is responsible for: (1) appointing the actuary for the plans, (2) having actuarial valuations of the plans prepared, and (3)

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[8] At page 6.

[9] *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules.* By way of further background, this 2008 Report examined the legislation that governs the funding of defined benefit plans in Ontario, the rules relating to pension deficits and surpluses, and other issues relating to the security, viability and sustainability of the pension system in Ontario. Professor Arthurs' 2008 Report was undertaken for the Ministry of Finance and was completely separate from his 2011 Report relating to the review of OMERS governance.

[10] See Section 4.4.2, at page 61.

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determining the actuarial methods and assumptions to be used in the valuation, based on the recommendations of the actuary is not consistent with current Canadian governance norms and best practices. Again, these responsibilities should rest with the plan sponsor corporation, the SC, because it is the entity that is ultimately responsible for sustainability of the OMERS Plan. The recommended change would require amendments to the OMERS Act as well as current OMERS plan governance documentation (e.g., the Framework Agreement).

2. The SC should be responsible for approving the "funding policy".

Current Governance Structure

Again, under the OMERS Act, the SC is responsible for making decisions about the design on the OMERS Plan and setting contribution rates.[11] As the SC has evolved since 2006, it has adopted policies on the topics of funding objectives, target funding, deficit and surplus management measures and the management of reserves in furtherance of its responsibilities.[12]

Currently, the OMERS Act provides that the OAC is responsible for determining the "funding policy" for the plans.[13] The content and scope of the "funding policy" is not defined in the OMERS Act. The current funding policy prepared by the OAC covers funding risks and the tools available for the management of such risks and actuarial disciplines (e.g., the requirement to perform annual valuations, the review of actuarial assumptions). However, confusion regarding the respective roles of the OAC and SC in relation to funding matters has arisen in the past. For example, the OAC viewed the recent OMERS contribution rate allocation issue as falling within the AC's jurisdiction, while the SC saw it as a contribution rate setting sponsor function and commissioned an independent contribution rate study to seek a determination of the allocation of rates for 2013.

Proposed Change

MEPCO submits that the OMERS Act should be revised to provide that the SC, the "sponsor" corporation, is responsible for all funding policy responsibilities, including the "funding policy". The current OMERS Act which provides that the OAC is responsible for the funding policy - without defining the content of such policy – creates potential confusion and overlap.
Plan sponsors are responsible for funding occupational pension plans.[14] Currently, the Ontario PBA does not require that a funding policy be established for DB plans. However, a formal funding policy can assist a plan sponsor, since its general purpose is to establish a framework for funding a plan and takes into account factors such as the demographic characteristics of the plan's beneficiaries, stability and/or affordability of contributions, and the financial position of the

[11] Section 24 and 25 of the OMERS Act.

[12] For example, the SC has adopted the Statement of Plan Design Objectives and Strategy.

[13] Section 35(2)(b) of the OMERS Act.

[14] Section 55 of the PBA.

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sponsor.[15] The preparation of a funding policy is a "sponsor" function that stems directly from the sponsor's contribution obligations.

CAPSA's Guideline No. 7 *Pension Plan Funding Policy Guideline* as well as CAPSA's Guideline No. 6 *Pension Plan Prudent Investment Practices Guideline*, both provide that the development and maintenance of a funding policy is generally a plan sponsor responsibility. For example, Guideline 6 states:[16]

> Role of the Plan Sponsor
>
> While not a requirement under any current pension legislation, it is a good practice and good governance to develop and adopt a funding policy. In the course of activities related to the establishment of a funding policy, the plan sponsor is not held to a fiduciary standard of care.
>
> Role of the Plan Administrator
>
> <u>The plan administrator has certain responsibilities once the funding policy is adopted by the plan sponsor</u>, such as ensuring that the investment policy is consistent with the funding policy and the required contributions are made. [<u>emphasis added</u>]

CAPSA's Guideline 6 goes on to provide that the party responsible for the adoption and maintenance of a funding policy may vary according to the circumstances of the plan but that for most single employer pension plans the employer (the plan sponsor) is responsible for making funding decisions and should therefore be responsible for the development of the funding policy (page 5). A multi employer pension plan is then cited as a case where the plan administrator would typically be responsible for the adoption of the funding policy.

