Funding Policy – Primary Plan

ACTUARIAL SERVICES

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OVERALL PRINCIPLES

Funding is a joint responsibility of the OMERS Administration Corporation (AC) 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 renewal date:	February 2023
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 AC 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:

- AC's fiduciary responsibilities
- AC'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 the AC and the SC.

AC'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 AC and the SC, which describes the roles of the AC and SC in the funding process, AC 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 includes the Funding Management Strategy (FMS), which provides guidance on how benefits and contributions are to be modified as the Primary Plan cycles through periods of funding deficit and surplus. SPDOS also 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

AC'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 AC 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 Risk

Funding risk is the risk that OMERS will have to increase contributions or reduce benefits primarily as a result of unfavourable investment performance, adverse plan experience and plan maturity. This risk (generally in times of deficits and rising costs) and reward (generally in times of surpluses) of the ongoing plan is borne by members and employers in different manners:

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:

- underperformance of investment returns due to uncertainty and volatility in global economies and investable markets
- failure of the asset mix to generate required returns
- 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:
  - unexpected 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
  - potential membership disruptions
- legislative, regulatory and political uncertainties

Funding Risk Management

Funding risk is managed through the assessment of OMERS risk profile against objectives in its risk appetite and a coordinated process involving a variety of protocols:

- **Actuarial** – regular 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 funded status and control the funding risk
- **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:

- alignment with OMERS strategic objective of making the Primary Plan a sustainable, affordable and meaningful defined benefit pension plan
- compliance with all relevant legislation and professional standards and requirements, using actuarial methods and assumptions that are appropriate for the purpose of the assessment, and
- long-term viability of the funding objectives shall not be compromised for short-term objectives

Actuarial assessments comprise primarily of the following:

- annual actuarial valuation
- annual actuarial projections
- periodic review of actuarial assumptions and methods and work performed by the external actuary
- actuarial analysis of proposed plan changes, and
- other periodic studies including those pertaining to contribution rate allocation, member equity and asset liability studies

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, if required under the PBA, shall be performed on a solvency and a wind-up basis
- The going concern actuarial valuation shall be performed using the projected unit credit actuarial cost method. 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, actuarial assumptions represent best estimate of the most likely outcomes of future events
- The methodology to determine the real discount rate assumption should
    1. be based on projected long-term passive net investment returns from the external actuary's investment model using the Primary Plan's target strategic asset mix, where the model's effective date is no more than six months in advance of the valuation date,
    2. include a margin for conservatism informed by OMERS risk appetite, and
    3. target a minimum decrease of five basis points per year to within a range of 3.50% to 3.75% by 2025 and to within a range of 3.25% to 3.50% by 2030, where adjustments to the discount rate will be made in increments of five basis points
- The real discount rate shall be determined annually by AC following a consultative process between AC 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

Actuarial Analysis of Proposed Changes to Plan Design or SPDOS

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

Other Studies

A contribution rate study will be performed as requested by the SC in support of SPDOS, generally once every three years. Other studies including Asset Liability Studies will be performed regularly as needed as part of the protocol to manage funding risk.

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, AC'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

Depending on the activity, other areas of AC may also be responsible for the work.

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. The reasons for granting an exception should be recorded in writing and communicated annually to the AC Board by the Policy Sponsor.

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.

ROLES & RESPONSIBILITIES

Policy Approver	AC 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