MEPCO is of the view that CAPSA's reference to a multi employer pension plan in Guideline 6 should be interpreted as a reference to a trusteed multi-employer plan where employers' contributions to the plan are fixed and accrued benefits can be reduced in the event of a deficit. The governance structure of the OMERS Plan is akin to a single employer pension plan in that the SC (as the "sponsor" corporation) is responsible for the benefit design and setting contribution levels. As a result, the SC should be responsible for the funding policy.

Consistent with the roles and responsibilities of the SC and current Canadian governance norms and best practices, it is MEPCO's view that the OMERS Act should be amended to provide that the SC be responsible for approving the funding policy for the OMERS Plan.

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[15] CAPSA's Guideline No. 7, *Pension Plan Funding Policy Guideline*

[16] At page 4. Also see page 4 of Guideline No. 6, *Pension Plan Prudent Investment Practices Guideline.*

Additional Recommendations

MEPCO expects that other parties will make submissions regarding the fact that over 20% of the OMERS Plan membership does not have an active voice in the governance process. While MEPCO will not be making a recommendation on how this can be accomplished, it is MEPCO's submission that AMO's representation on the OAC and SC should not be diluted if additional members are appointed to the Boards of Directors of OAC and SC (i.e., AMO should be allowed to appoint an additional member to both the SC and the OAC). Municipal employees account for approximately 46% of the Plan membership and as such it is critical that AMO appointed employer representatives play a significant role in the overall governance of the OMERS Plan. MEPCO has advised the SC on how to remedy this representation issue.

Conclusions

In 2011, Professor Arthurs, an expert in occupation pension plans, supported the continuation of the current OMERS bi-cameral governance model. MEPCO also supports the existing bi-cameral governance model which separates the roles of (1) sponsor and (2) administrator. MEPCO is however advocating that the SC - the corporate entity that has ultimate responsibility for the long-term viability and sustainability of OMERS -should play a greater role in the approval of actuarial valuation reports and the funding policy.

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We thank you for the opportunity to comment on these issues, and hope that our comments are considered. We understand that you will be receiving comments from many stakeholders and request the opportunity to make further submissions to you in order to respond to the input received from other stakeholders.

Please kindly contact the undersigned at (416) 971-9856, ext. 316, with any questions or comments.

Respectfully,

Pat Vanini
President, MEPCO
Executive Director, AMO

APPENDIX A

The Board of Directors of the SC

Employer Representatives	Plan Member Representatives
Ontario Association of Children's Aid Societies (OACAS)	Police Pensioners Association of Ontario (PPAO)
Ontario Public School Boards' Association (OPSBA)	Ontario Public Service Employees Union (OPSEU)
City of Toronto	Canadian Union of Public Employees (CUPE) Local 416
Association of Municipalities of Ontario (AMO)*	Ontario Secondary School Teachers' Federation (OSSTF)
Electricity Distributors Association (EDA)	Police Association of Ontario (POA)
Ontario Association of Police Services Boards (OAPSB)	Canadian Union of Public Employees (CUPE) Ontario*
Association of Municipalities of Ontario (AMO)	Ontario Professional Fire Fighters Association (OPFFA)*

*Sponsors Corporation Board Co-Chairs

The Board of Directors of the OAC

Employer Representatives	Plan Member Representatives
Ontario Catholic School Trustees' Association (OCSTA)	Canadian Union of Public Employees (CUPE) Ontario
City of Toronto	Canadian Union of Public Employees (CUPE) Ontario
Association of Municipalities of Ontario (AMO)	Ontario Professional Firefighters Association (OPFFA)*

Ontario Association of Children's Aid Societies (OACAS)	Ontario Public Service Employees Union (OPSEU)
Electricity Distributors Association (EDA)	Retired Member
Ontario Association of Police Services Boards (OAPSB)	Ontario Secondary School Teachers' Federation (OSSTF)
Association of Municipalities of Ontario (AMO)	Police Association of Ontario (POA)

*Current Administration Corporation Board Chair

The Municipal Employers Pension Centre of Ontario (MEPCO)

MEPCO is a not-for-profit corporation, created by AMO, to ensure that its employer representatives on the OMERS Sponsors Corporation and Administrative Corporation are informed well-resourced and supported by leading pension expertise. MEPCO can raise and manage funds, hire experts who will provide appropriate research and information, and share insights with others as needed.

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